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Treasury Management Update Quarter 3 2023/24

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1. Synopsis

The Council currently holds £40m in investments and £286m of borrowing. This report shows the return on those investments over quarter 3, the economic outlook for the next 3 years and confirms activities align with the Council approved Treasury Management Strategy.

2. Executive Summary

2.1. The report outlines the treasury management activities of the Council in the third quarter of 2023/24. It highlights the economic environment in which treasury management decisions have been made and the interest rate forecasts of the Council's Treasury Advisor, Link Asset Services. It also updates Members on the internal treasury team's performance.

2.2. During Quarter 3 the internal treasury team achieved a return of 5.28% on the Council's cash balances, outperforming the benchmark by 0.09%. This amounts to additional income of £16,290 during the quarter which is included within the Council's outturn position in the Financial Monitoring Report. Further details on this are provided in paragraph 10.4 of the report. The Monetary Policy Committee (MPC) held the Bank Rate at 5.25% again in December 2023, although it is widely anticipated that this will be the peak Bank Rate and is likely to be held at this level until mid 2024.

2.3. Reducing returns on cash balances is directly attributable to the overall reduction in available balances. This is also set out in the MTFS and the Q3 Finance Report, elsewhere on this agenda. It is possible that short term borrowing will be required to ensure that the cash balances of the council are retained at an appropriate level through the second half of March. It is expected that cash balanced reduce anyway through February and March, as Council Tax receipts reduce at year end. Council Tax receipts then increase in April. Short term borrowing, if taken out, will be done at a cost calculated as the net difference between the cost of borrowing and benefit of short-term investment. At present this is estimated as 0.2%-0.3%.

2.4. The overall reduction in cash balances also reduces the extent to which the process of internal borrowing can be sustained. This is a preferable approach as is uses internal cash balances ahead of any external borrowing. As overall balances reduce (overall balances are made up principally of longer term earmarked and unearmarked reserves, supplemented by the impacts of corporate cashflows) it will become necessary to secure external borrowing.

2.5. Under the CIPFA Treasury Management Code, it is best practice to provide quarterly Treasury Management updates.

3. Recommendations

3.1. Members are asked to review the position as set out in the report –

a) Reducing cash balances, the result of the Council's long term financial management approach, indicates a need to take out external borrowing during 2024/25, as reflected in the Treasury Management Strategy 2024/25. This brings to an end a period of strong cash balances which have enabled reduced capital finance costs over the last 10 years.
b) Noting the summary of the wider economic environment and the Council's borrowings and investments set out in Appendix A
c) Noting the performance within prudential indicators for quarter 3, 2023/24 (Appendix B)

Report

4. Risk Assessment and Opportunities Appraisal

4.1. The assessment and management of risk are key considerations for any Treasury Management approach. Compliance with the CIPFA Code of Practice on Treasury Management, the Council's Treasury Policy Statement and Treasury Management Practices and the Prudential Code for Capital Finance together with the rigorous internal controls will enable the Council to manage the risk associated with Treasury Management activities and the potential for financial loss.

4.2. The Council's Audit Committee is the committee responsible for ensuring effective consideration of the Council's Treasury Management Strategy and policies.

4.3. The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998.

4.4. There are no direct environmental, equalities or climate change consequences arising from this report.

5. Financial Implications

5.1. The Council makes assumptions about the levels of borrowing and investment income over the financial year. Reduced borrowing as a result of capital receipt generation or delays in delivery of the capital programme will both have a positive impact of the council's cash position. Similarly, higher than benchmarked returns on available cash will also help the Council's financial position. For monitoring purposes, assumptions are made early in year about borrowing and returns based on the strategies agreed by Council in the preceding February. Performance outside of these assumptions results in increased or reduced income for the Council.

5.2. The Quarter 3 performance is above benchmark and has delivered additional income of £16,290 which is reflected in the Financial Monitoring Report Quarter 3 2023/24. Performance in Q4 2023/24 will be impacted by the availability of cash balances available for investment and the level of any short-term external borrowing secured. The net cost will be the difference between the borrowing cost and the investment return, expected to be 0.2%-0.3%.

5.3. As at 31 December 2023 the Council held £40 million in investments as detailed in Appendix A and borrowing of £286 million at fixed interest rates. The ability to secure fixed rates helps to manage the uncertainty and risk of changes to interest rates.

