Southend-on-Sea City Council

Agenda Item No.

Title: **Treasury Management Report – Quarter One 2023/24**

Meeting: Cabinet
Date: 18 September 2023
Classification: Part 1

Policy Context:

Key Decision: No

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Executive Councillor: Councillor Cox Leader and Cabinet Member for SEND

1. Executive Summary

1.1. The Treasury Management Report for Quarter One covers the treasury management activity for the period from April to June 2023 and compliance with the treasury management strategy for that period.

2. Recommendations

That the following is approved:

2.1. The Treasury Management Report for Quarter One 2023/24.

That the following is noted:

2.2. Treasury management activities were carried out in accordance with the CIPFA (The Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management in the Public Sector during the period from April to June 2023.

2.3. The loan and investment portfolios were actively managed to minimise cost and maximise interest earned, whilst maintaining a low level of risk.

2.4. £1.483m of interest and income distributions for all investments were earned during this three-month period at an average rate of 4.20%. This is 0.17% under the SONIA rate (Sterling Overnight Index Average) and 0.24% under the average bank rate. Also, the value of the externally managed funds decreased by a net of £0.643m due to changes in the unit price, giving a combined overall return of 2.38%. (Section 8).

2.5. The level of borrowing from the Public Works Loan Board (PWLB) (excluding debt relating to services transferred from Essex County Council on 1st April 1998) remained at £347.3m (HRA: £74.2m, GF: £273.1m) during the period from April to June 2023.

2.6. During the quarter the level of financing for 'invest to save' schemes remained the same at £8.22m.

3. Background

3.1. This Council has adopted the 'CIPFA Code of Practice for Treasury Management in the Public Sector' and operates its treasury management service in compliance with this code. The code recommends that local authorities submit reports regularly as part of its Governance arrangements.

3.2. Current guidance is that authorities should report formally at least twice a year and preferably quarterly. The Treasury Management Policy Statement for 2023/24 set out that reports would be submitted to Cabinet quarterly on the activities of the treasury management operation. This is the first quarterly report for the financial year 2023/24.

3.3. Appendix 1 shows the in-house investment position at the end of quarter one of 2023/24.

3.4. Appendix 2 shows the treasury management performance specifically for quarter one of 2023/24.

4. National Context

4.1. Despite the ongoing economic and fiscal challenges UK gross domestic product (GDP) is estimated to have risen by 0.2% in the quarter from April to June 2023. The services sector grew by 0.1% on the quarter, driven by increases in information and communication, accommodation and food service activities, and human health and social work activities. Manufacturing also grew by 1.6%.

4.2. The latest unemployment rate for the quarter from April to June 2023 was 4.2%, an increase of 0.3% on the previous quarter. The increase was driven by people unemployed for up to 6 months. The economic inactivity rate decreased but that was largely driven by those looking after family or home, whereas those inactive because of long-term sickness increased to a record high.

4.3. The Consumer Prices Index including owner occupiers' housing costs (CPIH) was at 7.8% in April, at 7.9% in May and 7.3% in June. The largest downward contributors to the CPIH inflation rate in June came from principally from falling prices for motor fuel, while food prices rose in June 2023 but by less than in June 2022, also leading to an easing in the rates.

4.4. During the quarter, in response to persistent inflationary pressures, the Bank of England increased the bank base rate from 4.25% to 4.5% on 11 May and further increased the rate to 5% on 22 June. The Monetary Policy Committee will continue to closely monitor indications of inflationary pressures in the economy as a whole and have indicated that they will adjust the bank base rate as necessary to return inflation to the 2% target.

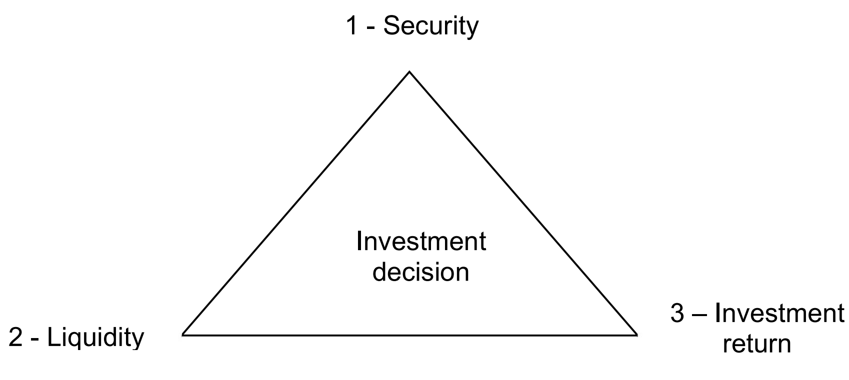
4.5. The economic situation together with the financial market conditions prevailing throughout the quarter provided opportunities for in-house treasury management activities. Variable rate instant access accounts benefited from the increasing interest rates and as fixed term deposits matured, advantage could be taken of the increased rates when reinvesting those monies. However, the prevailing financial market conditions were less favourable to the performance of the externally managed funds, with their unit prices all decreasing over the period from April to June 2023, albeit to a lesser extent than during 2022/23. The bond funds were impacted by the market conditions associated with the continued high rates of inflation. The property funds have been impacted by falling property valuations since mid-2022 and it is predicted that further smaller valuation declines are likely in 2023, followed by a period of stabilisation.

