Report

Governance and Audit Committee

Part 1

Date: 26 October 2023

Subject **Half Yearly Report on Treasury Management for the period 2023/24**

Purpose This report is to inform Governance & Audit Committee of treasury activities undertaken within the financial year 2023/24 and confirms that all treasury and prudential indicators have been adhered to. The Committee is asked to make any comments or observations, as needed, which will be included in this report when subsequently sent to Cabinet / Council.

Author Assistant Head of Finance / Chief Accountant

Ward All

Summary In line with the agreed Treasury Management Strategy, the Council continues to be both a short-term investor of cash and borrower to manage day-to-day cash flows. Current forecasts indicate that, in the future, temporary borrowing may be required to fund normal day-to-day cash flow activities and longer-term borrowing will increase to fund commitments in the current capital programme, as well as the impact of reduced capacity for 'internal borrowing'.

Up to the end of September 2023, the Council's net borrowing is £80.8m, a decrease of £10.6m on 31 March 2023 levels.

Proposal To note the report on treasury management activities during the first half year period of 2023-24 and offer Governance & Audit Committee an opportunity to provide feedback on this situation in the subsequent report to Cabinet/Council.

Action by Head of Finance / Assistant Head of Finance

Timetable Immediate

This report was prepared after consultation with:

- Treasury Advisors
- Head of Finance

Signed

Background

1. Treasury risk management within Newport City Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA Code). The revised edition had a number of key changes which the Authority has adopted in the 2023/24 financial year. The key changes are;
   - It particularly highlights the requirement that local authorities must not borrow to invest primarily for financial return.
   - The forward-looking prudential indicators must be monitored and reported to members at least quarterly (currently half-yearly) as part of the normal budget monitoring reports.
   - The Authority will also have to explicitly document a formal and comprehensive knowledge and skills schedule to ensure the effective acquisition and retention of treasury management skills for those responsible for the management, delivery, governance, decision-making and compliance with legislative requirements.

2. CIPFA defines Treasury Management as

   The management of the organisation'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.

   The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

3. The 2023/24 Treasury Management Strategy was approved by the Council as part of the Capital Strategy in February 2023 and can be viewed at the following location.

   https://democracy.newport.gov.uk/documents/s25059/05%20Council%20Report%20-%20Capital%20Strategy%20Treasury%20Strategy%202023-24.pdf?LLL=0

4. This report presents the following information:

   - details of capital financing, borrowing, any debt rescheduling and investment transactions
   - reports on the risk implications of treasury decisions and transactions
   - details the monitoring position on treasury management transactions
   - compliance with treasury limits set and Prudential Code

BORROWING STRATEGY / ACTIVITY

Short and Long Term Borrowing

5. Whilst the Council has significant long-term borrowing requirements, the Council's current strategy of funding capital expenditure is through the concept of 'internal borrowing', where the Council seeks to use its existing cash balances to afford its capital expenditure prior to taking out external borrowing i.e. deferring taking out new long term borrowing and funding capital expenditure from the Council's own cash resources for as long as is possible, which it has because of its 'cash-backed' reserves and, to a lesser extent, day to day positive cash-flows. The Council may undertake borrowing early if there is a clear underlying need for future borrowing and it feels it can minimise the risk of future interest rate rises while providing value for money. Any such action will be in line with advice from our treasury advisors.

6. There has been a substantial rise in the cost of both short- and long-term borrowing over the last 18 months. Bank Rate rose by 1% from 4.25% at the beginning of April to 5.25% at the end of September. Bank Rate was 2% higher than at the end of September 2022. Following the September Monetary Policy Committee, the Council's treasury advisors, Arlingclose, modestly

revised its interest forecast to reflect the central view that 5.25% will now be the peak in Bank Rate. In the short term the risks are to the upside if inflation increases again, but over the remaining part of the time horizon the risks are to the downside from economic activity weakening more than expected.

7. By using an internal borrowing strategy, the Council can also minimise cash holding at a time when counterparty risk remains relatively high, especially within the current economic climate. The interest rates achievable on the Council's investments are also lower than the current rates payable on long-term borrowing so this remains a sensible consideration in operating an 'internal borrowing' arrangement – i.e., it would cost more to borrow than it would to utilise existing investment balances and forego interest receivable. Whilst the strategy minimises investment counterparty risk, the risk of interest rate exposure is increased.

8. Given current investment levels, and whilst a couple of longstanding loans fall due for redemption between now and the financial year end, it is anticipated that the year-end position will still be a net investment balance of circa £22.8m. This also prudently assumes that capital spending is in line with the capital programme, when instead commonly service managers will identify an increasing need to slip capital budgets into following year as the year progresses, which in turn defers the need to borrow still further.

9. The following table compares the borrowing levels at the end of September with the equivalent from March 2023. A minimal amount of new long-term borrowing was required to be taken out in the first half of the financial year totalling £300k. This borrowing was from Salix which was interest free and was linked to a specific energy efficiency project. However, despite this there was still a net reduction in borrowing of £3.1m during 2023-24. This was due to the redemption of two small PWLB loans at the end of September, which have not been refinanced, plus there are a number of loans which are Equal Instalments of Principal (EIP) loans, which pays back principal over the life of the loan, so the borrowing levels decline naturally over the life of the loan as an alternative to maturity based loans where the amount borrowed is only repaid when the loan period expires.

