AUDIT COMMITTEE 27 OCTOBER 2023

TREASURY MANAGEMENT MID-YEAR REPORT 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, four treasury management reports a year, including an annual strategy and outturn report.

2. SUMMARY

2.1. This report provides an update on treasury management activity in the first half of 2023/24 and meets the requirement in the 2021 Code, mandatory from 1 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. UK inflation has remained high over the period, keeping market expectations elevated of how much further the Bank of England (BoE) would hike rates. The Bank of England's (BoE) Monetary Policy Committee (MPC) continued tightening monetary policy over most of the period, taking Bank Rate to 5.25% in August 2023, however, inflation data published in the latter part of the period undershot expectations, causing financial markets to reassess the peak in BoE Bank Rate. This was followed by the BoE deciding to keep Bank Rate on hold at 5.25% in September 2023.

3.3. Economic growth in the UK remained relatively weak over the period. In calendar Quarter 2 2023, the economy expanded by 0.4%, beating market expectations of a 0.2% increase. However, monthly Gross Domestic Product (GDP) data showed a 0.5% contraction in July 2023, which was the largest fall to date this calendar year and worse than the 0.2% decline predicted.

3.4. Although still high, inflation has fallen from its peak as annual headline CPI (Consumer Prices Index) declined to 6.7% in July 2023 from 6.8% in the previous month against market expectations for a rise. The largest downward contribution came from food prices.

3.5. Following the September MPC meeting, Arlingclose modestly revised its interest forecast to reflect the central view that 5.25% will now be the peak in Bank Rate.

Financial markets

3.6. Financial market sentiment and bond yields remained volatile, with the latter generally trending downwards as there were signs inflation, while still high, was moderating and interest rates were at a peak. Gilt yields fell towards the end of the period.

Credit review

3.7. In March 2023 Arlingclose 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, and the purchase of Credit Suisse by UBS, as well as other well-publicised banking sector issues. As a result, Arlingclose reduced the advised maximum duration limit for all banks on its recommended counterparty list to 35 days for unsecured investments. This stance continued to be maintained during Quarter 2 of the financial year.

3.8. Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress and no changes were made to recommended bank durations over Quarter 2 of the financial year. Credit default swaps are used as an indicator of credit risk, where higher premiums indicate higher perceived risks. Northern Trust Corporation was added to the counterparty list.

3.9. 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. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). These factors are summarised in Table 1.

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. On 31 March 2023, the Council had net borrowing of £86.8m arising from its revenue and capital income and expenditure The treasury management position at 30 September 2023 and the change over the first half of the year is shown in Table 2.

Table 2: Treasury Management Summary

	31/03/23 Balance £m	Movement £m	30/09/23 Balance £m	31/06/23 Rate %
Long-term borrowing	(114.0)	0.0	(114.0)	3.37
Short-term borrowing	(4.3)	0.1	(4.2)	2.70
Total borrowing	**(118.3)**	**0.1**	**(118.2)**	**3.34**
Long-term investments	13.6	(4.6)	9.0	4.55
Short-term investments	3.0	8.8	11.8	4.94
Cash and cash equivalents	14.9	13.3	28.2	5.15
Total investments	**31.5**	**17.5**	**49.0**	**4.99**
Net borrowing	**(86.8)**	**17.6**	**(69.2)**	

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 £17.6m shown in Table 2 reflects the normal pattern of the Council's cash balances, with higher cash 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 Public Works Loan Board (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 30 September 2023 the Council held £118.2m of loans. The vast majority of the outstanding loans are in relation to the resettlement of the Housing Revenue Account (HRA) in 2012/13. Outstanding loans on 30 September 2023 are summarised in Table 3.

Table 3: Borrowing Position

	31/03/23 Balance £m	Movement £m	30/09/23 Balance £m	30/09/23 Rate %	30/9/23 WAM* years
Public Works Loan Board	(118.3)	0.1	(118.2)	3.34	14.4
Total borrowing	**(118.3)**	**0.1**	**(118.2)**	**3.34**	**14.4**

* 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.

6.3. £0.1m of PWLB borrowing was repaid at maturity during the period.

7. TREASURY INVESTMENT ACTIVITY

7.1. The CIPFA Treasury Management Code now defines treasury management investments as those investments which arise from the Authority'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 £67.2m due to timing differences between income and expenditure. The investment position is shown in Table 4.

