Bath & North East Somerset Council		
MEETING	**Cabinet**	
MEETING DATE:	**7th September 2023**	EXECUTIVE FORWARD PLAN REFERENCE: **E** 3464
TITLE:	**Treasury Management Performance Report to 30th June 2023**	
WARD:	All	
AN OPEN PUBLIC ITEM		

List of attachments to this report:

Appendix 1 – Performance Against Prudential Indicators
Appendix 2 – The Council's Investment Position at 30th June 2023
Appendix 3 – Average monthly rate of return for first three months of 2023/24
Appendix 4 – The Council's External Borrowing Position at 30th June 2023
Appendix 5 – Arlingclose's Economic & Market Review Q1 of 2023/24
Appendix 6 – Interest & Capital Financing Budget Monitoring 2023/24
Appendix 7 – Summary Guide to Credit Ratings
Appendix 8 – Extract from Treasury Management Risk Register

1 THE ISSUE

1.1 Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA Code), which requires the Council to approve a Treasury Management Strategy before the start of each financial year, review performance during the year, and approve an annual report within six months after the end of each financial year.

1.2 This report gives details of performance against the Council's Treasury Management Strategy for the three months of 2023/24.

2 RECOMMENDATION

That Cabinet agrees that:

2.1 The Treasury Management Report to 30th June 2023, prepared in accordance with the CIPFA Treasury Code of Practice, is noted.

2.2 The Treasury Management Indicators to 30th June 2023 are noted.

3 THE REPORT

Summary

3.1 The estimated average rate of investment return for 1st April 2023 to 30th June 2023 is 4.30%, which is in 0.12% below the benchmark rate of 4.42% over the period.

3.2 The Council's Prudential Indicators for 2023/24 were agreed by Council in February 2023 and performance against the key indicators is shown in **Appendix 1**. All indicators are within target levels.

3.3 The Council's revenue budget for interest & capital financing costs for 2023/24 is £0.71m under budget, due to higher than budgeted investment returns as a result of interest rate rises since budget setting, and also a delay to borrowing requirements and associated interest costs. The breakdown of the 2023/24 revenue budget for interest and capital financing, and the forecast year end position, is included in **Appendix 6**.

Summary of Returns

3.4 The Council's investment position as at 30th June 2023 is given in **Appendix 2**. The balance of deposits as at 30th June 2023 are set out in the charts in this appendix, along with the equivalent details for the previous quarters position for comparison.

3.5 Estimated gross interest earned on investments totalled £583k. **Appendix 3** details the investment performance, showing the average rate of interest earned over this period was 4.30%, which is below the benchmark rate of average 7-day SONIA (4.42%). This shortfall is mainly due to existing short-term loans being locked in at a lower rate prior to the Bank of England base rate rises. The prior year comparators are also included in this appendix.

Summary of Borrowings

3.6 The Council's external borrowing as at 30th June 2023 totalled £219.1m and is detailed in **Appendix 4**. This includes £10m in new short-term loans taken out in April 2023 to cover the annual pension prepayment and allow us to maintain our liquidity indicator above £15m. A summary of the movement in borrowing during the final quarter and over the full year is shown in the following tables:

Borrowing Portfolio Movements	**Financial Year 2023/24 £m**
Balance as at 1st April 2023	**210.254**
New Loans Taken	10.000
PWLB Annuity Loan principal repayments	(1.143)
Balance as at 31st June 2023	**219,111**

3.7 The Council's Capital Financing Requirement (CFR) is forecast to be £462.1m at 31st March 2024, based on the Capital Programme agreed in February 2023, including both fully and provisionally approved schemes. The actual CFR at 31st March 2023 was £341m. This represents the Council's underlying need to borrow to finance capital expenditure and demonstrates that the borrowing taken to date relates to funding historical capital spend.

3.8 The lower level of current borrowing of £219.1m represents re-investment of the internal balances including reserves, reducing the in-year borrowing costs in excess of the potential investment returns.

3.9 The Liability Benchmark in **Appendix 1** illustrates the gap between current borrowing and the liability benchmark. This gap is a useful guide to the optimal amount and duration of borrowing to minimise interest and credit risk. This is currently £109m and circa 20 years. This is lower than the CFR as it takes account of the Council ability to internally borrow to fund capital.

3.10 Following Local Government Reorganisation in 1996, Avon County Council's residual debt is administered by Bristol City Council. All successor Unitary Authorities make an annual contribution to principal and interest repayment, for which there is a provision in the Council's revenue budget. The amount of residual debt outstanding as at 31st March 2023 apportioned to Bath & North East Somerset Council is £10.1m. Since this borrowing is managed by an external body and treated in the Council's Statement of Accounts as a deferred liability, it is not included in the borrowing figures referred to in paragraph 3.6.

Strategic & Tactical Decisions

3.11 As shown in the charts in **Appendix 2**, the investment portfolio of £52.85m as at 30th June 2023 is diversified across Money Market Funds, Strategic funds, the Government's Debt Management Account Deposit Facility and in highly rated UK Banks. The Council uses AAA rated Money Market funds to maintain short term liquidity.

3.12 Of the Council's total investment portfolio, £10m is in externally managed strategic pooled funds, where the objectives are regular revenue income and long-term price stability. These investments have been made in the knowledge that there is a risk that capital value could move both up and down on a frequent basis and are intended to be held over a long period of time to help manage any price fluctuations.

This investment includes £5m in Environmental Social and Governance (ESG) focused funds and £5m in a property fund, as listed below

- £5m CCLA Local Authorities Property Fund.
- £3m FP Foresight UK Infrastructure Income Fund.
- £2m VT Gravis Clean Energy Income Fund.

In the current economic environment of high inflation and interest rates, the value of equity, bonds and property have fallen significantly and as a result the fair value of our strategic investments has decreased from £8.78m at 31 March 2023 to £8.31m at 30 June 2023. This is shown in the table below:

	CCLA Local Authorities Property Fund	FP Foresight UK Infrastructure Income Fund	VT Gravis Clean Energy Income Fund	Total
Historic Cost	5,000,000	3,000,000	2,000,000	**10,000,000**
Fair Value as at:				
30/06/2023	4,330,486	2,354,436	1,626,336	**8,311,258**
31/03/2023	4,342,727	2,586,831	1,852,212	**8,781,770**
31/03/2022	5,199,881	3,065,260	2,045,847	**10,310,988**

This change in valuation does not have an impact on the revenue account due to a statutory override, and gains/losses will instead go to an unusable reserve. These will only be transferred to revenue if/when the Council's holding in the pooled funds are sold, or if the Government removes the override. The next review of the statutory override will take place prior to the end of 2024/25. The Council has in place a Capital Financing Reserve which can be used to help mitigate any future revenue impacts should the statutory override be removed.