Comparison	2023-24	2022-23
Public Works Loan Board	90,552,301	93,089,897
Interest Free Borrowing	9,947,012	9,905,757
LOBOs	30,000,000	30,000,000
Ex LOBO	5,000,000	5,000,000
Accrued Interest		606,212
	135,499,313	138,601,866

10. As well as traditional external borrowing via the Public Works Loans Board (PWLB), the Council has LOBO (Lender Option / Borrower Option) borrowing totalling £30m. One of the more unusual features of a LOBO is that the lender can volunteer a change in rate at certain intervals, and this is more probable in an environment of rising interest rates, as currently experienced. Therefore, all £30m outstanding is subject to potential change of interest rates by the lender (which would automatically trigger a right to the Council to repay these loans). No such calls have been made in the first 6 months of 2023/24, and should a change of interest rate be requested, a decision on how to proceed considering other financing options would be made in conjunction with our treasury advisors.

INVESTMENTS ACTIVITY / POSITION

11. The Council's strategies in this area of Treasury Management are:

- to be a short term and relatively low value investor, consistent with the pursuit of an ‘internal borrowing strategy’ and

- investment priorities should follow the priorities of security, liquidity and yield, in that order.

12. The following table compares the investment levels at the end of September 2023 with the equivalent from the end March 2023 and the previous year. This indicates a net increase in investment activity of £7.4m since March 2023, although it is anticipated that investment balances will naturally reduce as the year progresses.

Comparison	2023-24		2022-23	
Investment	-	54,680,000	-	47,231,574
	-	54,680,000	-	47,231,574

13. The January 2018 saw the implementation in the UK of the second Markets in Financial Instruments Directive (MiFID II), where treasury consulting firms were obliged to treat all local authorities as retail clients unless they opted up to professional client status and met certain criteria. Those criteria included holding a minimum of £10m investment balance and employing knowledgeable and experienced staff to carry out investment transactions. In February 2023, the Council invested in three covered bonds to satisfy this requirement; Santandar (£3.5m), Lloyds (£4m) and Cie de Financement Foncier (£2.5m). These are longer term investments which helps diversify our investment portfolio and provide a high level of investment security.

NON-TREASURY INVESTMENTS

14. The definition of investments in CIPFA’s revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in the Investment Guidance issued by Ministry of Housing, Communities and Local Government’s (MHCLG) and Welsh Government, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

15. The Authority held such investments in:

    - directly owned property such as office and commercial units of £10.6m
    - loans to developers £10.3m
    - shareholding in subsidiaries £0.3m (Newport Transport)

16. Directly held property is subject to annual valuation review which can change the value of the holding.

17. The developer loans activity reflects those regenerative partnership projects that are included within the capital programme to assist developers with cash flow loans on particular projects and which are required to be repaid plus interest.

OTHER TREASURY CONSIDERATIONS FOR 2023-24

Economic background and Counter Party Update

18. Appendix A outlines the underlying economic environment as provided by the Council’s Treasury Management Advisors, Arlingclose. This is very useful context in informing annual strategy and assisting in effective treasury decisions.

19. 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 Arlingclose reduced the advised maximum duration limit for all banks on its recommended counterparty list to 35 days. This stance continued to be maintained at the end of the period.

20. Following the issue of a Section 114 notice, in September Arlingclose advised against undertaking new lending to Birmingham City Council, and later in the month cut its recommended duration on Warrington Borough Council to a maximum of 100 days.