Table 4: Treasury investment position

Investments	31/03/2023 Balance £m	Movement £m	30/09/2023 Balance £m	30/09/23 Rate %	30/09/23 WAM* years
Short term Investments					
Banks and Building Societies:					
- Unsecured	5.0	(0.2)	4.8	4.48	0.00
- Secured	1.0	1.8	2.8	5.20	0.29
Money Market Funds	6.9	16.5	23.4	5.29	0.00
Government:					
- UK Treasury Bills	3.0	(2.0)	1.0	5.01	0.18
- Local Authorities	0.0	4.5	4.5	5.54	0.44
High quality bonds	0.0	1.5	1.5	5.44	0.25
Cash Plus Funds	2.0	0.0	2.0	2.85	0.01
	17.9	**22.1**	**40.0**	**5.09**	**1.16**
High yield investments					
Pooled Property Funds**	7.6	0.0	7.6	3.83	N/A
Pooled Equity Funds**	3.0	(1.5)	1.5	8.19	N/A
Pooled Multi-Asset Funds**	3.0	(3.0)	0.0	0.00	N/A
	13.6	**(4.5)**	**9.1**	**4.55**	N/A
TOTAL INVESTMENTS	**31.5**	**17.6**	**49.1**	**4.99**	**0.07**

* Weighted average maturity, excluding pooled funds
** The rates provided for pooled fund investments are reflective of annualised income returns over the year to 30 September 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 Treasury Management Strategy Statement (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. Over this financial year to date Bank Rate has increased by 1%, from 4.25% to 5.25% as at 30 September 2023. Short term investment interest rates have risen commensurately, with 3-month rates rising to around 5.25%, and 12 month rates to nearly 6%. The interest rates on Debt Management Account Deposit Facility (DMADF) deposits also rose, ranging between 4.8% and 5.4% and Money Market Rates between 5.0% and 5.3%.

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

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	3.76%
30.09.2023	AA-	74%	33	4.95%
Similar LAs	AA-	56%	63	4.71%
All LAs	AA-	59%	13	4.79%

7.8. Table 5 shows the average credit rating of the portfolio has remained consistent at AA- since March 2023, whilst bail-in exposure has dropped marginally. The Council's bail-in exposure is higher than that of comparative authorities, but it should be noted that a significant proportion of liquid balances are invested in money market funds, which are technically exposed to bail-in risk but as diversified products are considered by Arlingclose to be 'bail-in risk light'. The Council continues to utilise money market funds for the high levels of liquidity they offer whilst simultaneously providing better levels of security than unsecured bank deposits. This is in conjunction with the comparatively higher rates of return they offer to other short-dated instruments. Rates of return across the portfolio as a whole have improved since March 2023 and compare favourably to other Arlingclose clients. Weighted average maturity has increased across the portfolio, largely due to investment in longer-dated instruments such as local authority loans and high quality bonds.

Externally managed pooled funds

7.9. £9.1m 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. The funds have generated an average total return of 26.3% since purchase.

7.10. Financial market conditions were volatile during the six-month period. Global bond yields rose and remained elevated as it became apparent that policymakers were looking to keep rates high for some time amid persistently higher core inflation and tight labour markets.

7.11. The UK, Euro area and US equity markets were initially helped by resilient growth data and diminishing talk of recession. A weaker currency and better-than-expected fundamentals were broadly supportive for UK equities.

7.12. During the period investor sentiment for UK commercial property was more settled than in Quarter 3 and Quarter 4 of 2022 when the sharp rise in bond yields resulted in a big fall in property valuations. There were signs of returning investor interest, occupier resilience and a perception that the downturn in commercial real estate may be at an end. It helped rental income and led to some stabilisation in capital values. However, the combination of high interest rates and bond yield, higher funding costs and the prospect of sluggish economic growth constrain the outlook for commercial property.

7.13. The combination of the above had a marginal negative effect on the market value of the council's strategic investments since March 2023. Based on market values at 30 September 2023, the Council currently has a £0.8m unrealised loss on the £9.1m book value of its pooled fund holdings, summarised in Table 6.

Table 6: Higher yielding investments – market value performance

	Amount invested	Market value at 30/09/23	Gain / (fall) in capital value	
			Since purchase	2023/24
	£m	£m	£m	£m
Pooled property funds	7.6	7.1	(0.5)	(0.1)
Pooled equity funds	1.5	1.2	(0.3)	(0.0)
Total	**9.1**	**8.3**	**(0.8)**	**(0.1)**

7.14. However, the Council's investments in pooled funds target long-term price stability and regular revenue income. As shown in Table 7, the annualised income returns have averaged 4.02% pa (per annum) since purchase, contributing to a total return of 26.26%.

Table 7: Higher yielding investments – income and total returns since purchase

	Annualised income return	Total return
	%	%
Pooled property funds	3.88	25.05
Pooled equity funds	4.49	44.89
Pooled multi-asset funds	3.90	10.68
Total	**4.02**	**26.26**

7.15. 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 Council's medium- to long-term investment objectives are regularly reviewed. Following the latest review, and as outlined in the Quarter 1 report, the Council sold a combination of some of its pooled equity funds and pooled multi-assets funds in the second quarter of the year, given that prospects for income returns are currently no better than more secure cash investments. The pooled multi-asset funds are therefore included in Table 7 for indicative purposes, but these funds are no longer held.

7.16. The combination of these redemptions yielded a surplus of £264,000 on the original investments, which will be held against any potential future losses on the remaining pooled funds.

7.17. In April 2023 the Department for Levelling Up, Housing and Communities (DLUHC) 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 31 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 Council 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 DLUHC 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 as at 31 March 2023 (the last valuation) are listed in Table 8.

Table 8: 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 9.

