COTSWOLD
DISTRICT COUNCIL

Council name	**COTSWOLD DISTRICT COUNCIL**
Name and date of Committee	**AUDIT AND GOVERNANCE COMMITTEE – 30 NOVEMBER 2023**
Subject	**TREASURY MANAGEMENT MID-YEAR REPORT 2023-24**
Wards affected	N/A
Accountable member	Cllr Mike Evemy, Cabinet Member for Finance Email: mike.evemy@cotswold.gov.uk
Accountable officer	David Stanley, Deputy Chief Executive and Section 151 Officer Email: David.Stanley@cotswold.gov.uk
Report author	Sian Hannam, Treasury Accountant Email: sian.hannam@publicagroup.uk
Summary/Purpose	To receive and discuss details of the Council's Treasury Management performance for the period 01 April to 30 September 2023 and Quarter 2 Treasury Management Prudential Indicators.
Annexes	None
Recommendation(s)	That the Audit and Governance Committee resolves to: 1. Recommend to Council to approve the Council's Treasury Management performance for the period 01 April 2023 to 30 September 2023 and Quarter 2 Prudential Indicators.
Corporate priorities	The Council's Treasury Management Strategy underpins all of the Council Priorities and is relevant to the Council principle of "Value for money – we will use the council's resources wisely but will invest in the fabric and future of the district".
Key Decision	NO
Exempt	NO
Consultees/ Consultation	N/A

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1. BACKGROUND

1.1 In February 2011 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code). The CIPFA Code requires the Council to approve reports on treasury management activities at the end of the first half of the financial year and at the end of the financial year.

1.2 This report covers the Treasury Management activity and performance of Cotswold District Council for the period 01 April to 30 September 2023.

1.3 The Council's Treasury Management Strategy for 2023/24 was approved at the Council meeting on 15 February 2023. The Council has 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 are therefore central to the Council's Treasury Management Strategy.

1.4 The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management 2021 ("the Code"), which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year. The Code also recommends that members be informed of Treasury Management activities on a quarterly basis. This report therefore ensures this authority is embracing best practice in accordance with CIPFA's recommendations.

2. TREASURY MANAGEMENT – INTRODUCTION

2.1 The purpose of the treasury management operation is to ensure that cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in counterparties or instruments commensurate with the Council's low risk approach, pursuing optimum performance while ensuring that security of the investment is considered ahead of investment return. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure.

2.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure the Council can meet its capital spending obligations. The management of longer-term cash may involve the arrangement of long and/or short-term loans (external borrowing) or may use longer term cash flow surpluses in lieu of external borrowing (internal borrowing).

2.3 The Council continued to engage the services of Arlingclose for independent treasury advice during the year 2023/24. Arlingclose provide specialist treasury support to 25% of UK local authorities. They provide a range of treasury management services including technical advice on investment management and long-term capital financing. They advise on investment trends,

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developments, and opportunities consistent with the Council's Treasury Management Strategy.

2.4 The Council's treasury management advisors have provided commentary on the economic background that prevailed during the first half of 2023/24. This commentary is provided at Annex A.

3. TREASURY MANAGEMENT- SUMMARY POSITION - 1 APRIL 2023 to 30 SEPTEMBER 2023

3.1 On 31 March 2023, the Council had net investments of £27.972m 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 useable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below:

Table 1: Balance Sheet Summary

	31.3.23 Actual £m	**31.3.24 Forecast £m**
General Fund CFR	0.0200	0.486
Less: External borrowing	(0.451)	(0.357)
Less: Usable reserves	(22.869)	(15.000)
Less: Working capital	(4.672)	(5.4000)
Net Investments	**(27.972)**	**(20.270)**

3.2 The Council's current strategy is to fund capital expenditure through its capital receipts or to maintain investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk. If interest rates were to rise by 1%, then investment income would average 5.78%, whilst borrowing costs (based on 20-year PWLB Annuity Loan inclusive of the certainty rate) would be 5.25%. For every £1m borrowed there be an additional £5,300 income per annum.

3.3 The Council's strategy has been to diversify investments into pooled funds in order to reduce risk and increase returns. The treasury management position as at 31 March 2023 and the mid-year change is shown in Table 2 below.

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Table 2: Treasury Management Summary

	31.3.23 Balance £m	Movement £m	30.9.23 Balance £m	30.9.23 Rate %
Long-term borrowing	0.451	(0.046)	0.405	2.21
Total borrowing	**0.451**	**(0.046)**	**0.405**	**2.21**
Long-term investments	11.528	(0.176)	11.352	4.41
Short-term investments	4.361	10.817	15.178	5.28
Cash and cash equivalents	12.083	(8.959)	3.124	4.67
Total investments	**27.972**	**1.682**	**29.654**	**4.78**
Total investments	**27.972**	**1.682**	**29.654**	

4. BORROWING ACTIVITY

4.1 Local authorities can borrow from the Public Works Loan Board (PWLB) provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 Officer. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to re-finance existing loans or externalise internal borrowing.