5. Investments

5.1. A prime objective of our investment activities is the security of the principal sums invested. To ensure this security before an in-house deposit is made an organisation is tested against a matrix of credit criteria and then other relevant information is considered. During the period from April to June 2023 investment deposits were limited to those who met the criteria in the Annual Treasury Management Investment Strategy when the deposit was placed.

5.2. Other investment objectives are to maintain liquidity (i.e. adequate cash resources to allow the council to operate) and to optimise the investment income generated by surplus cash in a way that is consistent with a prudent level of risk. Investment decisions are made with reference to these objectives, with security and liquidity being placed ahead of the investment return. This is shown in the diagram below:

5.3.



Security:

5.4. To maintain the security of sums invested, we seek to lower counterparty risk by investing in financial institutions with good credit ratings, across a range of sectors and countries. The risk of loss of principal of all monies is minimised through the Annual Treasury Management Investment Strategy.

5.5. Pie chart 1 of Appendix 1 shows that at the end of quarter one; 34% of our in-house investments were placed with financial institutions with a long term credit rating of AAA, 22% with a long term rating of A+ and 44% with a long term rating of A.

5.6. As shown in pie chart 2 of Appendix 1 these monies were with various counterparties, 66% being placed directly with banks and 34% placed with a range of counterparties via money market funds.

5.7. Pie chart 3 of Appendix 1 shows the range of countries where the parent company of the financial institution with which we have monies invested is registered. For money market funds there are various counterparties spread across many countries.

Liquidity:

5.8. At the end of quarter one £47.2m of our in-house monies were available on an instant access basis and £37.5m was invested in fixed term deposits. The table below shows the fixed term deposits during the period April to June 2023.

Table 1: Fixed Term Deposits

Counterparty	Date of Deposit	Return Date	Number of days	Interest rate (%)	Amount (£m)
Santander UK plc	21/10/2022	23/10/2023	367	5.00	5
Santander UK plc	14/11/2022	14/11/2023	365	4.95	10
Lloyds Bank Corporate Markets (NRFB)*	29/12/2022	29/06/2023	182	4.33	2.5
Lloyds Bank Corporate Markets (NRFB)*	29/12/2022	29/09/2023	274	4.71	10
National Bank of Kuwait (International) plc	17/05/2023	16/05/2024	365	5.27	12.5

* NRFB – Non Ring-Fenced Bank

5.9. The maturity profile of our in-house investments is shown in pie chart 4 of Appendix 1.

Investment return:

5.10. During the quarter the Council used the enhanced cash fund manager Payden & Rygel to manage monies on its behalf. An average balance of £5.0m was invested in these funds during the quarter. The table on the next page shows the movement in the fund value over the quarter, the income distributions for that quarter, the returns both for each element and the combined return. See also Table 3 of Appendix 2.

Table 2: Payden Sterling Reserve Fund

Quarter 1	**£m**	**Investment return (%)**
Value of fund at start of quarter	4.962	
Decrease in fund due to value of unit price	(0.036)	(2.90)
Value of fund at end of quarter	4.926	
Income distributions	0.044	3.51
Combined investment income (income distribution plus change in fund value due to unit price)	0.008	0.61

5.11. The Council had an average of £92.1m of investments managed in-house over the period from April to June 2023, and these earned an average interest rate of 4.56%. Of the in-house managed funds:

- an average of £24.8m was held in the Council’s main bank account earning an average of 4.27% over the quarter. These monies were held in this account to ensure adequate cash resources to allow the council to operate.
- an average of £33.5m was held in money market funds earning an average of 4.43% over the quarter. These work in the same way as a deposit account but the money in the overall fund is invested in a number of counterparties, therefore spreading the counterparty risk.
- an average of £33.8m was held in fixed term deposits and earned an average return of 4.90% over the quarter.