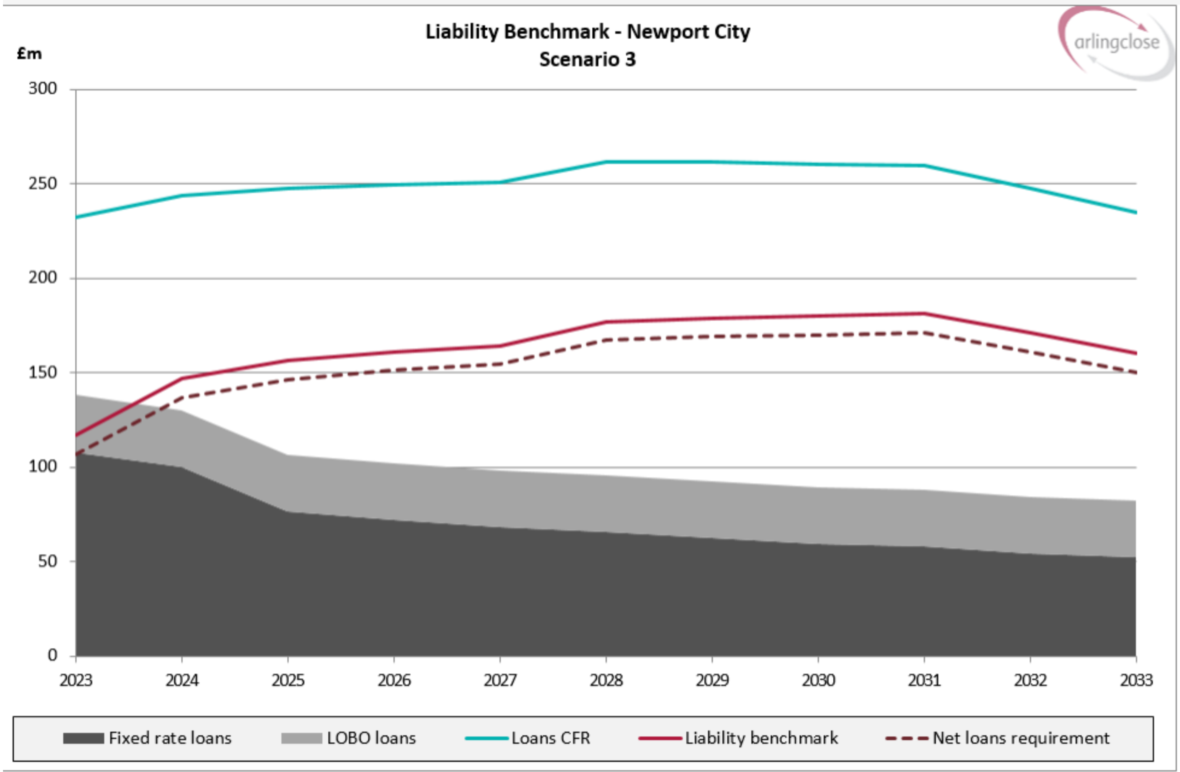
Compliance with Prudential Indicators approved by Council

21. The Authority measures and manages its exposures to treasury management risks using various indicators which can be found in Appendix B. The Authority has complied with the Prudential Indicators for the first half of 2023/24, set in February 2023 as part of the Treasury Management Strategy.

Liability Benchmark Indicator

22. CIPFA recommends that the optimum position for external borrowing should be at the level of the Liability Benchmark (i.e. all balance sheet resources should be used to maximise internal borrowing). If the outputs show future periods where external loans are less than the Liability Benchmark, then this indicates a borrowing requirement thus identifying where the authority is exposed to interest rate, liquidity and refinancing risks. Conversely, where external loans exceed the Liability Benchmark then this will highlight an over borrowed position which will result in excess cash in the organisation requiring investment thus exposing the authority to credit and reinvestment risks and a potential cost of carry. The treasury strategy should explain how the treasury risks identified by the Liability Benchmark are to be managed over the coming years.

23. The Liability Benchmark is effectively the Net Borrowing Requirement of a local authority plus a liquidity allowance. In its simplest form, it is calculated by deducting the amount of investable resources available on the balance sheet (reserves, cash flow balances) from the amount of outstanding external debt and then adding the minimum level of investments required to manage day-to-day cash flow. It is often denoted in pictorial form using the following graph:



24. In the chart above, the blue line reflects the accumulated value of historic, and future, unfunded capital expenditure – i.e. expenditure initially funded by borrowing and then funded via the revenue budget, over time, in the form of MRP (Minimum Revenue Provision). In effect, this line represents the gross amount of borrowing required.

The solid red line is the calculated actual/real level of borrowing required, taking into account the Council's internal borrowing capacity (i.e. the value of balance sheet resources at any point in time). The gap between the blue and red lines represents the internal borrowing capacity.

The grey shaded areas represent the actual borrowing undertaken by the Council as of 30 September 2023 and shows how these loans reduce as they are scheduled for repayment.

The white gap between the solid red line and the grey shaded areas represents the estimated amount of new borrowing required over the next ten years. A large proportion of this new borrowing would be to replenish existing maturing borrowing, with the remainder being required as a result of the Council's capital expenditure plans.

Outlook for short to medium term

25. As outlined in the Liability Benchmark graph, and elsewhere in the report, the Council has a longer term underlying need to borrow. This is driven by the increasing expenditure on the Capital Programme, with a significant peak expected during 2023/24 and 2024/25, as well as the need to refinance existing borrowing. It is anticipated that the need to borrow will crystallise towards the first half of the 2024/25 financial year. In the intervening period, the Council should be able to manage its cashflow requirements through its internal borrowing strategy and gradually reducing the level of investments held. If there are any short term cashflow needs, these can be addressed via short term borrowing.

26. Aside from LOBOs, which could potentially see interest rate rises, all of the external borrowing is on a fixed rate basis. Therefore, and in line with advice from the treasury advisors, the intention is to hold off undertaking any borrowing until absolutely necessary, in anticipation that rates will reduce,

even if not to the levels available in recent years. This position will be reviewed on a regular basis in conjunction with the treasury advisors, especially in light of the volatile economic context and the regularly changing borrowing rates.

