



## **CORPORATE AND REGENERATION SCRUTINY COMMITTEE – INFORMATION ITEM - 20TH FEBRUARY 2024**

**SUBJECT: TREASURY MANAGEMENT AND CAPITAL FINANCING  
PRUDENTIAL INDICATORS QUARTER 3 MONITORING  
REPORT (1ST APRIL 2023 TO 31ST DECEMBER 2023) –  
INFORMATION ITEM**

**REPORT BY: CORPORATE DIRECTOR FOR EDUCATION AND  
CORPORATE SERVICES**

### **1. PURPOSE OF REPORT**

- 1.1 To present Members with details of Treasury Management activities and Capital Financing, together with the related Prudential Indicators for the period 1<sup>st</sup> April 2023 to 31<sup>st</sup> December 2023.
- 1.2 To review the Treasury Management Strategy for 2023/24 as set out in the Annual Investment Strategy and Capital Financing Prudential Indicators Report.

### **2. SUMMARY**

- 2.1 In October 2010 the Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Service: Code of Practice (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports. This quarterly report provides an additional update.
- 2.2 This report includes the new requirement in the 2021 Code, mandatory from 1<sup>st</sup> April 2023, of quarterly reporting of the treasury management prudential indicators.
- 2.3 The Authority's Annual Treasury Strategy and Capital Financing Prudential Indicators for 2023/24 were approved by Council on the 23<sup>rd</sup> February 2023.

### **3. RECOMMENDATIONS**

- 3.1 Members are asked to note the contents of this report.

### **4. REASONS FOR THE RECOMMENDATIONS**

- 4.1 Compliance with the CIPFA "Code of Practice for Treasury Management in the Public Services".

## **5. THE REPORT**

### **5.1 Treasury Management**

#### **5.1.1 Borrowing Activity**

The Authority is operating a policy of internal borrowing in order to reduce risk and keep its interest costs low. As at the 31<sup>st</sup> March 2023 the internal borrowing position was £51.2m.

The Annual Treasury Management Strategy was approved by Council in February 2023. As part of the strategy approval was given to borrow up to £46.8m in 2023/24 to part fund the General Fund capital programme if required. A further £450m was approved for the HRA to fund the WHQS and Affordable Housing capital programme. No external borrowing has taken place during the reported period.

During the period covered by this report, PWLB loans to the value of £5.1m were repaid on maturity, these loans had an average interest rate of 4.42%. The £30k final balance of the WRU Loan and £517k of the Salix Loan were also repaid. Total debt outstanding as at 31<sup>st</sup> December 2023 was £310m and comprised of £241.3m PWLB loans; £30m market loans (LOBOs); £10m Bank loan; £25.9m WG loans, and a £2.8m Salix Energy Finance loan.

With respect to the £30m LOBO loans, 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 or to repay the loan at no additional cost. During the reporting period the total LOBO portfolio with a value of £30m had a rate option review, and the lenders chose not to exercise the option. The LOBO's represent 9.7% of the Authority's debt portfolio, which is exposed to interest rate risk.

The loans from Welsh Government are charged at zero interest providing the loan obligations are met, the loans will be repaid through future capital receipts generated from the projects.

#### **5.1.2 Rescheduling**

The Annual Strategy allows for the utilisation of debt rescheduling providing for both in- year and future year savings and additional revenue resources. No rescheduling opportunities were utilised during the period covered by this report.

#### **5.1.3 Investments**

During the reported period the Authority was holding £34.6m of long-term investments where the maturity date was greater than 365 days. These investments are in accordance with the approved Investment Strategy. The long-term investments comprise of UK Gilts, Bonds, Real Estate Investment Trusts (REITS) and pooled funds. The value of short-term deposits as at 31<sup>st</sup> December 2023 was £113.8m.

The total investments held as at 31<sup>st</sup> December 2023 were £148.4m and had a total income rate of return equating to 4.37%. The target rate which was set for return on investments in the Treasury Management Strategy 2023/24 was the base rate in place at that time of 3.50%. Over the reporting period, the base rate has increased from 4.25% to 5.25%, with an average rate of 4.93%. The overall return of 4.37% was below the target rate due to some historic investments which were made when interest

rates were significantly lower.

Investments in pooled funds allow the Authority to generate income returns and the intention is to hold them for a minimum of five years as per the Treasury Strategy 2022/23. These investments generated an income return of 5.21% during the reporting period.

The Authority continued to maintain its cash surpluses to subsidise the capital programme and delay any borrowing.