3.13 The Council's average investment return for short-term investments was 4.29%, which is 0.49% above the budgeted level of 3.80%. The average return for the £10m long-term strategic investments is 4.35%, 0.55% above the budgeted rate of 3.80%. The combined average return on all investments is 4.30%.

Investment Type/	Average YTD Investment Return
Short Term Investments Total	**4.29%**
Long Term Strategic Investments:	
CCLA Local Authorities Property Fund	4.13%
FP Foresight UK Infrastructure Income Fund	4.34%
VT Gravis Clean Energy Income Fund	4.83%
Long Term Strategic Investments Total (Est.)	**4.35%**
Overall Total	**4.30%**

3.14 The Council currently estimates that we should achieve £200k of additional income above the budgeted level by 31st March 2024. This is due to the impact of the higher than budgeted returns, and additional interest received from non-treasury activity.

Future Strategic & Tactical Issues

3.15 The Council's Treasury Management Advisor's economic and market review for the first quarter of 2023/24 is included in **Appendix 5**.

3.16 Interest rates have risen from 4.25% at 31 March 2023 to 5.00% on 30th June 2023 as the Bank of England's Monetary Policy Committee continues to tackle inflation, as core inflation continues to rise despite falls in headline inflation falling to 8.7%. As a result, Arlingclose's current interest rate forecast is for interest rate to continue to rise, peaking at 5.5% over the summer of 2023 and taking longer to fall.

3.17 The Council currently hold £20m in Lender Option Borrower Option (LOBO) debt, with an interest rate of 4.50%. Given the Bank rate is currently 5.00%, there is an increasing risk that these interest rates will be increased at the next call date in October 2023. If the lender seeks to increase the interest rate on these loans the Council has the option to repay the loan with no penalty. The Council is reviewing potential refinancing options with our Treasury Management advisors.

3.18 Current cashflow forecasts indicate that the Council will need to borrow to fund its Capital Programme from December 2023, as internal balances have fallen over the last year.

Budget Implications

3.19 The breakdown of the 2023/24 revenue budget and the forecast year end position for interest and capital financing, based on the period April to June 2023 is included in **Appendix 6**. An overall underspend of £710k is reported towards the Council's net revenue outturn, because of higher than budgeted investment income and a delay in borrowing.

4 STATUTORY CONSIDERATIONS

4.1 This report is for information only.

5 RESOURCE IMPLICATIONS (FINANCE, PROPERTY, PEOPLE)

5.1 The financial implications are contained within the body of the report.

6 RISK MANAGEMENT

6.1 A risk assessment related to the issue and recommendations has been undertaken, in compliance with the Council's decision-making risk management guidance.

6.2 The Council's lending & borrowing list is regularly reviewed during the financial year and credit ratings are monitored throughout the year. All lending/borrowing transactions are within approved limits and with approved institutions. Investment and borrowing advice is provided by our Treasury Management consultants, Arlingclose.

6.3 The CIPFA Treasury Management in the Public Services: Code of Practice requires the Council nominate a committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies. The Corporate Audit Committee carries out this scrutiny.

6.4 In addition, the Council maintain a risk register for Treasury Management activities, which is regularly reviewed and updated where applicable during the year. An extract from the risk register, detailing how the top 5 risks are managed, is included as **Appendix 8**.

7 EQUALITIES

7.1 As this report contains performance information for noting only, an Equality Impact Assessment is not considered necessary.

8 CLIMATE CHANGE

8.1 The Council will continue to avoid any direct treasury management investments in fossil fuel related companies and will engage with its advisors to explore and assess the potential for any future investment opportunities in funds with a Renewable Energy & Sustainability focus as these products continue to be developed by the market in response to the Climate & Nature Emergency agenda.

8.2 An ESG section has been included the Treasury Management Strategy document for 2023/24, with the treasury team monitoring investment options permitted under the new guidelines.

8.3 The Council holds £5m in longer term investments, split across two ESG focussed Strategic Funds, as detailed under 3.12.

9 OTHER OPTIONS CONSIDERED

9.1 None

10 CONSULTATION

10.1 Consultation has been carried out with the Cabinet Member for Resources, Chief Finance Officer, and Monitoring Officer.

Contact person	Claire Read - 01225 477109; Jamie Whittard - 01225 477213 Claire_Read@BATHNES.GOV.UK: Jamie_Whittard@BATHNES.GOV.UK
Background papers	2023/24 Treasury Management & Investment Strategy
Please contact the report author if you need to access this report in an alternative format	

APPENDIX 1
Performance against Treasury Management Indicators agreed in Treasury Management Strategy Statement

1. Treasury Borrowing limits
These limits include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over & above the operational limit for unusual cash movements.

The Authorised limits for external debt include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over and above the operational limit for unusual cash movements.

The Operational boundary for external debt is based on the same estimates as the authorised limit but without the additional headroom for unusual cash movements. This level also factors in the proposed approach to use internal cash-flow and future capital receipts as the preferred financing method for the capital programme.

	2023/24 Prudential Indicator	Actual as at 30th June 2023
Operational boundary – borrowing	£433m	£219.1m
Operational boundary – other long-term liabilities	£4m	£0m
Operational boundary – TOTAL	**£437m**	**£219.9m**
Authorised limit – borrowing	£462m	£219.1m
Authorised limit – other long-term liabilities	£4m	£0m
Authorised limit – TOTAL	**£466m**	**£219.1m**

2. Security: Average Credit Rating*
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. A summary guide to credit ratings is set out at **Appendix 7**.

	2023/24 Prudential Indicator	Actual as at 30th June 2023
	Rating	Rating
Minimum Portfolio Average Credit Rating	A-	AAA-

* *The calculation excludes the strategic investment in the CCLA Local Authority Property Fund and ESG focussed Investment Funds, which are unrated.*

3. Liquidity
The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

Liquidity risk indicator	2023/24 Prudential Indicator	Minimum During Quarter	Date of minimum
Minimum total Cash Available within 3 months	£15m	£24.9m	26-May-23

4. Interest rate exposures
This indicator is set to control the Council's exposure to interest rate risk. The upper limit represents the maximum one-year revenue impact of a 1% rise or fall in interest rates.

	2023/24 Prudential Indicator	Actual as at 30th June 2023
Upper limit on one-year revenue impact of a 1% rise in interest rates	+/- £1m	£0.408m
Upper limit on one-year revenue impact of a 1% fall in interest rates	+/- £1m	£0.408m

The impact of this limit is that the Council should never be holding a maturity adjusted net debt / investment position on variable rates of more than £100m.

