AUDIT COMMITTEE 28 JULY 2023

TREASURY MANAGEMENT REPORT Q1 2023/24

1. PURPOSE

1.1. New Forest District Council has adopted the key recommendations of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code), last updated in 2021 which requires the Council to approve, as a minimum, treasury management semi-annual and annual outturn reports.

2. SUMMARY

2.1. This quarterly report provides an additional update and includes the new requirement in the 2021 Code, mandatory from 1st April 2023, of quarterly reporting of the treasury management prudential indicators. The non-treasury prudential indicators are incorporated in the Council's normal Financial Monitoring report.

2.2. The Council's treasury management strategy was most recently updated and approved at a meeting of Full Council in February 2023. The Council has borrowed and invested 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 successful identification, monitoring and control of risk remains central to the Council's treasury management strategy.

2.3. Treasury management in the context of this report is defined as:

"The management of the organisation's 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."

2.4. Hampshire County Council's Investments & Borrowing Team has been contracted to manage the Council's treasury management balances since March 2014 but overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

3. EXTERNAL CONTEXT

3.1. The following sections outline the key economic themes in the UK against which investment and borrowing decisions have been made so far in 2023/24.

Economic commentary

3.2. From the start of the quarter until May it looked like peak global monetary policy rates were in sight as inflation continued to ease and central banks turned more dovish in tone. Only a few weeks later, stronger and more persistent inflation data, particularly in the UK, changed the picture.

Central Bank rhetoric and actions remained consistent with combatting 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.

3.3. Inflation fell from its peak of 11.1% reached in October 2022, but annual headline CPI in May 2023 was higher than the consensus forecast at 8.7% (8.4% expected), largely driven by services inflation, while the annual measure of underlying core inflation rose to 7.1% from 6.8%.

3.4. After a sharp rise in interest rate expectations, with clearly serious implications for mortgage markets due to higher inflation and wage data, the Bank of England's Monetary Policy Committee reaccelerated monetary policy tightening over the period with a 0.25% rise in May to a 0.5% rise in June, taking the Bank Rate to 5.0%. At both meetings the vote was 7-2 in favour of increasing rates, with the two dissenters preferring to keep rates on hold.

3.5. Interest rate expectations priced in further hikes in policy rates. Arlingclose, the authority's treasury adviser, revised its forecast to forecast a further 0.5% of monetary tightening to take Bank Rate to 5.5%. The risks, however, are that rates could be higher; financial markets are forecasting policy interest rates above 6%.

3.6. With many mortgages at low fixed rates now systematically being re-set over the next 12-24 months at higher rates at the end of their fixed rate period, there has been a lagged effect of the feed through of monetary policy on households' disposable income. The economic slowdown is expected to develop over time and therefore, despite the GfK measure of consumer confidence rising to -24 in June, it is likely confidence will be negatively affected at some point. The manufacturing sector contracted during the quarter according to survey data, which will eventually feed into services, whose expansion is slowing.

Financial markets

3.7. Financial market sentiment and bond yields remained volatile, the latter continuing their general upward trend as uncertainty and concern over higher inflation and higher interest rates continued to dominate.

3.8. Gilt yields rose over the period. The 5-year UK benchmark gilt yield rose from 3.30% to 4.67%, the 10-year gilt yield from 3.43% to 4.39%, and the 20-year yield from 3.75% to 4.51%.

Credit review

3.9. Having completed a review of its credit advice on unsecured deposits at UK and non-UK banks following concerns of a wider financial crisis after the collapse of Silicon Valley Bank purchase of Credit Suisse by UBS, as well as other well-publicised banking sector issues, in March 2023 Arlingclose reduced the advised maximum duration limit for all banks on its recommended counterparty list to 35 days. On the back of this, Arlingclose reduced its recommended maximum duration limit for unsecured deposits for all UK and Non-UK banks/institutions on its counterparty list to 35 days as a precautionary measure. No changes were made to the names on the list.

3.10. Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress but made no changes to the counterparty list or recommended durations over the quarter. Nevertheless, heightened market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Council's counterparty list recommended by Arlingclose remains under constant review.