Risks

Risk	Impact of Risk if it occurs* (H/M/L)	Probability of risk occurring (H/M/L)	What is the Council doing or what has it done to avoid the risk or reduce its effect	Who is responsible for dealing with the risk?
Investment counterparty not repaying investments	High, but depending on investment value.	Low	The Council only invests with institutions with very high credit scores. It employs advisors to monitor money market movements and changes to credit scores and acts immediately should things change adversely. The lower levels of funds available for investment will also alleviate the risk. Colleagues also monitor financial circulars and Treasury consultants advice to be able to respond in a timely fashion, and withdrew its investment from one local authority recently.	Members, Head of Finance, Treasury staff, based on advice from treasury advisors
Interest Rates moving adversely against expectations	Medium	Medium	Interest rates are currently volatile, however the Council's external borrowing is based on fixed interest rates, although there is a degree of risk in relation to LOBOs. The Council will continue to monitor interest rates in anticipation of a medium term need to borrow and will work with its treasury advisors to identify the optimum time to undertake any new borrowing.	Head of Finance, Treasury staff, treasury advisors

* Taking account of proposed mitigation measures

Links to Council Policies and Priorities

It is the Council's policy to ensure that the security of the capital sums invested is fully recognised and has absolute priority. The Council follows the advice of the Welsh Government that any investment decisions take account of security, liquidity and yield in that order.

Options Available and considered

The Prudential Code and statute requires that, during and at the end of each financial year, reports on these matters are presented to Council for approval.

Preferred Option and Why

The approach required by statute is quite prescriptive, such that there aren't many choices/options. This report is a regular half yearly event. The Governance and Audit Committee acts as the main scrutiny mechanism before a similar report is received by Cabinet/Council. The approach remains unchanged in advocating that the Committee notes the contents of the report in relation to Treasury activities and indicators and provides endorsement or feedback pertinent to add to the Cabinet/Council report.

Comments of Chief Financial Officer
Decisions made on treasury matters will be made with a view to comply with the Treasury Management Strategy, Prudential Indicators, taking advice, where needed, from our treasury advisors.

The report reflects a relatively stable period from a treasury management perspective. Borrowing levels have reduced slightly, as expected and investment balances have actually increased, although it is expected that this trend will reverse during the second half of the year, as would traditionally be the case. As highlighted in previous reports, and confirmed by the Liability Benchmark indicator, there remains an underlying, medium-term, need to borrow, which is currently anticipated to crystallise during the first part of 2024/25.

The indications are that interest rate volatility has now calmed, with our treasury advisors forecasting that rates will remain broadly in line with current levels, before starting to steadily reduce. Because of this, and the fact that there is not an imminent need to borrow, there is not an intention to undertake new long-term external borrowing until absolutely necessary, unless there are financial advantages of doing so. Rates will continue to be closely monitored on a regular basis, to identify any change in circumstances.

It may be necessary to undertake some short-term borrowing to assist with managing day to day cashflow requirements and, if that is required, I have the necessary delegated authority to undertake this. The same also applies should any existing LOBOs be repaid and require refinancing. However, should any LOBOs be redeemed, it is anticipated that it will be possible to manage this from existing short-term investment balances, without the need to commit to new long-term borrowing.

Comments of Monitoring Officer
There are no legal implications. The in year and annual treasury management report is consistent with relevant Chartered Institute of Public Finance and Accountancy Guidance, Treasury Management principles and the Council's investment Strategy.

Comments of Head of People and Business Change
There are no direct HR implications associated with the report.

The Well-being of Future Generations Act requires public bodies to balance short-term needs with the needs to safeguard the ability to meet long-term needs as outlined in the approach taken.

Comments of Cabinet Member
N/A

Local issues
N/A

Scrutiny Committees
N/A

Fairness and Equality Impact Assessment:
- **Wellbeing of Future Generation (Wales) Act**
- **Equality Act 2010**
- **Socio-economic Duty**

- **Welsh Language (Wales) Measure 2011**

For this report, a full Fairness and Equality Impact Assessment has not been undertaken. This is because this report is not seeking any strategic decisions or policy changes, with its purpose being to update on the treasury management activities for the year retrospectively. However, fairness and equality are considered as part of service delivery and will feature in annual finance reports, such as the Treasury and Capital Strategy.

In terms of the Wellbeing of Future Generations (Wales) Act, and the five ways of working contained within it, this report highlights examples of these being supported. This report is a backwards looking report of the treasury management activities of the Council. It shows that we followed the treasury management strategy and the compliance with prudential code and treasury management indicators. This links into the long-term objectives of the authorities and ensures that the Councils' activities are carried out in an affordable, prudent and sustainable manner.

In the case of the Welsh Language, the service will continue to ensure that, wherever possible, services or information is available in the medium of Welsh.

The Equality Act 2010 contains a Public Sector Equality Duty, which came into force on 06 April 2011. The Act identifies a number of 'protected characteristics', namely age; disability; gender reassignment; pregnancy and maternity; race; religion or belief; sex; sexual orientation; marriage and civil partnership. The new single duty aims to integrate consideration of equality and good relations into the regular business of public authorities. Compliance with the duty is a legal obligation and is intended to result in better-informed decision-making and policy development and services that are more effective for users. Nothing in this report is considered to have a direct equality impact.

Consultation
N/A

Background Papers
Report to Council February 2023: Capital Strategy and Treasury Strategy.