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at new market rates, which includes amounts which are maturing each year in PWLB annuity loans.

5. Maturity Structure of borrowing
This indicator is set to control the Council's exposure to refinancing risk.

	Upper Limit	Lower Limit	Actual as at 30th June 2023
	%	%	%
Under 12 months	50	Nil	4.6
12 months and within 24 months	50	Nil	0.0
24 months and within 5 years	75	Nil	0.0
5 years and within 10 years	75	Nil	6.8
10 years and within 25 years	100	25	52.0
Over 25 years	100		36.6

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date that the lender can demand repayment. For LOBO's, this is shown at the date of maturity.

* The CIPFA Treasury management Code now requires the prudential indicator relating to Maturity of Fixed Rate Borrowing to reference the maturity of LOBO loans to the earliest date on which the lender can require payment, i.e. the next call date (which are at 6 monthly intervals for the £20m of LOBO's). However, the Council would only consider repaying these loans if the Lenders exercised their options to alter the interest rate.

6. Upper limit for total principal sums invested for over 364 days

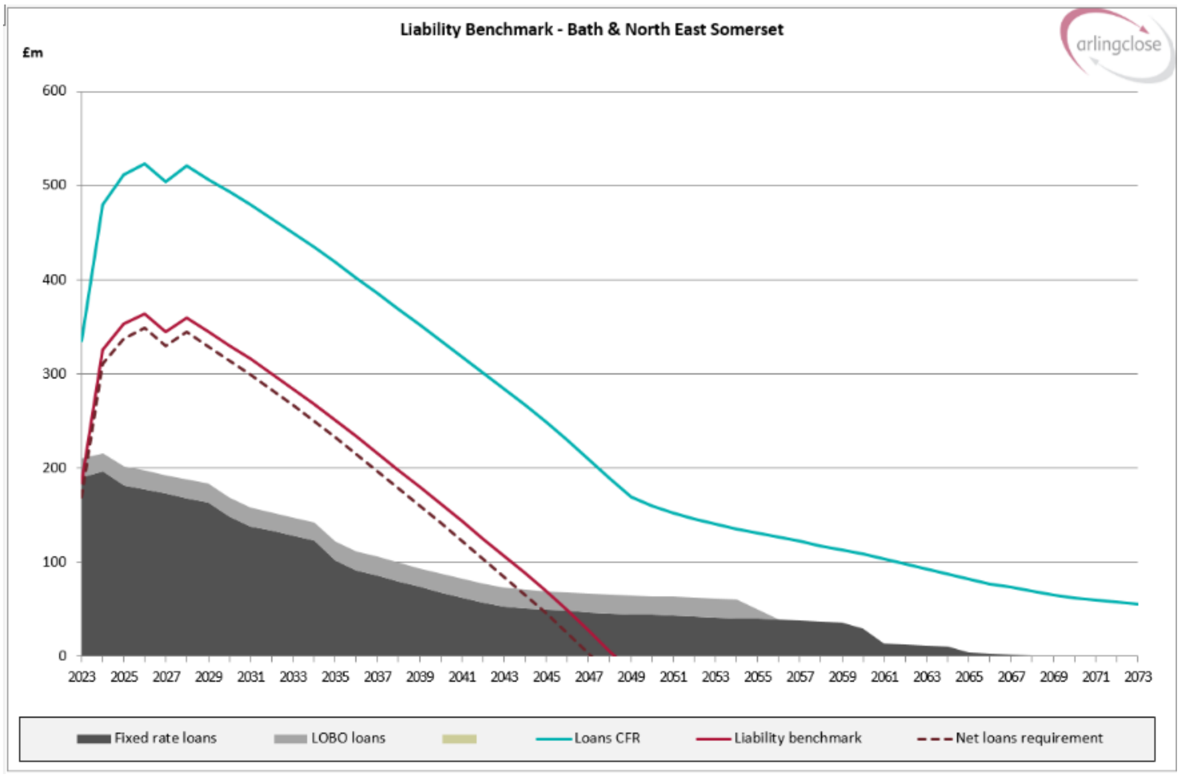
The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price risk indicator	2023/24 Prudential Indicator	Actual as at 30th June 2023
Limit on principal invested beyond 31st March 2024	£50m	£10m*
Limit on principal invested beyond 31st March 2025	£20m	£10m*
Limit on principal invested beyond 31st March 2026	£10m	£10m*

*The Council includes the CCLA LA Property Fund & two long term ESG focussed Investment Funds against this indicator as they are both held as Long-Term Strategic Investments.

7. Liability Benchmark

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. The liability benchmark itself 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 required to manage day-to-day cash flow.



The difference between actual borrowing (the grey slopes) and the liability benchmark (the solid red line) shows that the Council is under borrowed by around £109m in 2023/24. When it comes to considering new borrowing this funding gap can be used as a guide to the optimal amount and length of borrowing required to minimise interest rate and credit risk.

APPENDIX 2

The Council's Investment position at 30th June 2023

The term of investments is as follows:

Term Remaining	Balance at 30th June 2023	Comparator Balance at 31st March 2023
	£m	**£m**
Notice (instant access funds)	37.85	27.30
Up to 1 month	5.00	5.00
1 month to 3 months	0.00	0.00
3 months to 6 months	0.00	0.00
6 months to 12 months	0.00	0.00
Strategic Funds	10.00	10.00
Total	**52.85**	**42.30**

The investment figure is made up as follows:

	Balance at 30th June 2023	Comparator Balance at 31st March 2023
	£m	**£m**
B&NES Council	50.00	40.45
Schools	2.85	1.86
Total	**52.85**	**42.30**

The Council had a total average net positive balance of £49.6m during the period April 2023 to June 2023.