4. LOCAL CONTEXT

4.1. On 31st March 2023, the Authority had net borrowing of £86.8m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31/03/23 Balance £m	31/03/24 Forecast £m
General Fund CFR	27.5	29.0
Housing Revenue Account CFR	10.8	21.1
HRA Settlement	118.1	114.0
Total CFR	**156.4**	**164.1**
Financed By:		
External Borrowing	118.3	114.0
Internal Borrowing	38.1	50.1
Total Borrowing	**156.4**	**164.1**

4.2. The treasury management position at 30th June 2023 and the change over the quarter is shown in Table 2 below.

Table 2: Treasury Management Summary

	31/03/23 Balance £m	Movement £m	30/06/23 Balance £m	31/06/23 Rate %
Long-term borrowing	(114)	0	(114)	3.37
Short-term borrowing	(4.3)	0.0	(4.3)	2.69
Total borrowing	**(118.3)**	**0.0**	**(118.3)**	**3.34**
Long-term investments	13.6	0.0	13.6	4.13
Short-term investments	3.0	2.8	5.8	5.38
Cash and cash equivalents	14.9	10.0	24.9	4.67
Total investments	**31.5**	**12.7**	**44.2**	**4.60**
Net borrowing	**(86.8)**	**12.7**	**(74.1)**	

Note: the figures in Table 2 are from the balance sheet in the Council's statement of accounts adjusted to exclude operational cash, market value adjustments and accrued interest.

4.3. The decrease in net borrowing of £12.7m shown in Table 2 reflects the normal pattern of the Council's cash balances, with higher balances at the start of the financial year due to the uneven pattern of grant receipts. Further details are provided in the Borrowing Strategy and Treasury Investments Activity sections of this report.

5. BORROWING UPDATE

5.1. The Council has no plans to borrow to invest primarily for commercial return and so is unaffected by the changes to the Prudential Code.

5.2. The Council is not planning to purchase any investment assets primarily for yield, so is able to retain full access to the PWLB.

5.3. Further, the Council has invested in pooled funds as part of its Treasury Management strategy. This is not a policy to primarily generate yield but a part of the implementation of the wider Treasury Management strategy to invest the Council's surplus cash and reserves ensuring it is investing its funds prudently, having regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. By investing a diversified portfolio in respect of yield this meets the Council's aim of protecting reserves from high inflation.

5.4. The Council is a net borrower and as stated in the Treasury Management Strategy 2023/24, the Council expects a positive liability benchmark across the forecast period, which generally means an authority is required to take external borrowing to fund the gap between its resources and the CFR. Although the Council currently has taken external borrowing, this is not predicted to be sufficient to meet the CFR between 2023 and 2033 and therefore, as a result, further borrowing will be considered by the Section 151 Officer over the coming months and years, if required.

5.5. The Section 151 Officer will review the current pooled fund investment prior to making any external borrowing decisions.

6. BORROWING ACTIVITY

6.1. At 30th June 2023 the Council held £118.3m of loans.The vast majority of the outstanding loans are in relation to the resettlement of the HRA in 2012/13. Outstanding loans on 30th June are summarised in Table 3.

Table 3: Borrowing Position

	31/03/23 Balance £m	Movement £m	30/06/23 Balance £m	30/06/23 Rate %	30/06/23 WAM* years
Public Works Loan Board	(118.3)	0.0	(118.3)	3.34	14.6
Total borrowing	**(118.3)**	**0.0**	**(118.3)**	**3.34**	**14.6**

* Weighted average maturity

Note: the figures in Table 3 are from the balance sheet in the Council's statement of accounts adjusted to exclude accrued interest.

6.2. The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

7. TREASURY INVESTMENT ACTIVITY

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

7.2. The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year to date the Council's investment balances have ranged between £35.3m and £60.6m due to timing differences between income and expenditure. The investment position is shown in Table 4 below.