5.12. In accordance with the Treasury Management Strategy the performance of investments managed in-house during the quarter is compared to the SONIA rate. Throughout the quarter in-house performance was higher than the SONIA rate (Sterling Overnight Index Average) which fluctuated between 4.18% and 4.93%. The bank base rate started the quarter at 4.25%, increased to 4.5% on 11 May and increased to 5% on 22 June. Performance is shown in Graph 1 of Appendix 2.

5.13. As investment balances fluctuate, all investment returns quoted in this report are calculated using the average balance over the period and are quoted as annualised returns.

6. Short Dated Bond Funds

6.1. During the quarter two short-dated bond funds were used for the investment of medium term funds: Royal London Investment Grade Short Dated Credit Fund and the AXA Sterling Credit Short Duration Bond Fund.

6.2. The monies are invested in units in the fund, the fund is then invested as a whole by the fund managers into corporate bonds in the one to five year range. An income distribution will be generated from the coupon on the bond and income distributions are paid to the Council. The price of units can rise and fall, depending on the price of bonds in the fund so these funds are invested over the medium term with the aim of realising higher yields than short term investments.

6.3. In line with the capital finance and accounting regulations the Council's Financial Instrument Revaluation Reserve will be used to capture all the changes in the unit value of the funds. Members should be aware that investment returns in some quarters will look very good and in other quarters there may be losses reported, but these will not impact the revenue account as only the distributions paid to the Council will impact that and not the change in the unit price.

6.4. An average of £7.2m was managed by AXA Investment Managers UK Limited. The table below shows the movement in the fund value over the quarter, the income distributions for that quarter, the returns both for each element and the combined return. See also Table 2 of Appendix 2.

Table 3: AXA Sterling Credit Short Duration Bond Fund

Quarter 1	**£m**	**Investment return (%)**
Value of fund at start of quarter	7.286	
Decrease in fund due to value of unit price	(0.181)	(10.01)
Value of fund at end of quarter	7.105	
Income distributions*	0.057	3.14
Combined investment income (income distribution plus change in fund value due to unit price)	(0.124)	(6.87)

* This income distribution is an estimate and will be confirmed and distributed in quarter 2.

6.5. An average of £7.0m was managed by Royal London Asset Management. The table below shows the movement in the fund value over the quarter, the income distributions for that quarter, the returns both for each element and the combined return. See also Table 2 of Appendix 2.

Table 4: Royal London Investment Grade Short Dated Credit Fund

Quarter 1	**£m**	**Investment return (%)**
Value of fund at start of quarter	6.975	
Decrease in fund due to value of unit price	(0.184)	(10.64)
Value of fund at end of quarter	6.791	
Income distributions	0.065	3.74
Combined investment income (income distribution plus change in fund value due to unit price)	(0.119)	(6.90)

7. Property Funds

7.1. Throughout the quarter long term funds were invested in two property funds: Patrizia Hanover Property Unit Trust and Lothbury Property Trust.

7.2. The monies are invested in units in the fund, the fund is then invested as a whole by the fund managers into properties. An income distribution is generated from the rental income streams from the properties in the fund. Income distributions are paid to the Council. There are high entrance and exit fees and the price of the units can rise and fall, depending on the value of the properties in the fund, so these funds are invested over the long term with the aim of realising higher yields than other investments.

7.3. In line with the capital finance and accounting regulations the Council's Financial Instrument Revaluation Reserve will be used to capture all the changes in the unit value of the funds. Members should be aware that investment returns in some quarters will look very good and in other quarters there may be losses reported, but these will not impact the revenue account as only the distributions paid to the Council will impact that and not the change in unit price.

7.4. An average of £19.1m was managed by Patrizia Property Investment Managers LLP. The table below shows the movement in the fund value over the quarter, the income distributions for that quarter, the returns both for each element and the combined return. See also Table 1 of Appendix 2.

Table 5: Patrizia Hanover Property Unit Trust

Quarter 1	**£m**	**Investment return (%)**
Value of fund at start of quarter	19.111	
Decrease in fund due to value of unit price	(0.055)	(1.15)
Value of fund at end of quarter	19.056	
Income distributions*	0.179	3.76
Combined investment income (income distribution plus change in fund value due to unit price)	0.124	2.61

* This income distribution is an estimate and will be confirmed and distributed in quarter 2.

7.5. An average of £11.4m was managed by Lothbury Investment Management Limited. The table below shows the movement in the fund value over the quarter, the income distributions for that quarter, the returns both for each element and the combined return. See also Table 1 of Appendix 2.

Table 6: Lothbury Property Trust

Quarter 1	**£m**	**Investment return (%)**
Value of fund at start of quarter	11.393	
Decrease in fund due to value of unit price	(0.187)	(6.61)
Value of fund at end of quarter	11.206	
Income distributions*	0.091	3.22
Combined investment income (income distribution plus change in fund value due to unit price)	(0.096)	(3.39)

* This income distribution is an estimate and will be confirmed and distributed in quarter 2.