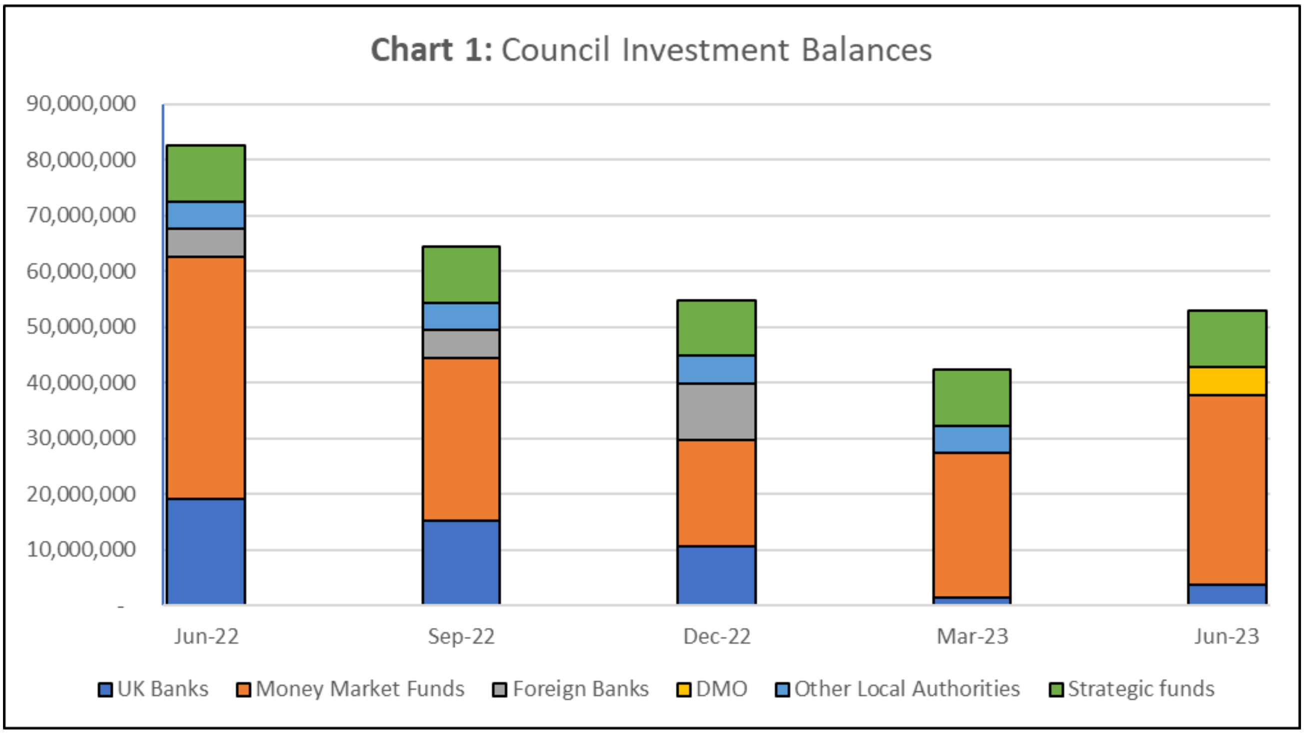


Chart 1: Council Investment Balances
90,000,000
80,000,000
70,000,000
60,000,000
50,000,000
40,000,000
30,000,000
20,000,000
10,000,000
-
Jun-22
Sep-22
Dec-22
Mar-23
Jun-23
UK Banks
Money Market Funds
Foreign Banks
DMO
Other Local Authorities
Strategic funds

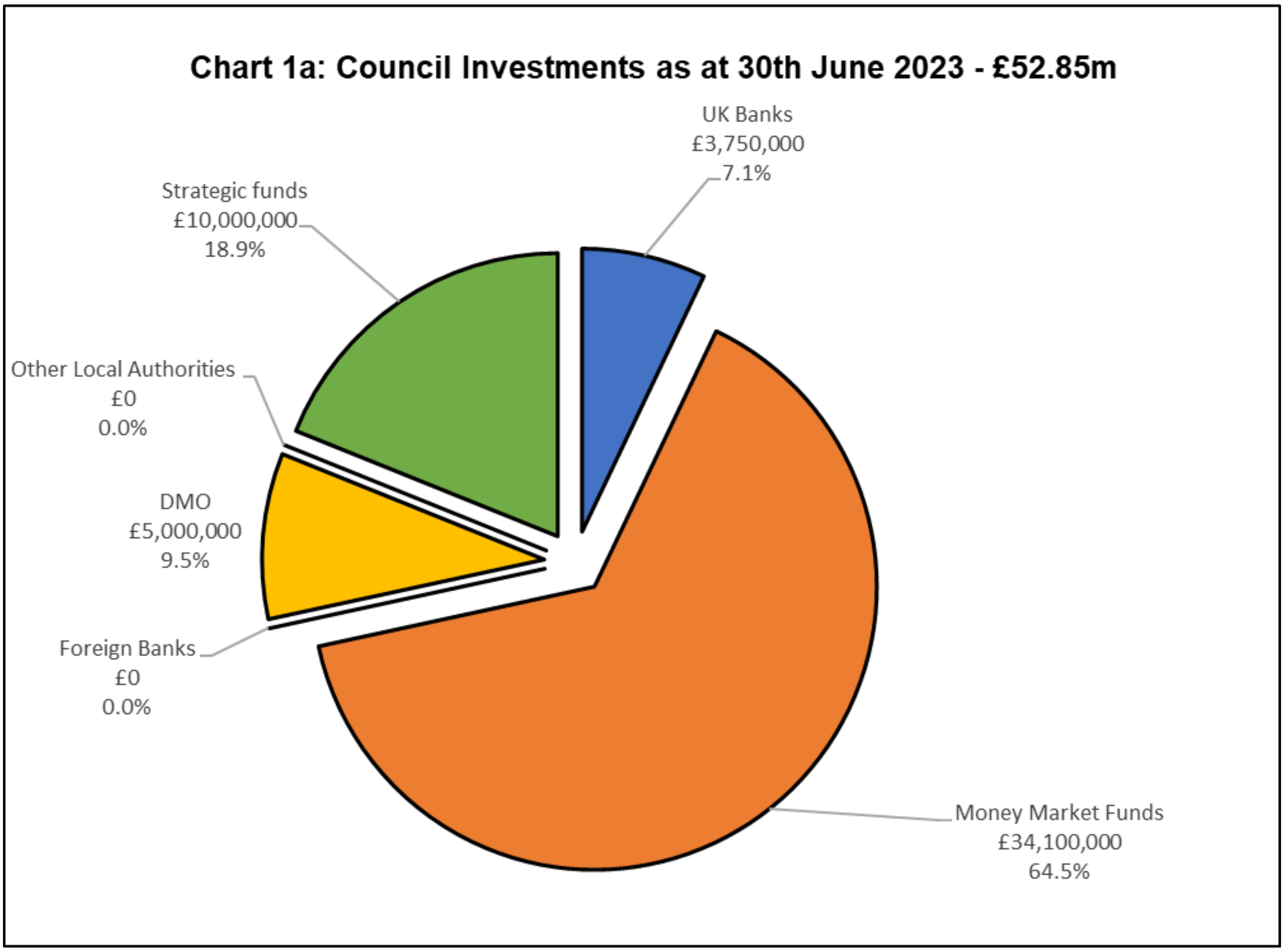


Chart 1a: Council Investments as at 30th June 2023 - £52.85m
UK Banks
£3,750,000
7.1%
Strategic funds
£10,000,000
18.9%
Other Local Authorities
£0
0.0%
DMO
£5,000,000
9.5%
Foreign Banks
£0
0.0%
Money Market Funds
£34,100,000
64.5%