4.2 Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action and re-financing debt.

4.3 Competitive market alternatives are available for authorities with or without access to the PWLB. However, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders.

4.4 CIPFA's Prudential Code on Capital Finance and the Treasury Management Code of Practice have been updated for 2023/24. The main changes to the Codes are shown below:

4.5 **Prudential Code** – The updated code includes the following as the focus of the substantive changes:

- Provisions in the code, which present the approach to borrowing in advance of need in order to profit from additional sums borrowed, have been strengthened. The relevant parts of the code have augmented to be clear that borrowing for debt-for-yield investment is not permissible under the Prudential Code. This recognises that commercial activity is part of regeneration but underlines that such transactions do not include debt-for yield as the primary purpose of the investment or represent an unnecessary risk to public funds.

- Proportionality is included as an objective in the Prudential Code. Provisions have been added so that an authority incorporates an assessment of risk to levels of resources used for capital purposes.
- Capital strategies are required to report investments under the following headings: service, treasury management and commercial investments.

4.6 **Treasury Management Code** – The main changes to the Treasury Management code are as follows:

- Investment management practices and other recommendations relating to non-treasury investments are included within the Treasury Management Practices (TMPs) alongside existing TMPs.
- Introduction of the Liability Benchmark as a treasury management indicator for local government bodies.
- Environmental, Social and Governance (ESG) risks are incorporated into TMP1 (Risk Management) rather than a separate TMP 13.
- The purpose and objective of each category of investments should be described within the Treasury Management Strategy

4.7 The Council is not planning to purchase any investment assets primarily for yield within the next three years and so is able to fully access the PWLB.

4.8 The Council's first Community Municipal Investment (CMI), named 'Cotswold Climate Investment' (CMI) which targeted a £500,00 fundraise closed on the 16 August 2022, fully funded by over 450 investors. As at 30 September 2023 the Council's balance on the loan administered through Abundance Investments Limited for the purpose of Community Municipal Investments was £405k. The Cotswold Climate Investment will support a range of projects, including installing publicly available off-street electric vehicle charging points (EVCPs) around the district to encourage electric vehicle take-up, and improving the energy and carbon performance of the Council's Cirencester offices.

4.9 In order to support the Capital Programme in the future, the Council may need to undertake borrowing, there is no expectation of undertaking borrowing in the current financial year. Any future borrowing decision will be reported back to members of this Committee and will be subject to consideration and approval by either Cabinet or Council as appropriate.

5. INVESTMENT PERFORMANCE AND PROJECTIONS

5.1 The Council invested funds, representing income received in advance of expenditure plus balances and reserves held. During the first half of the year, the Council's investment balances ranged between £47m and £31m million due to timing differences between income and expenditure. The investment position is shown in table 3 below:

Table 3: Treasury Investment Position

	31.3.23 Balance £m	Net Movement £m	30.9.23 Balance £m	30.9.23 Income Return %
Bank of England DMADF	4.283	10.804	15.087	5.28
Money Market Funds/ Call Accounts	12.083	(8.958)	3.125	4.67
Real Estate Investment Trust (REIT)	1.007	(0.010)	0.997	2.88
Cash Plus Fund	1.096	0.026	1.122	N/A
Pooled Funds (1)	9.503	(0.180)	9.323	4.41
Total investments	**27.972**	**1.682**	**29.654**	**4.78**

(1) See breakdown at Table 4 below.

5.2 Both the CIPFA Code and Government guidance require the Council 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 Council'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.

5.3 The Investment income budget for 2023/24 is £0.719m, as approved in February 2023. As part of Treasury Management monitoring, a review of Investment income expectations for the year indicates income could exceed budget by £0.836m by year end (based on investment returns in the first half of the year). Increases in the Base Rate have fed through to higher short-term deposit and MMF interest rates. These have increased from 4.25% at the start of the year to 5.25% by September, further increases are not currently expected unless inflation remains stubbornly high. There has been a small increase in Pooled Fund interest, further details are included in section 6 of this report.