The portfolio as at 31<sup>st</sup> December 2023 comprised of the following types of investments:

Counterparty	Investment Product	Sector	£m
<b>Banks &amp; Building Societies</b>	Bonds and Fixed Term Deposits.	Financial	28.6
<b>Money Market Fund</b>	Cash Pooled Fund	Financial	28.3
<b>UK Government</b>	Gilts and DMO	UK Government	10.0
<b>Local Authorities and Housing Associations</b>	Fixed-term cash deposits	Local Government	62.0
<b>External Fund Managers</b>	Property Pooled Fund	Property	8.8
<b>External Fund Managers</b>	Bond Pooled Fund	Mixed	2.2
<b>External Fund Manager</b>	Equity Pooled Fund	Mixed	5.3
<b>External Fund Manager</b>	Multi Asset Pooled Fund	Mixed	2.3
<b>REIT</b>	Pooled Fund	Property	0.9
<b>Total Investments as at 31<sup>st</sup> December 2023</b>			<b>148.4</b>

**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 has been withdrawn in England from this date. The Authority will discuss with Arlingclose the implications for the investment strategy and what action may need to be taken if this override is also withdrawn in Wales.

#### 5.1.4 Economic Outlook

UK inflation rates finally started to decline, mirroring the sharp but earlier drop seen in the Eurozone and US. Despite the fall, the Consumer Price Index (CPI) remained substantially in excess in the Bank of England's (BoE) 2% target, at 3.9% for November 2023. Market expectations for further rises in Bank Rate fell from October through to year end, indicating that the 5.25% level reached in August 2023 was indeed the peak for Bank Rate.

Economic growth in the UK remained weak over the period, edging into recessionary territory. In calendar Q3 2023, the economy contracted by 0.1%, following no change in Q2. Monthly GDP data showed a 0.3% contraction in October, following a 0.2% rise in September. While other indicators have suggested a pickup in activity in the subsequent months, Q4 GDP growth is likely to continue the weak trend.

July data showed the unemployment rate increased to 4.2% (3mth/year) while the employment rate rose to 75.7%. Pay growth edged lower as the previous strong pay rates waned; total pay (including bonuses) growth was 7.2% over the three months to October 2023, while regular pay growth was 7.3%. Adjusting for inflation, pay growth in real terms were positive at 1.3% and 1.4% for total pay and regular pay respectively.

Inflation continued to fall from its peak as annual headline CPI declined to 3.9% (down from 4.6%) in November 2023. The largest downward contribution came from energy and food prices. The core rate also surprised on the downside, falling to 5.1% from 5.7%.

The BoE's Monetary Policy Committee held Bank Rate at 5.25% throughout the period, although a substantial minority continued to vote for a 25 basis point rate rise. The Bank continues to tighten monetary policy through asset sales, as it reduces the size of its balance sheet. Financial market Bank Rate expectations moderated over the period as falling inflation and weakening data showed that higher interest rates were working in the UK, US, and Eurozone.

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, it is likely this will reverse at some point and spending will struggle. Higher rates will also impact exposed businesses; according to S&P/CIPS survey data, the UK manufacturing and construction sectors contracted during the quarter. The services sector recovered, however, with the PMI rising strongly in December, possibly due to improving consumer confidence.

Gilt yields fell towards the end of the period. The 10-year UK benchmark gilt yield rose from 4.57% to peak at 4.67% in October before dropping to 3.54% by the end of December 2023. The Sterling Overnight Rate (SONIA) averaged 5.19% over the period.

Following the December MPC meeting, Arlingclose, the authority's treasury adviser, maintained its central view that 5.25% is the peak in Bank Rate. Short term risks are broadly balanced, but over the remaining part of the time horizon the risks are to the downside from economic activity weakening more than expected

Official Bank Rate	Upside Risk	Arlingclose (Central case)	Downside Risk
2024 Q1	0.25	5.25%	-0.25
2024 Q2	0.25	5.25%	-0.50
2024 Q3	0.50	5.00%	-0.75
2024 Q4	0.50	4.75%	-1.00
2025 Q1	0.50	4.25%	-1.00
2025 Q2	0.50	4.00%	-1.00
2025 Q3	0.50	3.75%	-1.00
2025 Q4	0.75	3.50%	-1.00

### 5.1.5 Borrowing Update

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.

The authority is not planning to purchase any investment assets primarily for yield within the next 3 years.