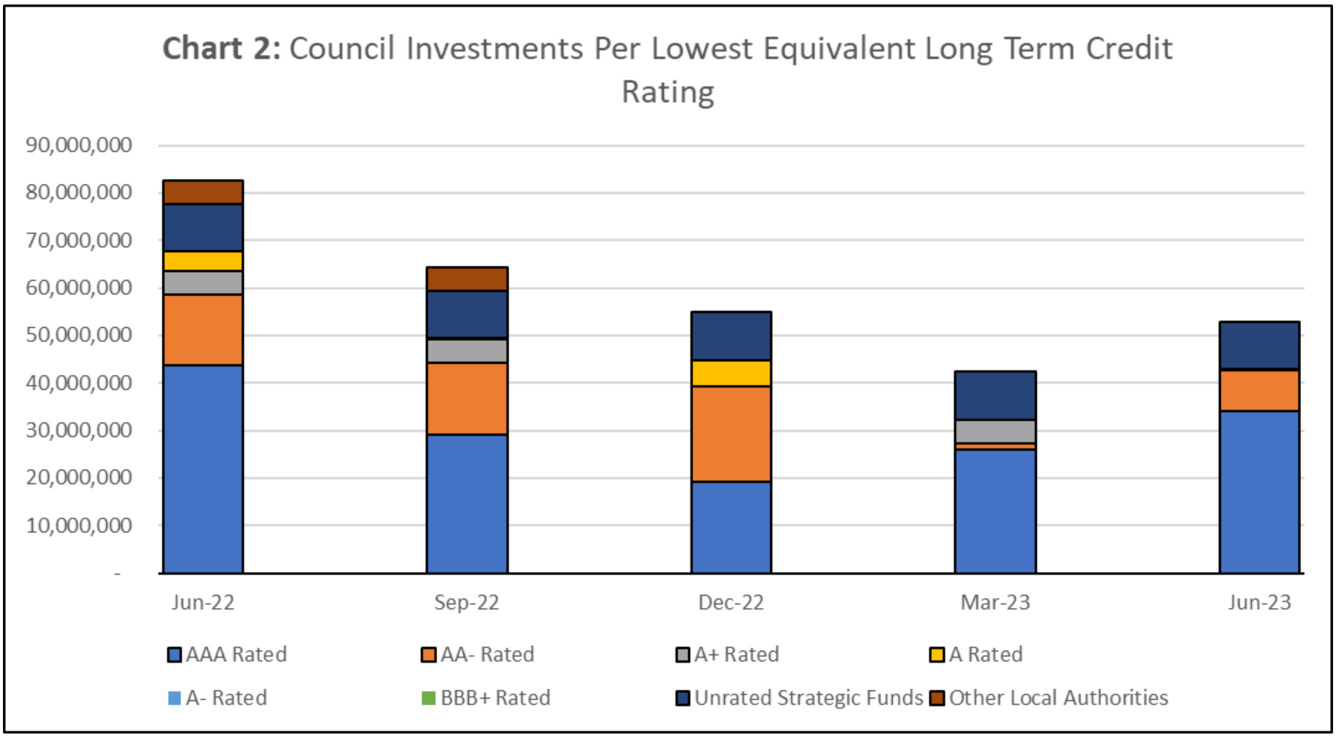


Chart 2: Council Investments Per Lowest Equivalent Long Term Credit Rating
90,000,000
80,000,000
70,000,000
60,000,000
50,000,000
40,000,000
30,000,000
20,000,000
10,000,000
-
Jun-22
Sep-22
Dec-22
Mar-23
Jun-23
AAA Rated
AA- Rated
A+ Rated
A Rated
A- Rated
BBB+ Rated
Unrated Strategic Funds
Other Local Authorities