6. EXTERNALLY MANAGED POOLED FUNDS

6.1 Of the Council's investments, £11.5m are held in externally managed strategic pooled cash, bond, equity, multi-asset, and property funds and a further £1m is invested in a Housing Real Estate Investment Trust where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds have generated a revenue return of £0.281m (4.41% annualised) in the first half of the financial year. As at 30 September 2023, there is a capital loss of £1.155m against the initial investment due to external economic conditions. Unfortunately, due to continued global instability and lack of confidence in the market there has been further capital loss of £183k in

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the six months to September. Members are reminded that Pooled Funds are held for the longer-term and the capital value will fluctuate over each financial year.

6.2 Table 4 below shows the current valuations of the Pooled Funds portfolio, Cash Plus Fund and REIT at 30 September 2023, compared with the opening balances of 1 April 2023

Table 4: Pooled Funds, Cash Plus Fund and REIT

FUND NAME	Initial Investment	1st April Fund Value	30th Sept Value	Dividends in 2023/24 (as at 30 Sept)	Gain / (Loss) for 2023/24	Gain / (Loss) to Initial Principal	% Return Capital & Dividend 2023/24
	£	£	£	£	£	£	%
CCLA Property Fund	2,500,000	2,241,061	2,215,397	55,941	(25,664)	(284,603)	1.21%
Schroders Income Maximiser Fund (E)	1,000,000	801,858	781,817	40,932	(20,040)	(218,183)	2.09%
CCLA Diversified Income Fund (M)	1,000,000	939,659	925,211	18,359	(14,448)	(74,789)	0.39%
M&G UK Income Fund (E)	2,000,000	1,793,403	1,723,254	66,181	(70,149)	(276,746)	-0.20%
Investec Diversified Fund (M)	2,000,000	1,814,069	1,765,901	39,995	(48,168)	(234,099)	-0.41%
Columbia Threadneedle Bond Fund (B)	2,000,000	1,842,079	1,820,765	45,131	(21,313)	(179,235)	1.19%
Federated Cash + Fund (C)	1,000,000	1,096,121	1,122,443	-	26,321	122,443	2.63%
Fundamentum Housing REIT	1,000,000	1,000,000	990,000	14,250	(10,000)	(10,000)	0.43%
Total	**12,500,000**	**11,528,249**	**11,344,788**	**280,789**	**(183,461)**	**(1,155,212)**	**(4.78)**

Key: E- Equity, M – Multi asset, B –Bond, C – Cash

6.3 Pooled funds capital value fell in the period April to September, by 2.11%. 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. 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. The FTSE All Share index was marginally lower at the end of the 6-month period at 4127 on 30/9/23 v 4157 on 31/3/23.

6.4 For existing longer-term investors in fixed income securities, the prospect of a higher-for-longer rate environment weighed on sentiment. Yields rose in Q2 2023 on the expectation that central banks would continue hiking rates but fell in August as investors grew confident that policy rates were close to their peak, then rose again in September as oil prices climbed above $90/barrel. There was also some effect from quantitative tightening by the Bank of England. This affected capital values of the Authority's longer-dated bond funds during the six-month period and, to a lesser extent, the multi-asset funds where there was some offset from equity performance.