Table 4: Treasury investment position

Investments	31/03/2023 Balance £m	Movement £m	30/06/2023 Balance £m	30/06/23 Rate %	30/06/23 WAM* years
Short term Investments					
Banks and Building Societies:					
- Unsecured	5.0	(0.2)	4.8	4.22	0.00
- Secured	1.0	1.8	2.8	5.13	0.54
Money Market Funds	6.9	13.2	20.1	4.78	0.00
Government:					
- UK Treasury Bills	3.0	(2.0)	1.0	5.01	0.43
Cash Plus Funds	2.0	0.0	2.0	5.95	0.02
	17.9	**12.8**	**30.7**	**4.81**	**0.99**
High yield investments					
Pooled Property Funds**	7.6	0.0	7.6	3.50	N/A
Pooled Equity Funds**	3.0	0.0	3.0	5.68	N/A
Pooled Multi-Asset Funds**	3.0	0.0	3.0	4.17	N/A
	13.6	**0.0**	**13.6**	**4.13**	**N/A**
TOTAL INVESTMENTS	**31.5**	**12.8**	**44.2**	**4.60**	**0.05**

* Weighted average maturity, excluding pooled funds
** The rates provided for pooled fund investments are reflective of annualised income returns over the year to 31 March 2023 based on the market value of investments at the start of the year.

Note: the figures in Table 4 are from the balance sheet in the Council's accounts but adjusted to exclude operational cash, market value adjustments and accrued interest.

7.3. Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

7.4. The security of investments has been maintained by following the counterparty policy and investment limits within the TMSS, taking advice from Arlingclose on changes in counterparty credit worthiness, and making use of secured investment products that provide collateral. The Council should invest in liquid investments to ensure money is available when required to meet its financial obligations, spreading these investments across a number of counterparties to mitigate operational risk.

7.5. As demonstrated by the liability benchmark shown later in this report, the Council expects to be a long-term borrower and new treasury investments are therefore primarily made to manage day-to-day cash flows using short-term low risk instruments. The existing portfolio of strategic pooled funds will be maintained to diversify risk into different sectors and boost investment income.

7.6. Bank Rate increased by 0.75%, from 4.25% at the beginning of April to 5% by the end of June 2023, with the prospect of further increases to come. Short-dated cash rates rose commensurately, with 3-month rates rising to around 5.25% and 12-month rates to nearly 6%. The rates on DMADF deposits also rose, ranging between 4.8% and 5.4% by the end of June and Money Market Rates between 4.7% and 4.9%

7.7. The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below .

Table 5: Investment benchmarking (excluding pooled funds)

	Credit rating	Bail-in exposure	Weighted average maturity (days)	Rate of return
31.03.2023	AA-	75%	2	3.86%
30.06.2023	AA-	87%	26	4.73%
Similar LAs	A+	65%	45	4.50%
All LAs	A+	63%	11	4.44%

Externally managed pooled funds

7.8. £13.6m of the Council's investments are invested in externally managed strategic pooled funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability.

7.9. Financial market conditions were volatile during the quarter, but favourable in some areas. Resilient economic data, which led to diminishing talk of recessions at a time when interest rate peaks are thought to be near initially helped UK, euro-area and US equity markets. However, UK equities fell in May (sterling's strength weighed on some sectors) and ended the quarter marginally lower. Eurozone equities were slightly higher but did not match the larger global rally in US equities (helped by a soft-landing scenario for the economy and enthusiasm over AI) and Japanese equities.

7.10. UK property markets continued to struggle as higher interest rates and bond yields and higher funding costs weighed on the sector. There was some improvement in May, building on signs of returning investor interest and transactional activity in calendar Q1 and a perception that the downturn in commercial real estate may be bottoming out. This has helped support capital values and rental income. The additional move upwards in yields in late May/June and the prospect of sluggish economic growth however constrain the outlook.

7.11. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's medium- to long-term investment objectives are regularly reviewed. Following the latest review the Council will sell a combination of some of its pooled equity funds and pooled multi-assets funds where the prospects for income returns are no better than more secure cash investments. The combination of these redemptions should yield a small surplus on the original investments which can be held against future losses on the remaining pooled funds.

7.12. In April 2023 the Department for Levelling Up, Housing and Communities published the full outcome of the consultation on the extension of the statutory override on accounting for gains and losses on pooled investment funds. The override has been extended for 2 years until 31st March 2025 but no other changes have been made; whether the override will be extended beyond the new date is unknown but commentary to the consultation outcome suggests not. The Authority will discuss with Arlingclose the implications for the investment strategy and what action may need to be taken.

8. NON-TREASURY INVESTMENTS

8.1. The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the council holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).

