CAERPHILLY COUNTY BOROUGH COUNCIL
CYNGOR BWRDEISTREF SIROL CAERFFILI

CABINET - 18TH SEPTEMBER 2024

SUBJECT: **TREASURY MANAGEMENT AND CAPITAL FINANCING PRUDENTIAL INDICATORS OUTTURN REPORT FOR 2022/23**

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

1. PURPOSE OF REPORT

1.1 To present Cabinet with details of Treasury Management activities and Capital Financing, together with the related Prudential Indicators for 2023/24.

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.

2.2 This report includes the requirement in the 2021 Code, mandatory from 1st April 2023, of 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 23rd February 2023.

3. RECOMMENDATIONS

3.1 Cabinet 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 31st March 2024 the internal borrowing position was £42.9m.

The Annual Treasury Management Strategy was approved by Council in February 2023. As part of the strategy approval was given to borrow £46.8m in 2023/24 to part fund the General Fund capital programme if required. A further £45.0m was approved for the HRA to fund the WHQS and Affordable Housing capital programme. During the reported period the only external borrowing that has taken place is a £1 million pound interest free Welsh Government Transforming Towns loan to support town Centre Regeneration. This funding will enable the Council to provide loans to third parties in relation to town centre properties. Also two temporary loans were taken out at year-end for short-term cashflow purposes for £3.2m from other Local Authorities; the duration of these loans were a week. Aside from these loans, internal funds have been used in place of borrowing. No borrowing was required by the HRA as underspends in Revenue were used to fund the Capital programme.

During the 2023/24 financial year, PWLB loans to the value of £5.7m were repaid on maturity. Such loans had an average interest rate of 4.41%. £0.030m of the WRU Loan £0.517m of the Salix Loan and a £10m LOBO with Commerzbank was also repaid. Total debt outstanding as at 31st March 2024 was £304.8m and comprised of £240.8 m PWLB loans; £20m market loans (LOBOs); £10m Bank loan; £28.0m WG loans, £2.8m Salix Energy Finance loan and £3.2m Local Authority loans.

With respect to the aforementioned LOBO loans, the lenders have 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 our total LOBO portfolio with a value of £30m had a rate option reviewed, and the lenders chose to exercise the option on the £10m Commerzbank loan. Commerzbank proposed to increase the interest rate on this loan from 4.10% to 5.84%. As a result we decided to repay this loan at no additional cost as accepting the revised terms would mean the Authority would still have refinancing risk for the loan in later years. The LOBO's represent 6.6% of the Authority's debt portfolio, which is exposed to interest rate risk.

The loans from Welsh Government are charged at zero interest providing we meet the loan obligations, the loans will be repaid though future capital receipts and revenue income generated from the projects.

5.1.2 <u>Rescheduling</u>

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 <u>Investments</u>

At the end of 2023/24 the Authority was holding £29.5m of long-term investments where the maturity date is greater than 365 days. These investments are in accordance with the approved Investment Strategy. The long-term investments comprise of UK Gilts, Real Estate Investment Trusts (REITS) and pooled funds. The value of short-term deposits as at 31st March 2024 was £100.7m.

The total investments held as at 31st March 2024 were £130.2m and had a total average rate of income return of 4.46%. The minimum target rate which was set for our return on investments in the Treasury Management Strategy 2023/24 was the base rate in place at that time. Over the reporting period, the base rate has increased from 4.25% to 5.25%, with an average rate of 5.02%. Our return of 4.46% did not meet the minimum target rate of 5.02%. This was primarily due to some Local Authority investments which were taken out as interest rates were starting to rise, these will all mature by September 2024. Also, we hold two historical investments in Government Gilts which are due to mature in 2026 and 2034 which are bringing in lower returns.

Our investments in pooled funds allow the Authority to generate enhanced income returns and the intention is to hold them for a minimum of five years as per the Treasury Strategy 2023/24. These investments generated an income return of 5.37% during the reporting period.

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

The portfolio as at 31st March 2024 comprised of the following types of investments:

Counterparty	Investment Product	Sector	£m
Banks and Building Societies	Bonds and Fixed Term Deposits.	Financial	23.5
Money Market Fund	Cash Pooled Fund	Financial	20.1
UK Government	Gilts and DMO	UK Government	10.0
Local Authorities and Housing Associations	Fixed-term cash deposits	Local Government	57.0
External Fund	Property Pooled Fund	Property	8.8

Managers			
External Fund Managers	Bond Pooled Fund	Mixed	2.3
External Fund Manager	Equity Pooled Fund	Mixed	5.3
External Fund Manager	Multi Asset Pooled Fund	Mixed	2.3
REIT	Pooled Fund	Property	0.9
Total Investments as	**at 31st March 2024**		**130.2**

5.1.4 Economic Outlook

UK inflation continued to decline from the 8.7% rate seen at the start of 2023/24. By the last quarter of the financial year headline consumer price inflation (CPI) had fallen to 3.4% in February and continued to fall to 2% in May in line with the Bank of England's target. The core measure of CPI, i.e. excluding food and energy, also slowed in February to 4.5% from 5.1% in January. This has continued to fall but slower than expected which has contributed to the BoE maintaining the Bank Rate to the end of the 2023/24 financial year at 5.25%, a level unchanged since August 2023.