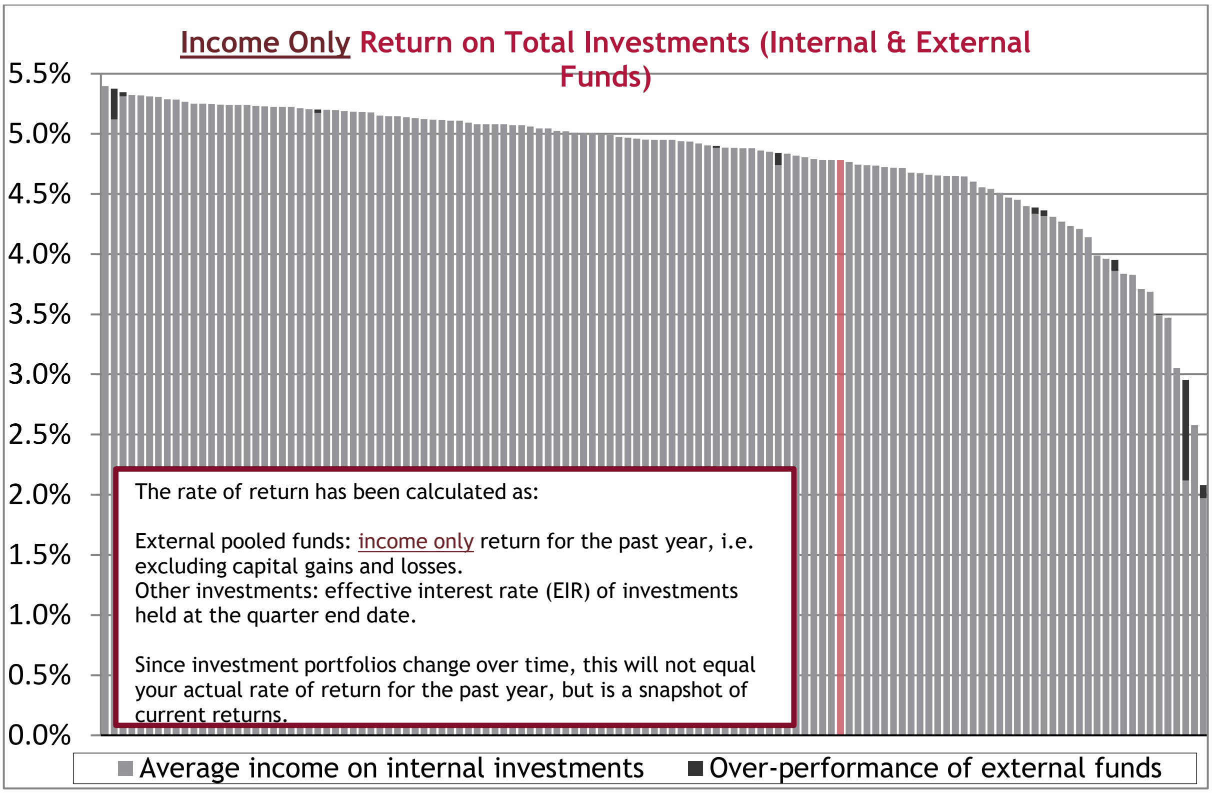
6.5 Investor sentiment for UK commercial property was more settled than in Q3 and Q4 of 2022 when the sharp rise in bond yields resulted in a big fall in property valuations. There were signs of returning investor interest, occupier resilience and a perception that the downturn in commercial real estate may be bottoming out. 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.

6.6 The combination of the above had negative effect on the combined value of the Authority's strategic funds since March 2023. Income from the Authority's cash plus funds has improved as maturing securities are replaced by higher yielding ones in this fund.

6.7 Because the Council's externally managed 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 investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year minimum period total returns will exceed cash interest rates.

6.8 Table 5 below shows that as at 30 September 2023, Cotswold District Council (red bar) achieved an average rate on investments of 4.78%, 84th in a pool of 125 Local Authorities where the top 100 ranged between 4.56% and 5.40%.

Table 5: Cotswold District Council investment returns v Arlingclose clients (125) as at 30 September 2023



7. ARLINGCLOSE'S ECONOMIC OUTLOOK FOR THE REMAINDER OF 2023/24

7.1

	Current	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26
Official Bank Rate													
Upside Risk	-	0.25	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	1.00	1.00
Arlingclose Central Case	5.25	5.25	5.25	5.25	5.00	4.75	4.25	4.00	3.75	3.50	3.25	3.00	3.00
Downside Risk	-	-	-0.25	-.050	-.075	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00

7.2 UK inflation and wage growth remain elevated but, following a no-change MPC decision in November, Bank Rate appears to have peaked in this rate cycle. Near-term rate cuts are unlikely, although downside risks will increase as the UK economy likely slides into recession and inflation falls more quickly.

7.3 The much-repeated message from the MPC is that monetary policy will remain tight as inflation is expected to moderate to target only slowly. In the Bank's forecast, wage, and services inflation, in particular, will the keep CPI above the 2% target until 2026.

7.4 The UK economy has so far been relatively resilient, but recent data indicates a further deceleration in business and household activity growth as higher interest rates start to bite. Global demand will remain soft, offering little assistance in offsetting weakening domestic demand. A recession remains a likely outcome.

7.5 Employment demand is easing, although the tight labour market has resulted in higher nominal wage growth. Anecdotal evidence suggests slowing recruitment and pay growth, and we expect unemployment to rise further. As unemployment rises and rates remain high, consumer sentiment will deteriorate. Household spending will therefore be weak. Higher interest rates will also weigh on business investment and spending.

7.6 Inflation will fall over the next 12 months. The path to the target will not be smooth, with higher energy prices and base effects interrupting the downtrend at times. The MPC's attention will remain on underlying inflation measures and wage data. We believe policy rates will remain at the peak for another 10 months, or until the MPC is comfortable the risk of further 'second-round' effects have diminished.

7.7 The MPC held Bank Rate at 5.25% in November. Arlingclose believe this is the peak for Bank Rate.

7.8 The MPC will cut rates in the medium term to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering second-round effects. Arlingclose see rate cuts from Q3 2024 to a low of around 3% by early-mid 2026.