8.2. Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) and Welsh Government also broadens the definition of investments to include all such assets held partially or wholly for financial return.

8.3. This could include loans made to local businesses or the direct purchase of land or property and such loans and investments will be subject to the council's normal approval process for revenue and capital expenditure and need not comply with the treasury management strategy.

8.4. The Council's existing non-treasury investments are listed in Table 6.

Table 6: Non-treasury investments

	31/03/23 Asset value £m
Hythe Marina	2.553
Saxon Inn, Calmore	0.179
Meeting House Lane	0.177
New Milton Health Centre	2.629
Ampress Car Park	2.030
The Parade Salisbury Road, Totton	1.599
1-3 Queensway, New Milton	1.013
Unit 1 Nova Business Park	0.559
Drive -Thru Salisbury Road, Totton	1.382
Units 1-3 27 Salisbury Road, Totton	1.901
85 Station Road, New Milton	5.000
1b Junction Road, Totton	0.208
Unit 800 Ampress Park, Lymington	1.904
Total investment properties	**21.134**
Lymington Town Hall	3.645
Hardley Industrial Estate	5.088
Total income earning properties	**8.733**
Grand total	**29.867**
Property Under Construction	
Employment Land at Crow Lane	9.552

9. COMPLIANCE REPORT

9.1. The Council confirms compliance of all treasury management activities undertaken during the quarter with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

9.2. Compliance with specific investment limits is demonstrated in table 7 below

Table 7: Investment limits

	2023/24 Maximum £m	30/06/23 Actual £m	2023/24 Authorised Limit	Complied
The UK Government	0.0	1.0	n/a	✓
Local authorities & other government entities	0.0	0.0	Unlimited	✓
Secured investments	2.8	2.8	Unlimited	✓
Banks (unsecured)	4.98	4.8	Unlimited	✓
Building societies (unsecured)	0.0	0.0	£10m	✓
Registered providers	0.0	0.0	£10m	✓
Money market funds	37.8	20.1	Unlimited	✓
Strategic pooled funds	13.6	13.6	£50m	✓
Real estate investment trusts	0.0	0.0	£10m	✓
Other investments	0.0	0.0	£10m	✓

9.3. Compliance with the authorised limit and operational boundary for external debt, is demonstrated in Table 8.

Table 8: Debt limits

	Q1 2023/24 Maximum £m	30/06/23 Actual £m	2023/24 Operational Boundary £m	2023/24 Authorised Limit £m	Complied
Total debt	118.3	118.3	207.2	225.5	✓

9.4. Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

10. TREASURY MANAGEMENT INDICATORS

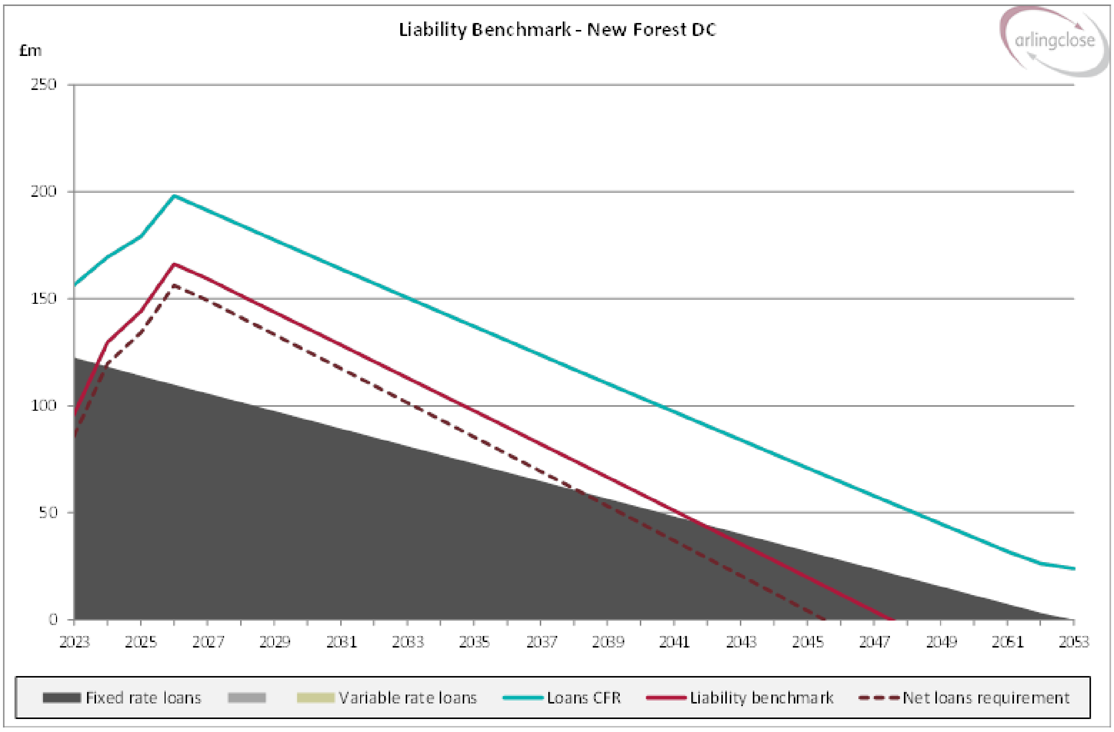
10.1. The Council measures and manages its exposures to treasury management risks using the following indicators.

