

## **Treasury Management Strategy Statement and Annual Investment Strategy Mid-year review report 2023/24**

### **1 Background**

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low-risk counterparties, providing adequate liquidity initially before considering optimising investment return.

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 operations. This management of longer-term cash may involve arranging long or short-term loans or using longer term cash flow surpluses and, on occasion, any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly, treasury management is defined as:

"The management of the local authority's 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."

### **2 Introduction**

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (last revised in 2021) was adopted by this Council on 20 February 2012.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the full council of an annual Treasury Management Strategy Statement - including the annual investment strategy and Minimum Revenue Provision policy - for the year ahead, a mid-year review report and an annual report covering activities during the previous year
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Executive, Resources and Contracts PDS Committee.

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first part of the 2023/24 financial year
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy
- The Council's capital expenditure, as set out in the capital strategy, and prudential indicators;

- A review of the Council's investment portfolio for 2023/24
- A review of the Council's borrowing strategy for 2023/24
- A review of any debt rescheduling undertaken during 2023/24
- A review of compliance with treasury and prudential limits for 2023/24

### **3 Key changes to the treasury and capital strategies**

No amendments to the strategy are proposed at this time.

### **4 Economic update (provided by Link Asset Services)**

- The first half of 2023/24 saw:
  - Interest rates rise by a further 100bps, taking Bank Rate from 4.25% to 5.25% and, possibly, the peak in the tightening cycle.
  - Short, medium and long-dated gilts remain elevated as inflation continually surprised to the upside.
  - A 0.5% m/m decline in real GDP in July, mainly due to more strikes.
  - CPI inflation falling from 8.7% in April to 6.7% in August, its lowest rate since February 2022, but still the highest in the G7.
  - Core CPI inflation declining to 6.2% in August from 7.1% in April and May, a then 31 years high.
  - A cooling in labour market conditions, but no evidence yet that it has led to an easing in wage growth (as the 3myy growth of average earnings rose to 7.8% in August, excluding bonuses).
- The 0.5% m/m fall in GDP in July suggests that underlying growth has lost momentum since earlier in the year. Some of the weakness in July was due to there being almost twice as many working days lost to strikes in July (281,000) than in June (160,000). But with output falling in 10 out of the 17 sectors, there is an air of underlying weakness
- The fall in the composite Purchasing Managers Index from 48.6 in August to 46.8 in September left it at its lowest level since COVID-19 lockdowns reduced activity in January 2021. At face value, it is consistent with the 0.2% q/q rise in real GDP in the period April to June, being followed by a contraction of up to 1% in the second half of 2023
- The 0.4% m/m rebound in retail sales volumes in August is not as good as it looks as it partly reflected a pickup in sales after the unusually wet weather in July. Sales volumes in August were 0.2% below their level in May, suggesting much of the resilience in retail activity in the first half of the year has faded.
- As the growing drag from higher interest rates intensifies over the next six months, we think the economy will continue to lose momentum and soon fall into a mild recession. Strong labour demand, fast wage growth and government handouts have all supported household incomes over the past year. And with CPI inflation past its peak and expected to decline further, the economy has got through the cost-of-living crisis without recession. But even though the worst of the falls in real household disposable incomes are behind us, the phasing out of financial support packages provided by the government during the energy crisis means real incomes are unlikely to grow strongly. Higher interest rates will soon bite harder too. We expect the Bank of England to keep interest rates at the probable peak of 5.25% until the second half of 2024. Mortgage rates are likely to stay above 5.0% for around a year.
- The tightness of the labour market continued to ease, with employment in the three months to July falling by 207,000. The further decline in the number of job vacancies from

1.017m in July to 0.989m in August suggests that the labour market has loosened a bit further since July. That is the first time it has fallen below 1m since July 2021. At 3.0% in July, and likely to have fallen to 2.9% in August, the job vacancy rate is getting closer to 2.5%, which would be consistent with slower wage growth. Meanwhile, the 48,000 decline in the supply of workers in the three months to July offset some of the loosening in the tightness of the labour market. That was due to a 63,000 increase in inactivity in the three months to July as more people left the labour market due to long term sickness or to enter education. The supply of labour is still 0.3% below its pre-pandemic February 2020 level.