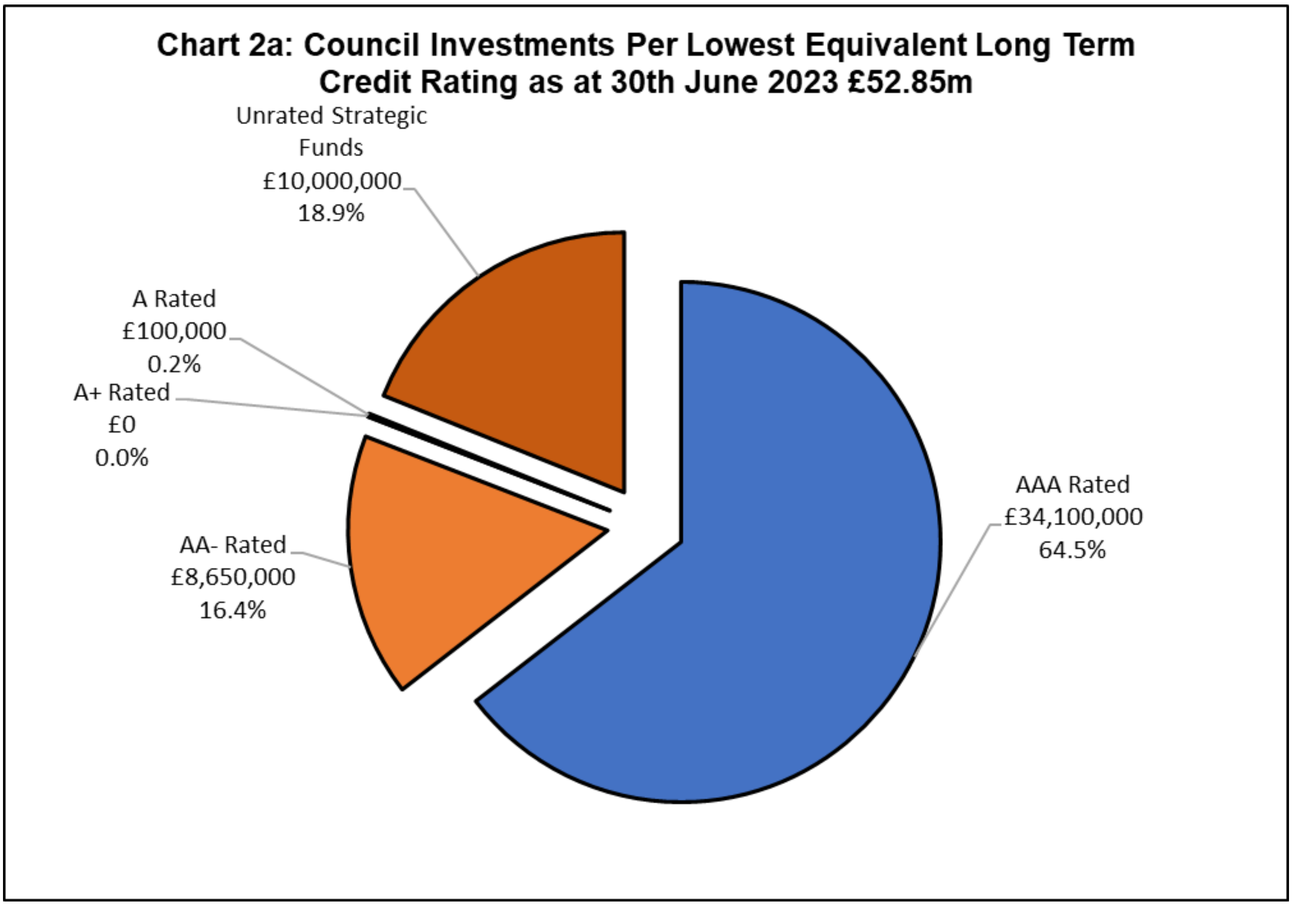


Chart 2a: Council Investments Per Lowest Equivalent Long Term Credit Rating as at 30th June 2023 £52.85m
Unrated Strategic Funds £10,000,000 18.9%
A Rated £100,000 0.2%
A+ Rated £0 0.0%
AA- Rated £8,650,000 16.4%
AAA Rated £34,100,000 64.5%

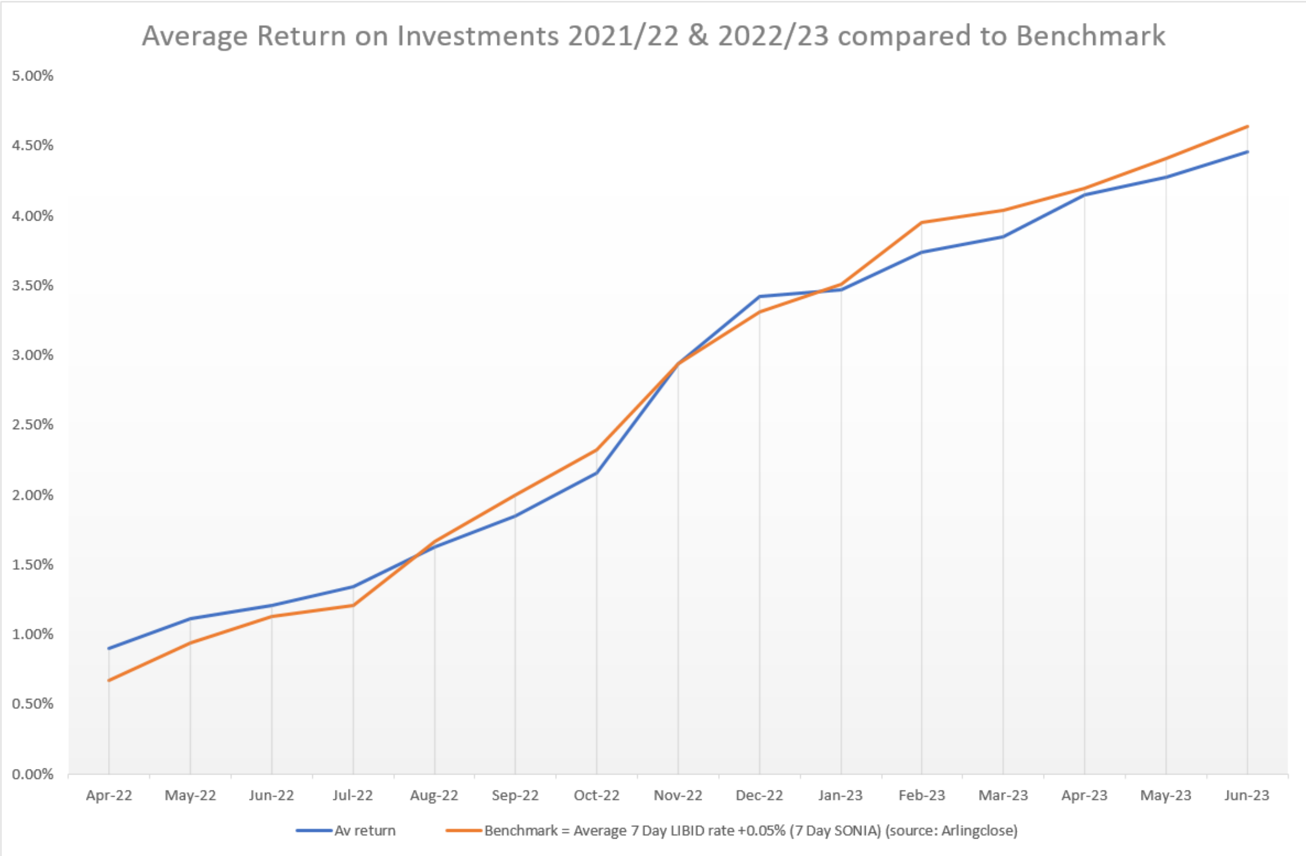
APPENDIX 3

Average rate of return on investments for 2023/24

	Average rate of interest earned	Benchmark = Average 7 Day SONIA rate	Performance against Benchmark
April 2023	4.15%	4.20%	-0.05%
May 2023	4.28%	4.41%	-0.13%
June 2023	4.46%	4.64%	-0.18%
Average	**4.30%**	**4.42%**	**-0.12%**

For Comparison, the average rate of return on investments for 2022/23 was as follows:

	Average rate of interest earned	Benchmark = Average 7 Day SONIA rate	Performance against Benchmark
April 2022	0.90%	0.67%	+0.23%
May 2022	1.11%	0.94%	+0.18%
June 2022	1.21%	1.13%	+0.08%
July 2022	1.34%	1.21%	+0.13%
August 2022	1.63%	1.67%	-0.04%
September 2022	1.85%	2.00%	-0.15%
October 2022	2.16%	2.32%	-0.16%
November 2022	2.94%	2.94%	0.00%
December 2022	3.42%	3.31%	+0.11%
January 2023	3.47%	3.51%	-0.04%
February 2023	3.74%	3.95%	-0.21%
March 2023	3.85%	4.04%	-0.19%
Average	**2.09%**	**2.30%**	**-0.21%**


Average Return on Investments 2021/22 & 2022/23 compared to Benchmark
5.00%
4.50%
4.00%
3.50%
3.00%
2.50%
2.00%
1.50%
1.00%
0.50%
0.00%
Apr-22
May-22
Jun-22
Jul-22
Aug-22
Sep-22
Oct-22
Nov-22
Dec-22
Jan-23
Feb-23
Mar-23
Apr-23
May-23
Jun-23
Av return
Benchmark = Average 7 Day LIBID rate +0.05% (7 Day SONIA) (source: Arlingclose)