Dated: 19th October 2023

APPENDIX A

Introduction

The Authority's treasury management strategy for 2023/24 was approved at a meeting on 28th February 2023. The Authority has borrowed and invested substantial 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 Authority's treasury management strategy.

External Context (Provided by the Council's Treasury Management Advisors

Economic background: UK inflation remained stubbornly high over much the period compared to the US and euro zone, keeping expectations elevated of how much further the Bank of England (BoE) would hike rates compared to the regions. 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 very soon after by the BoE deciding to keep Bank Rate on hold at 5.25% in September, against expectation for another 0.25% rise.

Economic growth in the UK remained relatively weak over the period. In calendar Q2 2023, the economy expanded by 0.2%. However, monthly GDP data showed a 0.5% contraction in July, the largest fall to date in 2023 and worse than the 0.2% decline predicted which could be an indication the monetary tightening cycle is starting to cause recessionary or at the very least stagnating economic conditions.

July data showed the unemployment rate increased to 4.3% (3mth/year) while the employment rate rose to 75.5%. Pay growth was 8.5% for total pay (including bonuses) and 7.8% for regular pay, which for the latter was the highest recorded annual growth rate. Adjusting for inflation, pay growth in real terms were positive at 1.2% and 0.6% for total pay and regular pay respectively.

Inflation continued to fall from its peak as annual headline CPI declined to 6.7% in July 2023 from 6.8% in the previous month against expectations for a tick back up to 7.0%. The largest downward contribution came from food prices. The core rate also surprised on the downside, falling to 6.2% from 6.9% compared to predictions for it to only edge down to 6.8%.

The Bank of England's Monetary Policy Committee continued tightening monetary policy over most of the period, taking Bank Rate to 5.25% in August. Against expectations of a further hike in September, the Committee voted 5-4 to maintain Bank Rate at 5.25%. Each of the four dissenters were in favour of another 0.25% increase.

Financial market Bank Rate expectations moderated over the period as falling inflation and weakening data gave some indication that higher interest rates were working. Expectations fell from predicting a peak of over 6% in June to 5.5% just ahead of the September MPC meeting, and to then expecting 5.25% to be the peak by the end of the period.

Following the September MPC meeting, Arlingclose, the authority's treasury adviser, modestly revised its interest forecast to reflect the central view that 5.25% will now be the peak in Bank Rate. In the short term the risks are to the upside if inflation increases again, but over the remaining part of the time horizon the risks are to the downside from economic activity weakening more than expected.

The lagged effect of monetary policy together with the staggered fixed term mortgage maturities over the next 12-24 months means the full impact from Bank Rate rises are still yet to be felt by households. As such, while consumer confidence continued to improve over the period, the GfK measure hit -21 in September, it is likely this will reverse at some point. Higher rates will also impact business and according to S&P/CIPS survey data, the UK manufacturing and services sector contracted during the quarter with all measures scoring under 50, indicating contraction in the sectors.

The US Federal Reserve increased its key interest rate to 5.25-5.50% over the period, pausing in September following a 0.25% rise the month before, and indicating that it may have not quite completed its monetary tightening cycle.

Having fallen throughout 2023, annual US inflation started to pick up again in July 2023, rising from 3% in June, which represented the lowest level since March 2021, to 3.2% in July and then jumping again to 3.7% in August, beating expectations for a rise to 3.6%. Rising oil prices were the main cause of the increase. US GDP growth registered 2.1% annualised in the second calendar quarter of 2023, down from the initial estimate of 2.4% but above the 2% expansion seen in the first quarter.

The European Central Bank increased its key deposit, main refinancing, and marginal lending interest rates to 4.00%, 4.50% and 4.75% respectively in September, and hinted these levels may represent the peak in rates but also emphasising rates would stay high for as long as required to bring inflation down to target.

Although continuing to decline steadily, inflation has been sticky, Eurozone annual headline CPI fell to 5.2% in August while annual core inflation eased to 5.3% having stuck at 5.5% in the previous two months. GDP growth remains weak, with recent data showing the region expanded by only 0.1% in the three months to June 2023, the rate as the previous quarter.

Financial markets: 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. The 5-year UK benchmark gilt yield rose from 3.30% to peak at 4.91% in July before trending downwards to 4.29%, the 10-year gilt yield rose from 3.43% to 4.75% in August before declining to 4.45%, and the 20-year yield from 3.75% to 4.97% in August and then fell back to 4.84%. The Sterling Overnight Rate (SONIA) averaged 4.73% over the period.

Credit review: 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 Arlingclose reduced the advised maximum duration limit for all banks on its recommended counterparty list to 35 days. This stance continued to be maintained at the end of the period.

During the second quarter of the period, Moody's revised the outlook on Svenska Handelsbanken to negative from stable, citing concerns around the Swedish real estate sector.

Having put the US sovereign rating on Rating Watch Negative earlier in the period, Fitch took further action in August, downgrading the long-term rating to AA+, partly around ongoing debt ceiling concerns but also an expected fiscal deterioration over the next couple of years.

Following the issue of a Section 114 notice, in September Arlingclose advised against undertaking new lending to Birmingham City Council, and later in the month cut its recommended duration on Warrington Borough Council to a maximum of 100 days.

Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress and although no changes were made to recommended durations over the period, Northern Trust Corporation was added to the counterparty list.

Heightened 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 Arlingclose remains under constant review.

APPENDIX B

Local Context

On 30th September 2023, the Authority had net borrowing of £80.8m 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 Actual £m	**31.03.24 Forecast £m**
General Fund CFR	270.9	280.0
Less: *Other debt liabilities	38.5	36.1
Borrowing CFR	**232.4**	**243.9**
Less: Usable reserves	-139	-104
Less: Working capital	-2	-4
Net borrowing	**91.4**	**136.2**

* finance leases, PFI liabilities and transferred debt that form part of the Authority's total debt

The treasury management position on 30th September 2023 and the change over the six months is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.23 Balance £m	**Movement £m**	**30.9.23 Balance £m**	**30.9.23 Rate %**
Long-term borrowing	128.7	(3.1)	125.6	3.6
Long term interest free borrowing	9.9	0.0	9.9	-
Short-term borrowing	0.0	-	-	-
Total borrowing	**138.6**	**(3.1)**	**135.5**	**3.6**
Long-term investments	(10.0)	0.0	(10.0)	4.3
Short-term investments	(30.2)	(11.3)	(41.5)	-
Cash and cash equivalents	(7.0)	3.8	(3.2)	0.3
Total investments	**(47.2)**	**(7.4)**	**(54.7)**	**4.6**
Net borrowing	91.4	(10.6)	80.8	8.2

A minimal amount of new long-term borrowing was taken out in the first half of the financial year totalling £300k. This borrowing was from Salix which was interest free and was linked to a specific energy efficiency project. However, the Council also have a number of other loans with Salix which are EIPs which is why long term interest free borrowing has not increased. The Council have also redeemed two small PWLB loans at the end of September, which have not been refinanced, plus we have a number of loans with PWLB which are Equal Instalments of Principal (EIP) loans as well.

Short term investments have increased during the period but this is part of the normal day to day treasury management activity of managing cashflows.

Borrowing

CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement and so may lead to new borrowing, unless directly and primarily related to the functions of the Authority. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield unless these loans are for refinancing purposes.

The Authority has not invested in assets primarily for financial return or that are not primarily related to the functions of the Authority. It has no plans to do so in the future.

Borrowing strategy and activity

As outlined in the treasury strategy, the Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing lower interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective. The Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

There was a substantial rise in the cost of both short- and long-term borrowing over the last 18 months. Bank Rate rose by 1% from 4.25% at the beginning of April to 5.25% at the end of September. Bank Rate was 2% higher than at the end of September 2022.

UK gilt yields were volatile, mainly facing upward pressure since early April following signs that UK growth had been more resilient, inflation stickier than expected, and that the Bank of England saw persistently higher rates through 2023/24 as key to dampening domestic demand. Gilt yields, and consequently PWLB borrowing rates, rose and broadly remained at elevated levels. On 30th September, the PWLB certainty rates for maturity loans were 5.26% for 10-year loans, 5.64% for 20-year loans and 5.43% for 50-year loans. Their equivalents on 31st March 2023 were 4.33%, 4.70% and 4.41% respectively.

At 30th September the Authority held £135.5m of loans, a decrease of £3.1m to 31st March 2023, as part of its strategy for funding previous years' capital programmes. Outstanding loans on 30th September are summarised in Table 3A below.

Table 3A: Borrowing Position

	31.3.23 Balance £m	**Net Movement £m**	**30.9.23 Balance £m**	**30.9.23 Weighted Average Rate %**	**30.9.23 Weighted Average Maturity (years)**
Public Works Loan Board	93.1	(2.5)	90.6	3.6	18.0
Banks (LOBO)	30.0	-	30.0	4.4	31.0
Banks (fixed-term)	5.0	-	5.0	3.8	54.7
Local authorities (long-term)	-	-	-	-	-
Local authorities (short-term)	-	-	-	-	-
Other inc. WG loans	9.9	0.0	9.9	-	0.4
Accrued interest	0.6	(0.6)	-		
Total borrowing	**138.6**	**(3.1)**	**135.5**	**3.6**	**21.3**

The Authority's borrowing decisions are not predicated on any one outcome for interest rates

LOBO loans: On 1st April 2023, the Authority held £30m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate and terms or to repay the loan at no additional cost.

As market interest rates rose, there was increased probability of call options on the LOBOs being exercised by lenders. £30m of LOBO loans had annual/semi-annual call option dates during the six-month period to September 2023, no LOBO loans were called

The Authority has £30m LOBO loans with call dates within the next 12 months, some of which will occur during the remainder of the financial year. The Authority has liaised with treasury management advisors Arlingclose over the likelihood of the options being exercised. If the option is exercised and an increased rate proposed, the authority will consider its options at that particular point, in conjunction with advice from Arlingclose. It may choose to repay the loan from existing short term investment balances and, in doing so, mitigate the risk of future interest rate rises on that particular loan. Alternatively, depending upon the availability of cash and the new rate being proposed, the Authority may decide to accept the new interest rate.