7.9 The immediate risks around Bank Rate remain on the upside, but these diminish over the next few quarters and shift to the downside before balancing out, due to the weakening UK economy and dampening effects on inflation.

7.10 Arlingclose expects long-term gilt yields to eventually fall from current levels (amid continued volatility) reflecting the lower medium-term path for Bank Rate. However, yields will remain relatively higher than in the past, due to quantitative tightening and significant bond supply.

8. COMPLIANCE

8.1 The Chief Finance Officer reports that all treasury management activities undertaken during the quarter complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 6 below.

Table 6: Investment Limits

Investment Limits Qtr2	2023/24 Maximum (£m)	30/09/2023 Actual (£m)	2023/24 Counterparty Limit (£m)	2023/24 Sector Limit (£m)	Complied? Yes/No
Any single organisation, except the UK Government	0	0	3	Unlimited	Yes
Any group of organisations under the same ownership	0	0	3	Unlimited	Yes
Negotiable instruments held in a broker's nominee account	0	0	3	3	Yes
Limit per non-UK country	0	0	3	3	Yes
Registered providers and registered social landlords	0	0	3	10	Yes
Unsecured investments with banks and building societies	3.1	0	3	10	Yes
Money Market Funds	12.096	3.01	3	20	Yes
Strategic pooled funds	11.5	11.5	4	20	Yes
Real Estate Investment Trusts	1	1	3	20	Yes

8.2 Compliance with the Authorised Limit and Operational Boundary for external debt is demonstrated in table 7 below.

Table 7: Debt and the Authorised Limit and Operational Boundary

	Q2 2023/24 Maximum	30.09.23 Actual	2023/24 Operational Boundary	2023/24 Authorised Limit	Complied? Yes/No
	£m	£m	£m	£m	
Borrowing	0.451	0.405	10	10	YES
Total debt	**0.451**	**0.405**	**10**	**10**	

8.3 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.

9. TREASURY MANAGEMENT PRUDENTIAL INDICATORS

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

9.2 **Liability Benchmark -** This new 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 of £13 required to manage day-to-day cash flow.

	31.3.23 Actual £m	31.3.24 Forecast £m	31.3.25 Forecast £m	31.3.26 Forecast £m
Loans CFR	0.02	0.5	2.9	2.8
Less: Balance sheet resources	-27.78	-20.4	-18.6	-18.7
Net loans requirement	-27.76	-19.9	-15.7	-15.9
Plus: Liquidity allowance	15.0	13.0	13.0	13.0
Liability benchmark	**-12.76**	**-6.9**	**-2.7**	**-2.9**
Existing borrowing	**0.451**	**0.361**	**0.264**	**0.162**

*A negative liability benchmark indicates that the Council would be able to fund borrowing 'internally' from balance sheet resources rather than needing to externally borrow.

9.3 **Long-term Treasury Management Investments:** 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 prudential limits on the long-term treasury management limits are:

Long Term Q2	2023/24 £m	2024/25 £m	2025/26 £m	No fixed date £m
Limit on principal invested beyond year end	15.0	15.0	15.0	15.0
Actual principal invested beyond year end at 30.9.23	£0	n/a	n/a	12.5
Complied?	Yes	n/a	n/a	Yes

9.4 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.

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9.5 **Security**: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Q2 Average Credit Rating	2023/24 Target	30/09/23 Actual	Complied?
Portfolio average credit rating	A-	AA-	Y

9.6 **Interest Rate exposures** – This indicator is set to control the Council's exposure to interest rate risk. Bank Rate rose by 1.25% from 4.25% on 1st April to 5.25% by 30th September. The upper limits on the one-year impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator Q2	2023/24 Target	30.9.23 Actual	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	-£0.05m	-£0.331m	No
Upper limit on one-year revenue impact of a 1% fall in interest rates	£0.05m	£0.331m	No

Due to the lack of capital expenditure the weighted average on variable rate investments (MMFs) has been higher than originally forecast. The 1% increase was therefore higher than the target and we have generated more interest income.

10. FINANCIAL IMPLICATIONs

10.1 Financial implications are outlined in the body of the report.

11. LEGAL IMPLICATIONS

11.1 There are no legal implications arising from this report.

12. RISK ASSESSMENT

12.1 This report discusses the impact of economic risk on the value and returns associated with the Council's investment portfolio together with the risk of low interest rates on the Council's revenue budget.

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13. EQUALITIES IMPACT

13.1 None.

14. CLIMATE AND ECOLOGICAL EMERGENCIES IMPLICATIONS

14.1 None directly arising from this report.

15. BACKGROUND PAPERS

15.1 None.

(END)