APPENDIX 4

Council's External Borrowing at 30th June 2023

Lender	Amount outstanding @ 31st March 2023	Change in Quarter	Amount outstanding @ 30th June 2023	Start date	End date	Interest rate
	£	£	£			
Long term						
PWLB489142	10,000,000	-	**10,000,000**	15/10/2004	15/10/2034	4.75%
PWLB497233	5,000,000	-	**5,000,000**	12/05/2010	15/08/2035	4.55%
PWLB497234	5,000,000	-	**5,000,000**	12/05/2010	15/02/2060	4.53%
PWLB498834	5,000,000	-	**5,000,000**	05/08/2011	15/02/2031	4.86%
PWLB498835	10,000,000	-	**10,000,000**	05/08/2011	15/08/2029	4.80%
PWLB498836	15,000,000	-	**15,000,000**	05/08/2011	15/02/2061	4.96%
PWLB503684	5,300,000	-	**5,300,000**	29/01/2015	08/04/2034	2.62%
PWLB503685	5,000,000	-	**5,000,000**	29/01/2015	08/10/2064	2.92%
PWLB505122	15,869,859	(344,561)	**15,525,299**	20/06/2016	20/06/2041	2.36%
PWLB508126	8,607,342	(164,092)	**8,443,250**	06/12/2018	20/06/2043	2.38%
PWLB508202	9,531,537	(55,480)	**9,476,058**	12/12/2018	20/06/2068	2.59%
PWLB508224	4,293,391	(82,994)	**4,210,397**	13/12/2018	20/06/2043	2.25%
PWLB505744	7,810,341	-	**7,810,341**	24/02/2017	15/08/2039	2.28%
PWLB505966	8,085,202	-	**8,085,202**	04/04/2017	15/02/2042	2.26%
PWLB506052	6,870,715	-	**6,870,715**	08/05/2017	15/02/2042	2.25%
PWLB506255	6,599,366	(39,369)	**6,559,998**	10/08/2017	10/04/2067	2.64%
PWLB506729	8,438,087	(166,462)	**8,271,625**	13/12/2017	10/10/2042	2.35%
PWLB506995	8,467,200	(164,102)	**8,303,098**	06/03/2018	10/10/2042	2.52%
PWLB506996	8,825,459	(126,082)	**8,699,377**	06/03/2018	10/10/2047	2.62%
PWLB507749	8,613,628	-	**8,613,628**	10/09/2018	20/07/2043	2.42%
PWLB508485	19,141,417	-	**19,141,417**	11/02/2019	20/07/2068	2.52%
PWLB509840	8,800,947	-	**8,800,947**	04/09/2019	20/07/2044	1.40%
KBC Bank N.V *	5,000,000	-	**5,000,000**	08/10/2004	08/10/2054	4.50%
KBC Bank N.V *	5,000,000	-	**5,000,000**	08/10/2004	08/10/2054	4.50%
Commerzbank AG Frankfurt*	10,000,000	-	**10,000,000**	27/04/2005	27/04/2055	4.50%
Short Term						
West of England Combined	-	5,000,000	**5,000,000**	28/04/2023	26/04/2024	4.45%
Portsmouth C.C.	-	5,000,000	**5,000,000**	28/04/2023	26/04/2024	4.45%
Total Borrowing	**210,254,492**	**8,856,859**	**219,111,351**			

*All LOBO's (Lender Option / Borrower Option) have reached the end of their fixed interest period and have reverted to the variable rate of 4.50%. The lender has the option to change the interest rate at 6 monthly intervals. Should the lender use the option to change the rate, then at this point the borrower has the option to repay the loan without penalty.

The "Change in Quarter" movement on some of the PWLB loans reflects that these loans have an annuity repayment profile, so repayments of principal are made on a 6 monthly basis throughout the life of the loans.

APPENDIX 5: Arlingclose Economic & Market Review

Economic background: From the start of the quarter until May it looked like peak global monetary policy rates were in sight as inflation continued to ease and central banks turned more dovish in tone. Only a few weeks later, stronger, and more persistent inflation data, particularly in the UK, changed the picture.

The UK situation was not welcome news for the Bank of England. GDP growth was weak, confirmed at 0.1% in Q1, although more recent monthly GDP data has been somewhat better. The housing market has stalled, consumer demand is weak but seemingly recovering despite higher interest rates, and labour demand remained strong, with repercussions for wage growth which is accelerating.

April data showed the unemployment rate increased to 3.8% (3mth/year) while the employment rate rose to 76.0%. Pay growth was 6.5% for total pay (including bonuses) and 7.2% for regular pay, the largest growth rate of the latter outside of the Covid pandemic. Once adjusted for inflation, however, growth in total pay and regular pay remained negative.

Inflation fell from its peak of 11.1% reached in October 2022, but annual headline CPI in May 2023 was higher than the consensus forecast at 8.7% (8.4% expected), largely driven by services inflation, while the annual measure of underlying core inflation rose to 7.1% from 6.8%.

After a sharp rise in interest rate expectations, with clearly serious implications for mortgage markets due to higher inflation and wage data, the Bank of England's Monetary Policy Committee reaccelerated monetary policy tightening over the period with a 0.25% rise in May to a 0.5% rise in June, taking Bank Rate to 5.0%. At both meetings the vote was 7-2 in favour of increasing rates, with the two dissenters preferring to keep rates on hold.

Interest rate expectations priced in further hikes in policy rates. Arlingclose, the authority's treasury adviser, revised its forecast to forecast a further 0.5% of monetary tightening to take Bank Rate to 5.5%. The risks, however, are that rates could be higher; financial markets are forecasting policy interest rates above 6%.

With many mortgages at low fixed rates now systematically being re-set over the next 12-24 months at higher rates at the end of their fixed rate period, there has been a lagged effect of the feed through of monetary policy on households' disposable income. The economic slowdown is expected to develop over time and therefore, despite the GfK measure of consumer confidence rising to -24 in June, it is likely confidence will be negatively affected at some point. The manufacturing sector contracted during the quarter according to survey data, which will eventually feed into services, whose expansion is slowing.

Despite the US Federal Reserve increasing its key interest rate to 5.00-5.25% over the period, activity in the region continued to defy monetary tightening, particularly in labour markets which have so far appeared robust, supporting the Fed's assertations of two more rate hikes after it paused in June. Annual US inflation continued to ease, falling from 4.9% in April to 4.0% in May, the lowest level since March 2021. US GDP growth at 2% annualised in the first calendar quarter of 2023 was also significantly stronger than expected against the initial estimate of 1.3%.