6. Climate Change Appraisal

6.1. The Council's Financial Strategy includes proposals to deliver a reduced carbon footprint for the Council therefore the Treasury Team is working with the Council in order to achieve this. There are no direct climate change impacts arising from this report. Shropshire Council's investment portfolio has no level 1, 2 or 3 emissions. It comprises of straightforward cash deposits with financial institutions and other Local Authorities.

7. Background

7.1. The Council defines its treasury management activities as "the management of the authority'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 report informs Members of the treasury activities of the Council between 1 April 2023 and 31 December 2023.

7.2. The council had £40m invested at the end of the third quarter period, as set out in Appendix A. This is a reduction in the overall investment balance over previous periods, and reflects the gradual application of reserves in line with budget plans across recent years. During the period of comparatively high cash balances, the council has benefited from the ability to fund borrowing internally ('internal borrowing') rather than needing to secure external borrowing (via PWLB).

8. Economic Background

8.1. An overview of the general economic position is included as Appendix A, and with further detail in Appendix D. Decisions on Council investment activity are influenced by this wider context. This highlights:

- Consumer Price Indices (CPI) inflation fell from 8.7% in April to 4.6% in October, then again to 3.9% in November.
- a sharp fall in wage growth.
- A 0.3% decline in real GDP in October due to the ongoing drag from higher interest rates.

8.2. For wider context and consideration of the global financial outlook, an economic and borrowing update for the third quarter of 2023/24 is attached in Appendix D.

9. Economic Forecast

9.1. The Council receives its treasury advice from Link Asset Services. Their latest interest rate forecasts to 31 December 2026 are shown below. The Bank Rate was again held at 5.25% in December by the MPC in the December meeting. It is anticipated that 5.25% will be the peak bank rate and this may be elevated for a while in a bid to squeeze inflation out of the economy. The table below demonstrates the latest forecasts of interest rates over the next 3 years which will impact on future investment returns and the consequent benchmark.

Link Group Interest Rate View	07.11.23												
	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26
BANK RATE	5.25	5.25	5.25	5.00	4.50	4.00	3.50	3.25	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.30	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.40	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.50	3.30	3.30	3.30	3.30	3.30
5 yr PWLB	5.00	4.90	4.80	4.70	4.40	4.20	4.00	3.80	3.70	3.60	3.50	3.50	3.50
10 yr PWLB	5.10	5.00	4.80	4.70	4.40	4.20	4.00	3.80	3.70	3.70	3.60	3.60	3.50
25 yr PWLB	5.50	5.30	5.10	4.90	4.70	4.50	4.30	4.20	4.10	4.10	4.00	4.00	4.00
50 yr PWLB	5.30	5.10	4.90	4.70	4.50	4.30	4.10	4.00	3.90	3.90	3.80	3.80	3.80

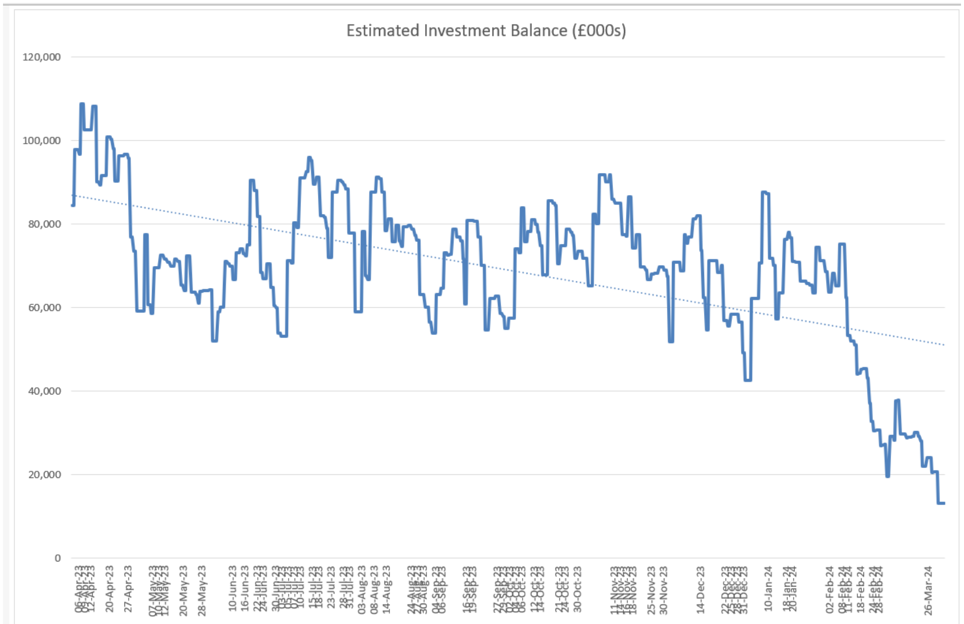
10. Treasury Management Strategy

10.1 The Treasury Management Strategy (TMS) for 2023/24 was approved by Full Council on 2 March 2023 and the Treasury Management Strategy for 2024/25 will be presented to Council on 29 March 2024. The Council's Annual Investment Strategy, which is incorporated in the TMS, outlines the Council's investment priorities as the security and liquidity of its capital.