Liability benchmark

10.2. This new indicator compares the Authority's actual 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 required to manage day-to-day cash flow.

Table 8: Liability benchmark

	31/03/23 Actual £m	31/03/24 Forecast £m	31/03/25 Forecast £m	31/03/26 Forecast £m
Loans CFR	156.4	169.4	179.0	198.1
Less: Balance sheet resources	(70.5)	(49.8)	(44.9)	(41.9)
Net loans requirement	**85.8**	**119.6**	**134.1**	**156.2**
Plus: Liquidity allowance	10.0	10.0	10.0	10.0
Liability benchmark	**95.8**	**129.6**	**144.1**	**166.2**
Existing borrowing	**118.3**	**114.0**	**109.9**	**109.9**



10.3. Table 8 and the graph shown above illustrates that by the end of 2023/24, the Council's existing borrowing will no longer be sufficient to meet the liability benchmark and the Council will need to source external borrowing if it is to meet the full delivery of its capital programme. The Council will keep this position under review and continue to take advice from Arlingclose on the most appropriate time to borrow when it is required.

Maturity structure of borrowing

10.4. This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits show the maximum and minimum maturity exposure to fixed rate borrowing as agreed in the Treasury Management Strategy Statement.

Table 9: Refinancing rate risk indicator

	30/06/23 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	4%	25%	0%	✓
12 months and within 24 months	3%	25%	0%	✓
24 months and within 5 years	10%	25%	0%	✓
5 years and within 10 years	17%	25%	0%	✓
10 years and above	65%	100%	0%	✓

Principal sums invested for periods longer than a year

10.5. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments.

The limits on the total principal sum invested to final maturities beyond the period end were:

Table 10: Price risk indicator

	2023/24	2024/25	2025/26
Actual principal invested beyond a year	£13.6m	£13.6m	£13.6m
Limit on principal invested beyond a year	£35m	£35m	£35m
Complied	✓	✓	✓

10.6. The table includes investments in strategic pooled funds of £13.6m as although these can usually be redeemed at short notice, the Council intends to hold these investments for at least the medium-term.

11. CRIME AND DISORDER AND ENVIRONMENTAL IMPLICATIONS

11.1. None arising directly from this report.

12. RECOMMENDATIONS

Members are recommended to:

12.1. Consider the performance of the treasury function detailed in this report.

Further information	Background papers
Please contact: Daniel O'Rourke Corporate Accountant Investments & Borrowing Hampshire County Council Daniel.O'Rourke@hants.gov.uk Alan Bethune Strategic Director of Corporate Resource, and Transformation Section 151 Officer New Forest District Council alan.bethune@nfdc.gov.uk	The Prudential Code, CIPFA Guidance Notes and ODPM Investment Guidance Local Government Act 2003 SI 2003/3146 Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 Treasury Management Strategy Report 2023/24 Audit Committee – 27 January 2023 Council – 27 February 2023 Treasury Management Outturn Report 2022/23 Audit Committee – 31 May 2023