In the euro zone, the picture was somewhat different. The European Central Bank maintained its hawkish tone and increased its key deposit, main refinancing, and marginal lending interest rates to 3.50%, 4.00% and 4.25% respectively. There were signs of weakening activity, particularly in Germany whose manufacturing sector has taken a hit from high energy prices and weaker global demand. However, inflation remained sticky, annual headline CPI fell to 5.5% in June while annual core inflation rose to 5.4% from 5.3%, which means the ECB is unlikely to stop monetary tightening.

Financial markets: Financial market sentiment and bond yields remained volatile, the latter continuing their general upward trend as uncertainty and concern over higher inflation and higher interest rates continued to dominate.

Gilt yields rose over the period. The 5-year UK benchmark gilt yield rose from 3.30% to 4.67%, the 10-year gilt yield from 3.43% to 4.39%, and the 20-year yield from 3.75% to 4.51%. The Sterling Overnight Rate (SONIA) averaged 4.37% over the quarter.

Credit review: Having completed a review of its credit advice on unsecured deposits at UK and non-UK banks following concerns of a wider financial crisis after the collapse of Silicon Valley Bank purchase of Credit Suisse by UBS, as well as other well-publicised banking sector issues, in March Arlingclose reduced the advised maximum duration limit for all banks on its recommended counterparty list to 35 days.

Over the period S&P upgraded NatWest Group and related entities to A+ (except NatWest Markets which was upgraded to A), revised the UK sovereign outlook to stable from negative, and upgraded both Barclays Bank PLC and Barclays Bank UK PLC to A+.

Fitch put the US sovereign rating on Rating Watch Negative following increased political partisanship which at the time was hindering the latest resolution to raise the debt ceiling. It also upgraded the outlook on United Overseas Bank to stable, the outlook on Clydesdale to positive, and the outlook on Bank of Montreal to stable.

Moody’s withdrew Guildford BC’s rating (who chose not to continue being rated) and affirmed the Aaa rating of the European Investment Bank.

Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress but made no changes to the counterparty list or recommended durations over the quarter. Nevertheless, 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.

APPENDIX 6

Interest & Capital Financing Costs – Budget Monitoring 2023/24

April 2023 to June 2023	**YEAR END POSITION**			
	Budgeted Spend or (Income) £'000	**Actual Spend or (Income) £'000**	**Actual over or (under) spend £'000**	**ADV/FAV**
Interest & Capital Financing				
- Debt Costs	8,873	8,373	(500)	FAV
- Internal Repayment of Loan Charges	(14,708)	(14,708)	0	-
- Ex Avon Debt Costs	910	900	(10)	FAV
- Minimum Revenue Provision (MRP)	11,164	11,164	0	-
- Interest on Balances*	(1,450)	(1,650)	(200)	FAV
Total	**4,789**	**4,079**	**(710)**	**FAV**

APPENDIX 7

Summary Guide to Credit Ratings

Rating	Details
AAA	Highest credit quality – lowest expectation of default, which is unlikely to be adversely affected by foreseeable events.
AA	Very high credit quality - expectation of very low default risk, which is not likely to be significantly vulnerable to foreseeable events.
A	High credit quality - expectations of low default risk which may be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
BBB	Good credit quality - expectations of default risk are currently low but adverse business or economic conditions are more likely to impair this capacity.
BB	Speculative - indicates an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time.
B	Highly speculative - indicates that material default risk is present, but a limited margin of safety remains. Capacity for continued payment is vulnerable to deterioration in the business and economic environment.
CCC	Substantial credit risk - default is a real possibility.
CC	Very high levels of credit risk - default of some kind appears probable.
C	Exceptionally high levels of credit risk - default is imminent or inevitable.
RD	Restricted default - indicates an issuer that has experienced payment default on a bond, loan, or other material financial obligation but which has not entered into bankruptcy filings, administration, receivership, liquidation, or other formal winding-up procedure, and which has not otherwise ceased operating.
D	Default - indicates an issuer that has entered into bankruptcy filings, administration, receivership, liquidation, or other formal winding-up procedure, or which has otherwise ceased business.

APPENDIX 8

Extract from Treasury Management Risk Register – Top 5 Risks

			Current Risk Score												Trend		
	Risk Nr	Description	Likelihood					Impact					This Period	Periods Ago			Management Action
			1	2	3	4	5	1	2	3	4	5		1	2	3	
			L		M	H		L		M	H						
1	R01	Liquidity Risk - The risk that cash will not be available when it is needed, that ineffective management of liquidity creates additional unbudgeted costs, and that the organisation's business/service objectives will be thereby compromised.		2						3			6	6	6	6	Obtain approval of annual Treasury Management Strategy by February Council. Carry out weekly reviews of investment portfolio and planned actions. Carry out monthly dashboard meeting with Chief Finance Officer. Consider short and medium term cash balances and cashflows to inform any short - medium term borrowing requirement.
2	R02	Interest Rate Risk - The risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately				4				3			12	12	9	9	Monitor interest rates on a monthly basis and compare with budget to determine impact on Council finances and report through monthly Treasury Dashboard. Report implication of interest rate changes to Cabinet as part of quarterly Treasury Management Performance Report. Explore alternative potential investment products following new freedoms - including corporate bonds, gilts, Certificate of Deposits etc. Discussion with our treasury advisors on any new borrowing in terms of duration and timing given the current volatility in the gilt market and PWLB interest rates.
3	R04	Inflation Risk - The risk that prevailing levels of inflation cause an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately.				4					4		16	16	12	12	Liaise with Chief Finance Officer to ensure Inflation both current and projected forms part of the medium term financial planning framework.
4	R05	Credit and Counterparty Risk - The risk of failure by a third party to meet its contractual obligations to the organisation under an investment, borrowing, capital, project or partnership financing, particularly as a result of the third party's diminished creditworthiness, and the resulting detrimental effect on the organisation's capital or current (revenue) resources.			3						4		12	12	12	12	Complete annual review of Counterparty List with external advisors to feed into Treasury Management Strategy. Regular review of counterparty financial standing through use of credit ratings, credit default swap rates and national press coverage and liaison with Chief Finance Officer and external advisors to consider any issues / change in circumstances of counterparties.
5	R09	Key Personnel - There is a risk that staff absence results in the inability to process Treasury Management transactions.			3					3			9	9	9	9	Produce & maintain a Business Continuity Plan to manage staff absences Provide refresher training and periodically ask secondary process operators to run the treasury process to ensure that there are a number of people able to perform the treasury activity