A new PWLB HRA rate which is 0.4% below the certainty rate was made available from 15<sup>th</sup> June 2023. Initially available for a period of one year, this discounted rate is to support local authorities borrowing for the Housing Revenue Account and for refinancing existing HRA loans. This rate will now be available until June 2025.

The UK Infrastructure Bank, which is wholly owned and backed by HM Treasury, has been set up with £4bn of funding earmarked for lending to Local Authorities. Loans will be available for qualifying projects at gilt yield plus 0.4%, which is 0.4% lower than the PWLB certainty rate.

### 5.1.6 Counterparty Update

Arlingclose maintained the advised maximum duration limit for all banks on its recommended counterparty list to 35 days over the period.

In October, Moody's revised the outlook on the UK's Aa3 sovereign rating to stable from negative. This led to similar rating actions on entities that include an element of government support in their own credit ratings, including banks and housing associations. Local authorities were, however, downgraded on expectations of lower government funding.

Following the issue of a Section 114 notice, in November Arlingclose advised against undertaking new lending to Nottingham City Council. After reducing its recommended duration on Warrington Borough Council to a maximum of 100 days in September, the local authority was subsequently suspended from the Arlingclose recommended list following a credit rating downgrade by Moody's to Baa1.

Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress, but no changes were made to recommended durations over the period.

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.

### 5.1.7 Non-Treasury Investments

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. Such investments can comprise of property; shared ownership housing; loans to local businesses/ subsidiaries; and shareholdings. During the reported period the Authority did not hold any non-treasury related investments.

## 5.2 **Prudential Indicators**

### 5.2.1 Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, the Authority does not associate borrowing with particular items or types of expenditure. In practice, the raising and repaying of loans is determined primarily by professional and expert advice and may not necessarily take place in the relevant year. In order to create an operating environment within which the Treasury Manager can legitimately react to appropriate advice, the various authorised limits as identified in Appendix 1 are set at a level in excess of the CFR. In the financial year to date, the Authority has been operating within the approved limits.

Appendix 1 shows a projected CFR value of £351.459m as at 31<sup>st</sup> March 2024. The actual CFR as at 31<sup>st</sup> March 2023 was £363.256m. Certain capital schemes have been delayed or the scheme extended which has resulted in a lower funding requirement than budgeted.

### 5.2.2 Prudential Indicators – "Prudence"

The Prudential Indicators for Treasury Management are shown in Appendix 1, and the Authority is currently operating within the approved limits.

### 5.2.3 Prudential Indicators – "Affordability"

There is a requirement to analyse and report the capital financing costs and express those costs as a percentage of the net revenue streams of the Authority. These are identified in Appendix 2 and currently show a projected reduction from the original

budget as a consequence of deferred borrowing for the General Fund. As a result of charging HRA for internal borrowing, their capital financing costs have increased.

#### 5.2.4 Capital Expenditure and Funding

A summary of capital expenditure and funding is attached at Appendix 3 and shows that there will be an underspend on the core capital budget. The original HRA budget was set on the 2022/23 business plan however this budget was subsequently revised downwards in the 2023/24 business plan.

### **6. ASSUMPTIONS**

- 6.1 The details set out in the report are based on actuals that have occurred between 1<sup>st</sup> April 2023 and 31<sup>st</sup> December 2023 (period 9).

### **7. SUMMARY OF INTEGRATED IMPACT ASSESSMENT**

- 7.1 This report is for information only and no Integrated Impact Assessment is required.

### **8. FINANCIAL IMPLICATIONS**

- 8.1 As detailed throughout the report.

### **9. PERSONNEL IMPLICATIONS**

- 9.1 There are no personnel implications arising from this report.

### **10. CONSULTATIONS**

- 10.1 There are no consultation responses that have not been reflected in this report.

### **11. STATUTORY POWER**

- 11.1 Local Government Acts 1972 and 2003.

Author: Rhiann Williams – Group Accountant- Treasury and Capital  
E-mail: [willirh@caerphilly.gov.uk](mailto:willirh@caerphilly.gov.uk)

Consultees:  
Richard Edmunds – Corporate Director of Education and Corporate Services  
Stephen Harris – Head of Financial Services and S151 Officer  
Leanne Sykes - Deputy S151 Officer  
Andrew Southcombe – Finance Manager, Corporate Finance  
Cllr E. Stenner – Cabinet Member for Finance and Performance

Appendices:

Appendix 1 – Treasury Management Prudential Indicators – Prudence

Appendix 2 – Capital Finance Prudential Indicators – Affordability

Appendix 3 – Capital Expenditure and Funding