- But the cooling in labour market conditions still has not fed through to an easing in wage growth. While the monthly rate of earnings growth eased sharply from an upwardly revised +2.2% in June to -0.9% in July, a lot of that was due to the one-off bonus payments for NHS staff in June not being repeated in July. The headline 3myy rate rose from 8.4% (revised up from 8.2%) to 8.5%, which meant UK wage growth remains much faster than in the US and in the Euro-zone. Moreover, while the Bank of England's closely watched measure of regular private sector wage growth eased a touch in July, from 8.2% 3myy in June to 8.1% 3myy, it is still well above the Bank of England's prediction for it to fall to 6.9% in September.
- CPI inflation declined from 6.8% in July to 6.7% in August, the lowest rate since February 2022. The biggest positive surprise was the drop in core CPI inflation, which declined from 6.9% to 6.2%. That reverses all the rise since March and means the gap between the UK and elsewhere has shrunk (US core inflation is 4.4% and in the Euro-zone it is 5.3%). Core goods inflation fell from 5.9% to 5.2% and the further easing in core goods producer price inflation, from 2.2% in July to a 29-month low of 1.5% in August, suggests it will eventually fall close to zero. But the really positive development was the fall in services inflation from 7.4% to 6.8%. That also reverses most of the rise since March and takes it below the forecast of 7.2% the Bank of England published in early August.
- In its latest monetary policy meeting on 20 September, the Bank of England left interest rates unchanged at 5.25%. The weak August CPI inflation release, the recent loosening in the labour market and the downbeat activity surveys appear to have convinced the Bank of England that it has already raised rates far enough. The minutes show the decision was "finely balanced". Five MPC members (Bailey, Broadbent, Dhingra, Pill and Ramsden) voted for no change and the other four (Cunliffe, Greene, Haskel and Mann) voted for a 25bps hike.
- Like the US Fed, the Bank of England wants the markets to believe in the higher for longer narrative. The statement did not say that rates have peaked and once again said if there was evidence of more persistent inflation pressures "further tightening in policy would be required". Governor Bailey stated, "we'll be watching closely to see if further increases are needed". The Bank also retained the hawkish guidance that rates will stay "sufficiently restrictive for sufficiently long".
- This narrative makes sense as the Bank of England does not want the markets to decide that a peak in rates will be soon followed by rate cuts, which would loosen financial conditions and undermine its attempts to quash inflation. The language also gives the Bank of England the flexibility to respond to new developments. A rebound in services inflation, another surge in wage growth and/or a further leap in oil prices could conceivably force it to raise rates at the next meeting on 2nd November, or even pause in November and raise rates in December.
- The yield on 10-year gilts fell from a peak of 4.74% on 17th August to 4.44% on 29th September, mainly on the back of investors revising down their interest rate expectations. But even after their recent pullback, the rise in gilt yields has exceeded the rise in most other Developed Market government yields since the start of the year. Looking forward, once inflation falls back, gilt yields are set to reduce further. A (mild) recession over the

next couple of quarters will support this outlook if it helps to loosen the labour market (higher unemployment/lower wage increases).

- The pound weakened from its cycle high of \$1.30 in the middle of July to \$1.21 in late September. In the first half of the year, the pound bounced back strongly from the Truss debacle last autumn. That rebound was in large part driven by the substantial shift up in UK interest rate expectations. However, over the past couple of months, interest rate expectations have dropped sharply as inflation started to come down, growth faltered, and the Bank of England called an end to its hiking cycle.
- The FTSE 100 has gained more than 2% since the end of August, from around 7,440 on 31st August to 7,608 on 29th September. The rebound has been primarily driven by higher energy prices which boosted the valuations of energy companies. The FTSE 100's relatively high concentration of energy companies helps to explain why UK equities outperformed both US and Euro-zone equities in September. Nonetheless, as recently as 21st April the FTSE 100 stood at 7,914.