10.2 The Council aims to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate, it is considered appropriate to:

- Keep investments short term (up to 1 year),
- Only invest with highly credit rated financial institutions using Link's suggested creditworthiness approach, including sovereign credit rating and Credit Default Swap (CDS) overlay information provided by Link.
- The Treasury Team continue to take a prudent approach keeping investments short term and with the most highly credit rated organisations.

10.3 In the third quarter of 2023/24 the internal treasury team outperformed its benchmark by 0.09%. The investment return was 5.28% compared to the benchmark of 5.19%. This amounts to additional income of £16,290 during the quarter which is included in the Council's outturn position in the Financial Monitoring Report. Estimated investment Balances are identified weekly based on latest information relating to anticipated spending and receipts. The summary of the position over the last 12 months is shown in the chart below. This clearly shows an overall reduction in available cash balances, within a managed 'corridor' of highs and lows arising from the necessary in- and out-flows of cash resources.



10.4 Reducing balances is structurally preferable – councils must hold a level of balances on hand to help deal with unanticipated pressures, but the level of reserves to be held is a result of local circumstances, political leadership, and the local assessment of risk. Using reserves is a useful way to defer the point in time at which action is required to be taken – for example, by allowing more complex solutions to be implemented. While reserves are retained at a high level (a situation seen at the end of the COVID crisis) it is possible to use available cash balances to delay external borrowing for capital purposes, instead using 'internal borrowing' as a more cost effective approach to capital finance. Using reserves to enable longer term efficiency is a proven approach to effective local financial management.

At present, the Council is using internal borrowing at a level around £100m. Assuming a borrowing rate of 5%, the level of saving per year is around £5m. External borrowing has not been undertaken in around 10 years – a total saving of around £50m arising from careful management of revenue and capital budgets.

However, the reducing level of balances means that it will no longer be possible to internally borrow through the MTFS period. It is anticipated that external borrowing will be required during 2024/25, and this is being planned for in the revised Treasury Management Strategy for 2024/25. This will not have an adverse impact on the revenue budget position as the necessary levels of budget provision have already been set aside (as part of the Minimum Revenue Provision or 'MRP' budgets).

From April 2022 the Treasury team are benchmarked against the 3 Month Sterling Overnight Index Average (SONIA). We have now moved into a rising interest rate environment and therefore the benchmark rate has also increased sharply on the back of this. It should be noted that within the current investment portfolio, there are still some longer-term legacy investments fixed at lower rates when the Bank Rate was between 3.50% and 4.25%, still to renew. These investments were placed when market rates were much lower. These will mature in January and be replaced at much higher rates therefore the return of the investment portfolio will increase significantly, and the performance compared to benchmark will become more favourable.

10.5 A full list of investments held as at 31 December 2023, compared to Link's counterparty list, and changes to Fitch, Moody's and Standard & Poor's credit ratings are shown within Link's Monthly Investment Analysis Review at Appendix A. None of the approved limits within the Annual Investment Strategy were breached during the third quarter of 2023/24. Officers continue to monitor the credit ratings of institutions on a daily basis. Delegated authority has been put in place to make any amendments to the approved lending list.

10.6 Due to the MPC's decision to hold the Bank Rate to 5.25% in December 2023, investment and borrowing rates have remained at a higher rate on the back of this. The average level of funds available for investment purposes in the first quarter of 2023/24 was £78 million.

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)

Council, 2 March 2023 – Treasury Strategy 2023/24

Cabinet, 6 September 2023: Treasury Management Update Quarter 1 2023/24

Cabinet, 22 November 2023: Treasury Management Update Quarter 2 2023/24

Local Member:	N/A

Appendices [Please list the titles of Appendices]

A. Shropshire Council Monthly Investment Analysis Review as at 31 December 2023 (provided by Link Group)

B. Prudential Indicators for Quarter 3 2023/24

C. Prudential Borrowing Schedule

D. Economic Background and Borrowing Update