Table 9: Investment limits

	30/09/23 Actual £m	2023/24 Authorised Limit	Complied
The UK Government	1	n/a	✓
Local authorities & other government entities	4.5	Unlimited	✓
Secured investments	2.8	Unlimited	✓
Banks (unsecured)	6.3	Unlimited	✓
Building societies (unsecured)	0	£10m	✓
Registered providers	0	£10m	✓
Money market funds	23.3	Unlimited	✓
Strategic pooled funds	11.1	£50m	✓
Real estate investment trusts	0.0	£10m	✓
Other investments	0.0	£10m	✓

9.3. Compliance with the authorised limit and operational boundary for external debt, is demonstrated in Table 10.

Table 10: Debt limits

	H1 2023/24 Maximum £m	30/09/23 Actual £m	2023/24 Operational Boundary £m	2023/24 Authorised Limit £m	Complied
Total debt	118.5	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. The Council can confirm that the operational boundary has not been breached during this reporting period.

10. TREASURY MANAGEMENT INDICATORS

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

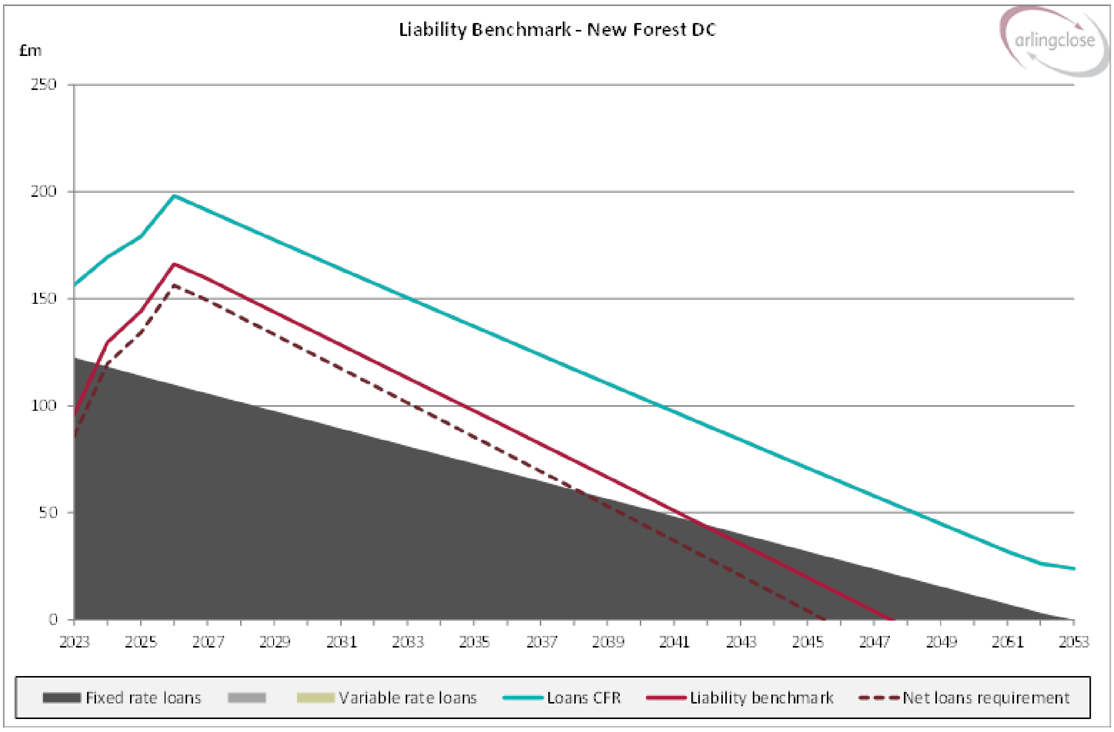
Liability benchmark

10.2. This indicator compares the Council’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 11: 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	**85.9**	**119.6**	**134.1**	**156.2**
Plus: Liquidity allowance	10.0	10.0	10.0	10.0
Liability benchmark	**95.9**	**129.6**	**144.1**	**166.2**
Existing borrowing	**118.3**	**114.0**	**109.9**	**109.9**

Graph 1: Liability Benchmark – New Forest District Council



10.3. Table 11 and Graph 1 illustrate that by the end of 2023/24, the Council's existing borrowing is forecast to 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 12: 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%	✓

Long term Treasury Management Investments

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 13: Long term investments

	2023/24	2024/25	2025/26
Actual principal invested beyond a year	£9.1m	£9.1m	£9.1m
Limit on principal invested beyond a year	£35m	£35m	£35m
Complied	✓	✓	✓

10.6. The table includes investments in strategic pooled funds of £9.1m as although these can usually be redeemed at short notice, the Council intends to hold these investments for at least the medium-term.

Interest rate exposures

10.7. The following indicator shows the sensitivity of the council's current investments and borrowing to a change in interest rates:

Table 14: Interest rate risk indicator

	30/09/23 Actual	Impact of +/-1% interest rate change
Sums subject to variable interest rates:		
Investments	£39.2m	+/- £0.4m
Borrowing	£0.0m	+/- £0.0m

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 Q1 Report 2023/24 Audit Committee – 28 July 2023