## **5 Treasury Management Strategy Statement and Annual Investment Strategy update**

The Treasury Management Strategy Statement (TMSS) for 2023/24 was approved by this Council on 27 February 2023. No revisions were proposed in the annual report 2022/23 (reported to Council on 17 July 2023) or in the mid-year review report.

## **6 Investment portfolio**

In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As shown by forecasts in section 3, it is a very volatile investment market, though recent successive increases in the Bank of England base rate have fed through into significantly improved lending rates with counterparties. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short-term strategy.

Details of the Council's investment activity during the first six months of 2023/24 are provided in the covering report and lists of current investments are provided in Appendices 2 (in maturity date order) and 3 (by counterparty). The Council held £379.6m of investments as at 30 September 2023 (£390.6m as at 30 September 2022).

The Director of Finance confirms that the approved limits within the annual investment strategy were not breached during the first six months of 2023/24.

The Council's budget for interest on investments in 2023/24 is £9.841m and the current projection is that the outturn will be £12.841m – a £3.000m surplus against budget.

### **Investment counterparty criteria**

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

## **7 Borrowing**

The Council's estimated capital financing requirement (CFR) for 2023/24 is £28.8m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The Council does not currently borrow to finance its capital expenditure and has, in recent years, only had to borrow short-term (for cashflow purposes) on very few occasions.

No borrowing is currently anticipated during this financial year, but it is possible that some may be required in future years.

## **Prudential and treasury indicators – mid-year review 2023/24**

The old capital control system was replaced in April 2004 by a prudential system based largely on self-regulation by local authorities themselves. At the heart of the system is The Prudential Code for Capital Finance in Local Authorities, developed by CIPFA. The Code requires the Council to set a number of prudential indicators designed to monitor and control capital expenditure, financing and borrowing. The indicators for 2023/24 were approved by Council in February 2023 and this annex sets out the actual performance against those indicators in the first six months, updating them where necessary. Prudential and treasury indicators are relevant for the purposes of setting an integrated treasury management strategy.

The Council is required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This original 2001 Code was adopted by the full Council in February 2002 and the revised 2011 Code was initially adopted by full Council in February 2012.

## **Prudential indicators for capital expenditure**

This table shows the revised estimates for capital expenditure and the changes since the capital programme for 2023/24 was agreed in February 2023. The increase in the latest estimate for 2023/24 is mainly brought forward underspend from the prior year, additional funding for Basic Need in schools (CEF line) and Disabled Facilities Grant (RRH line) and, more generally, the result of new schemes added to the programme, as highlighted in previous reports to the Executive and to PDS committees; offset by the re-phasing of budgets into future years. Budgets have also shifted between portfolios as a result of a decision to monitor Operational Property Review budgets, originally entirely held within RCCM, within the relevant portfolios.

<b>Capital expenditure by portfolio</b>	<b>2023/24 original estimate £m</b>	<b>2023/24 revised estimate £m</b>
Adult Care and Health	0.7	0.9
Children, Education and Families	4.3	4.4
Environment and Community Services	7.6	16.1
Resources, Commissioning and Contract Management	54.3	42.1
Renewal, Recreation and Housing	12.4	33.8
Estimated slippage/new schemes	23.0	-50.0
<b>Total</b>	<b>102.3</b>	<b>47.3</b>

## **Changes to the financing of the capital programme**

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure.