Other Debt Activity

Although not classed as borrowing, the Authority previously raised capital finance to afford Glan Usk School and the Southern Distributor Road. The Accounts for 2022-23 an outstanding liability of £39m to pay to the operator.

Treasury Investment Activity

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.

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the half year, the Authority's investment balances ranged between £47.2 and £80.9 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.23 Balance £m	Movement £m	30.09.23 Balance £m	30.09.23 Income Return %	30.09.23 Weighted average maturity Years
Banks & building societies (unsecured)	-	(0.9)	(0.9)	1.5	On Call
Government (incl. local authorities)	(30.2)	(11.3)	(41.5)	5.2	0.3
Money Market Funds	(7.0)	4.8	(2.3)	3.7	On Call
Covered Bonds	(10.0)	0.0	(10.0)	4.3	4.3
Total investments	**(47.2)**	**(7.4)**	**(54.7)**	**5.0**	**1.0**

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.

As demonstrated by the liability benchmark in this report, the Authority 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.

Bank Rate increased by 1%, from 4.25% at the beginning of April to 5.25% by the end of September. 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 4.1 and 5.2%.

The £10m that is available for longer-term investment is invested in covered bonds, which has been maintained since the last report and no change is expected in the medium term.

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

Statutory override: 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 two 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, although it should be noted that the Council currently has no long-term pooled fund investments.

Non-Treasury Investments

The definition of investments in the Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority 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).

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

The Authority also held investments in

- directly owned property such as office and commercial units of £10.6m
- loans to developers £10.3m
- shareholding in subsidiaries £0.3m

These investments generated £0.45m in 2022/23 of investment income for the Authority after taking account of direct costs.

Compliance

The Head of Finance reports that all treasury management activities undertaken during the quarter complied fully with the principles in the Treasury Management Code and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in Table 7 below.

Table 7: Investment Limits

Sector	Time limit	Counterparty limit	Sector limit	30.09.23 Actual	Complied? Yes / No
The UK Government	50 years	Unlimited	n/a		✓
Local authorities & other government entities	25 years	£10m	Unlimited	41.5	✓
Secured investments *	25 years	£10m	Unlimited	10.0	✓
Banks (unsecured) *	13 months	£10m	Unlimited	0.9	✓
Building societies (unsecured) *	13 months	£10m	£10m		✓
Registered providers (unsecured) *	5 years	£10m	£25m		✓
Money market funds *	n/a	£10m	Unlimited	2.3	✓
Strategic pooled funds	n/a	£10m	£25m		✓
Real estate investment trusts	n/a	£10m	£25m		✓
Other investments *	5 years	£10m	£5m		✓

Compliance with the Authorised Limit and Operational Boundary for external debt is demonstrated in table 8 below.

Table 8: Debt and the Authorised Limit and Operational Boundary

	2023/24 Maximum	30.09.23 Actual	2023/24 Operational Boundary	2023/24 Authorised Limit	Complied? Yes / No
Borrowing	138	135.5	150	246	✓
PFI and Finance Leases	38	36.2	39	39	✓
Total debt	**176**	**171.7**	**189**	**285**	✓

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.