The UK economy entered a technical recession in the second half of 2023, as growth rates of -0.1% and -0.3% respectively were recorded for Q3 and Q4. Over the 2023 calendar year GDP growth only expanded by 0.1% compared to 2022. Data released showed the UK economy emerged from this technical recession to expand by 0.7% in the first quarter of the calendar year.

Labour market data provided mixed messages for policymakers. During 2023/24 employment and vacancies declined, and unemployment rose to 4.3% in July 2023. The same month saw the highest annual growth rate of 8.5% for total pay (i.e. including bonuses) and 7.8% for regular pay growth (i.e. excluding bonuses), Thereafter, unemployment began to decline falling to 3.9% in January and pay growth also edged lower to 5.6% for total pay and 6.1% for regular pay, but remained above the Bank of England's forecast.

Having started the financial year at 4.25%, the Bank of England's Monetary Policy Committee (MPC) increased Bank Rates to 5.25% in August 2023. Bank Rate was maintained at 5.25% through to March 2024. Although financial markets shifted their interest rate expectations downwards with expectations, the MPC's focus remained on assessing how long interest rates would need to be restrictive in order to control inflation over the medium term.

. Over the financial year, the 10-year benchmark gilt yield rose from 3.44% to peak at 4.75% in August, before then dropping to 3.44% in late December 2023 and rising again to 3.92% in March.

The Sterling Overnight Rate (SONIA) averaged 4.96% over the period.

As at the 31st March 2024 the interest rates forecasts were as per table below.

Official Bank Rate	Upside Risk	Arlingclose (Central case)	Downside Risk
2024 Q4	0.25	4.75%	-0.25
2025 Q1	0.75	4.25%	-0.50
2025 Q2	1.00	3.75%	-0.50
2025 Q3	1.00	3.25%	-0.50
2025 Q4	1.00	3.00%	-0.50
2025/2026	1.00	3.00%	-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 has not invested in assets primarily for financial return or that are not primarily related to the functions of the Authority and is not planning to do so within the next 3 years.

A new PWLB HRA rate which is 0.4% below the certainty rate was made available from 15th June 2023. This rate will now be available to June 2025. The discounted rate is to support local authorities borrowing for the Housing Revenue Account and for refinancing existing HRA loans

There remains a strong argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields + 0.80%. The Authority will evaluate and pursue these lower cost solutions and opportunities with its advisor Arlingclose.

The UK Infrastructure Bank is one alternative source of funding which offers funding at gilt yields + 0.40% (0.40% below the PWLB certainty rate) and the possibility of more flexible funding structures than the PWLB. Funding from UKIB is generally only available for certain types of projects that meet its criteria of green energy, transport, digital, water and waste. The minimum loan size is £5 million.

5.1.6 Counterparty Update

In response to an improving outlook for credit markets, in January 2024 Arlingclose moved away from its previous temporary stance of a 35-day maximum duration and increased its advised recommended maximum unsecured duration limit on all banks on its counterparty list to 100 days.

Earlier in the period, SandP revised the UK sovereign outlook to stable and upgraded Barclays Bank to A+. Moody's also revised the UK outlook to stable.

In the final quarter of the financial year, Fitch revised the outlook on the UK sovereign rating to stable from negative based on their assessment that the risks to the UK's public finances had decreased since its previous review in October 2022, the time of the mini- budget.

Credit default swap prices began the financial year at elevated levels following the fallout from Silicon Valley Bank and collapse/takeover of other lenders. From then the general trend was one of falling prices and UK lenders' CDS ended the period at similar levels to those seen in early 2023.

Heightened market volatility is expected to remain a feature, at least in the near term and, credit default swap levels will be monitored for signs of ongoing credit stress. As ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remain 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, expert advice and may not necessarily take place in the relevant year. 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 CFR value of £360.688m as at 31st March 2024. 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. The General Fund currently shows a projected reduction from the original budget. This is in relation to a reduction in debt charges due to delays in borrowing requirements arising from slippage and underspends on capital programme. Investment income overachieved the budgeted level due to new medium term investments and increases in the Bank of England base rate. HRA shows an overspend as MRP has been charged on the underlying need to borrow irrespective of whether the actual external borrowing has taken place. This allows for the £17.9m that was due to be borrowed in 2019/20.

5.2.4 Capital Expenditure and Funding

A summary of capital expenditure and funding is attached at Appendix 3 and shows that there will is an underspend on the HRA capital budget There has been some reprofiling of the New Build Programme with is inherent of a development programme of this size, meaning spend is relatively low in this area and some contracts are likely to progress into the next financial year. Any underspend is ringfenced and is therefore carried forward accordingly. The HRA budget is as per the approved HRA Business Plan 2023/24. The outturn for General Fund includes expenditure which has been funded from outside our Core Capital Budget.

6. ASSUMPTIONS

6.1 The details set out in the report are based on actuals that have occurred between 1st April 2023 and 31st March 2024

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.

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L. Sykes- Deputy Head of Financial Services and Deputy S151 Officer
A. 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