<b>Capital expenditure</b>	<b>2023/24 original estimate £m</b>	<b>2023/24 revised estimate £m</b>
Supported	102.3	47.3
Unsupported	0.0	0.0
<b>Total spend</b>	<b>102.3</b>	<b>47.3</b>
Financed by:		
Capital receipts	40.6	3.4
Capital grants/contributions	40.1	24.6
General Fund	0.0	0.0
Internal borrowing	1.4	1.4
Revenue contributions	14.3	14.3
<b>Total financing</b>	<b>96.4</b>	<b>43.7</b>
<b>Borrowing need*</b>	<b>5.9</b>	<b>3.6</b>

\*In practice, while interest rates are high, the external borrowing requirement will be supported by internal borrowing.

### Changes to the prudential indicators for the CFR, external debt and operational boundary

It is a statutory duty for the Council to determine and keep under review the “affordable borrowing limits”, which comprise external/internal borrowing and other long-term liabilities, mainly finance leases. The Council’s approved treasury and capital prudential indicators (affordability limits) are outlined in the approved TMSS. The table below shows the expected “worst case” debt position over the period. This is termed the operational boundary. Bromley has an operational “borrowing” limit (“operational boundary”) of £40m.

The authorised limit, which represents the limit beyond which borrowing is prohibited, is another of the prudential indicators and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003 and, for Bromley, this figure has been set at £60m.

<b>Prudential Indicators</b>	<b>2023/24 original estimate £m</b>	<b>2023/24 revised estimate £m</b>
<b>CFR</b>	<b>29.9</b>	<b>28.8</b>
<b>Debt – operational boundary</b>		
Borrowing	10.0	10.0
Other long-term liabilities	30.0	30.0
<b>Total operational boundary</b>	<b>40.0</b>	<b>40.0</b>
<b>Debt – authorised boundary</b>		
Borrowing	30.0	30.0
Other long-term liabilities	30.0	30.0
<b>Total authorised boundary</b>	<b>60.0</b>	<b>60.0</b>

The table also shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. The Council’s capital financing requirement (CFR) as at 1 April 2023 was £29.9m. If the CFR is positive, the Council may borrow from the PWLB or the market (external

borrowing) or from internal balances on a temporary basis (internal borrowing). The Council's CFR relates to liabilities arising from finance leases entered into in recent years in respect of various items of plant and equipment and housing; the Council currently has no external borrowing.

### Other prudential indicators

Other indicators designed to control overall borrowing and exposures to interest rate movements are included in the summary table below, which will require the approval of full Council.

### Prudential and treasury indicators – summary

	2023/24	2023/24
	Original estimate	Revised estimate
<b>Total capital expenditure</b>	£102.3m	£47.3m
Ratio of financing costs to net revenue stream	0.0%	0.0%
Net borrowing requirement (net investments for Bromley)		
brought forward 1 April	£344.0m	£344.0m
carried forward 31 March	£379.6m	£379.6m
in year borrowing requirement (reduction in net investments for Bromley)	£35.6m	£35.6m
<b>Estimated CFR as at 31 March (finance lease liabilities)</b>	£29.9m	£28.8m
<b>Change in CFR</b>	-	- £1.1m

TREASURY MANAGEMENT INDICATORS	2023/24 Original estimate	2023/24 Revised estimate
<b>Authorised limit for external debt -</b>		
<b>Borrowing</b>	£30.0m	£30.0m
<b>other long-term liabilities</b>	£30.0m	£30.0m
<b>TOTAL</b>	<b>£60.0m</b>	<b>£60.0m</b>
<b>Operational boundary for external debt -</b>		
<b>borrowing</b>	£10.0m	£10.0m
<b>other long-term liabilities</b>	£30.0m	£30.0m
<b>TOTAL</b>	<b>£40.0m</b>	<b>£40.0m</b>
<b>Upper limit for fixed interest rate exposure</b>	100%	100%
<b>Upper limit for variable rate exposure</b>	20%	20%
<b>Upper limit for total principal sums invested beyond year-end dates</b>	£170.0m	£170.0m