Treasury Management Prudential Indicators

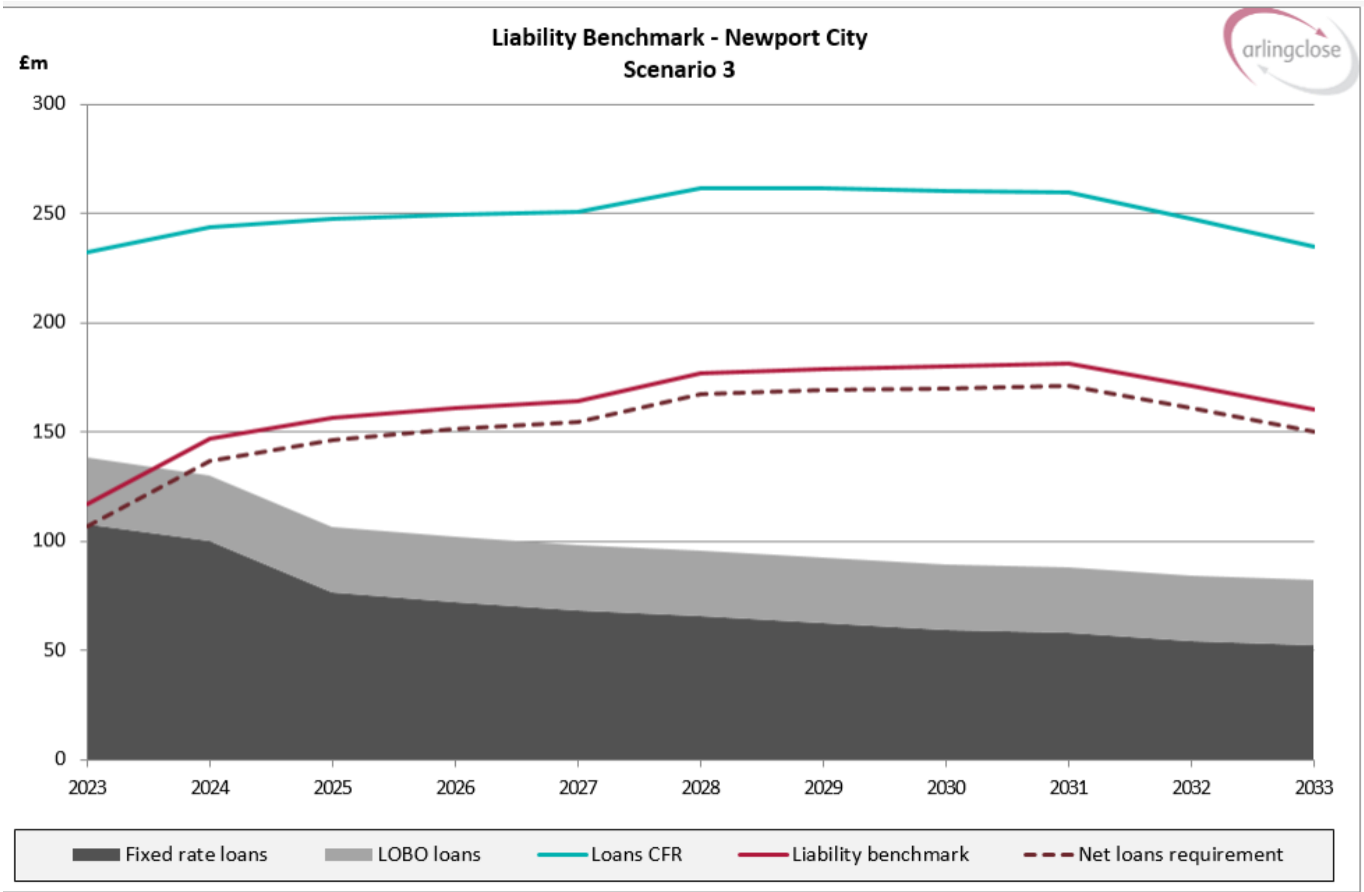
As required by the 2021 CIPFA Treasury Management Code, the Authority monitors and measures the following treasury management prudential indicators.

1. Liability Benchmark**:**

This 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 of £10m required to manage day-to-day cash flow.

	31.3.23 Actual	31.3.24 Forecast	31.3.25 Forecast	31.3.26 Forecast
Loans CFR	232.2	243.9	247.6	249.7
Less: Balance sheet resources	-125.3	-107.2	-101.1	-98.6
Net loans requirement	106.9	136.7	146.5	151.1
Plus: Liquidity allowance	10	10	10	10
Liability benchmark	**116.9**	**146.7**	**156.5**	**161.1**
Existing borrowing	**-137.2**	**-159.3**	**-135.4**	**-130.9**

Following on from the medium-term forecast above, the long-term liability benchmark assumes no new capital expenditure funded by borrowing until 2028/29 (other than that already approved as part of the Capital Programme), minimum revenue provision on new capital expenditure based on a 25 year asset life and income, expenditure and reserves all increasing by inflation of 2.5% p.a. This is shown in the chart below together with the maturity profile of the Authority's existing borrowing.



Whilst borrowing may be above the liability benchmark, strategies involving borrowing which is significantly above the liability benchmark carry higher risk.

2. <u>Maturity Structure of Borrowing</u>**:** This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	30.09.23 Actual	Upper limit	Lower limit	Complied

Under 12 months	27%	60%	0%	✓
12 months and within 24 months	17%	40%	0%	✓
24 months and within 5 years	8%	40%	0%	✓
5 years and within 10 years	9%	40%	0%	✓
10 years and within 20 years	17%	30%	0%	✓
20 years and within 30 years	3%	20%	0%	✓
30 years and within 40 years	15%	20%	0%	✓
40 years and within 50 years	0%	20%	0%	✓
50 years and above	4%	20%	0%	✓

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

3. Long-term Treasury Management Investments**:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury management limits are:

	2023/24	**2024/25**	**2025/26**	**No fixed date**
Actual principal invested beyond year end	10	10	10	10
Limit on principal invested beyond year end	£10m	£10m	£10m	£10m
Complied	✓	✓	✓	✓

Long-term investments with no fixed maturity date include strategic pooled funds, real estate investment trusts and directly held equity but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. Bank Rate rose by 1.25% from 4.25% on 1st April to 5.25% by 30th September.

Interest rate risk indicator	**Limit**	**30.09.23 Actual**	**Complied**
Upper limit on one-year revenue impact of a 1% rise in interest rates	£200,000	13,714	✓
Upper limit on one-year revenue impact of a 1% fall in interest rates	£100,000	31,800	✓

For context, the changes in interest rates during the first half of the year were:

	31/3/23	30/9/23
Bank Rate	4.25%	5.25%
1-year PWLB certainty rate, maturity loans	4.78%	5.69%
5-year PWLB certainty rate, maturity loans	4.31%	5.22%
10-year PWLB certainty rate, maturity loans	4.33%	5.26%
20-year PWLB certainty rate, maturity loans	4.70%	5.64%
50-year PWLB certainty rate, maturity loans	4.41%	5.43%

The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at new market rates.