7.6. Over the last few quarters the Lothbury Fund has received a lot of redemption requests from unitholders. These have been driven by three main reasons: pension funds changing the structure of their portfolios and coming out of property investments; the relative underperformance of the fund against its benchmarks in 2022/23 and the retirement of two long standing members of the Executive Board. The Lothbury Fund Managers have discretion to suspend redemptions from the fund when certain thresholds are met. As of 3 July 2023 these thresholds had been exceeded. Having regard to the level of redemptions, the current economic and market conditions and in order to manage sales to meet redemptions, the Fund Managers believed it was in the best interest of all investors to suspend redemptions. The suspension will run for a period of up to 12 months from the next settlement date of 10 October 2023.

7.7. The Council views its investment into property funds are over the long term with the aim of realising higher yields than other investments. The current fund valuations have decreased over the last four quarters and in line with the capital finance and accounting regulations the Council's Financial Instrument Revaluation Reserve has been used to capture those decreases in the unit value of the fund and therefore there has been no impact from these changes on the revenue budget. However, if units are sold this would realise any losses so the Council is not currently seeking to redeem any units. Quarterly income distributions will be received from the fund as normal.

7.8. If all the requested redemptions go ahead and are not withdrawn, the Lothbury Fund is likely to be much smaller. The Senior Fund Management team has agreed a revised fund strategy to reassess the asset portfolio, assuming a notional Fund size of £500m, which is about half of its current size. They believe this will better position the Fund into 2024 and beyond with a high-quality portfolio for the remaining investors. It will be focussed on retaining the highest quality assets in the best performing sectors. The Executive Board are currently presenting this revised fund strategy to all investors and some of those in the redemption queue are expected to change their mind and withdraw their requests. By the end of September the Fund Managers should have a clearer view on the level of ongoing Fund investment and therefore the value of assets that will need to be sold in an orderly way to meet the redemption requests. A further update will be provided as part of the quarter two report to November Cabinet.

8. Overall Investment Position

8.1. An average of £92.1m of investments were managed in-house. These earned £1.047m of interest during this three-month period at an average rate of 4.56%. This is 0.19% above the SONIA rate and 0.12% above the average bank base rate.

8.2. An average of £5.0m was managed by an enhanced cash fund manager. During this three-month period this earned £0.044m from income distributions at an average rate of 3.51% and the value of the fund decreased by £0.036m at an average rate of -2.90%, giving a combined return of 0.61%

8.3. An average of £14.2m was managed by two short-dated bond fund managers. During this three-month period these earned £0.122m from income distributions at an average rate of 3.44% and the value of the funds decreased by £0.365m at an average rate of -10.32%, giving a combined overall return of -6.88%.

8.4. An average of £30.5m was managed by two property fund managers. During this three-month period these earned £0.270m from income distributions at an average rate of 3.56% and the value of the funds decreased by £0.242m at an average rate of -3.19%, giving a combined overall return of 0.37%.

8.5. The total for interest and income distributions in paragraphs 8.1 to 8.4 above is £1.483m. The total change in external fund values due to the unit price is a net decrease of £0.643m, which is set out in the table below:

Table 7: Externally managed funds – changes in unit price

Fund	**Table Number**	**Amount (£m)**
Payden Sterling Reserve Fund	2	(0.036)
AXA Sterling Credit Short Duration Bond Fund	3	(0.181)
Royal London Investment Grade Short Dated Credit Fund	4	(0.184)
Patrizia Hanover Property Unit Trust	5	(0.055)
Lothbury Property Trust	6	(0.187)
Total net decrease due to changes in unit price		**(0.643)**

9. Borrowing

PWLB and short term borrowing

9.1. The Capital Financing Requirement (CFR) is the Council's theoretical need to borrow but the Section 151 Officer can manage the Council's actual borrowing position by either:

1 - borrowing to the CFR;
2 - choosing to use temporary cash flow funds instead of borrowing (internal borrowing) or;
3 - borrowing for future increases in the CFR (borrowing in advance of need).

9.2. The Council began 2023/24 in the second of the above scenarios, with actual borrowing below CFR.

9.3. This, together with the Council's cash flows, the prevailing Public Works Loans Board (PWLB) interest rates and the future requirements of the capital investment programme, were taken into account when deciding the amount and timing of any loans. During the quarter no new PWLB loans were taken out, no loans matured and no debt restructuring was carried out.

9.4. The level of PWLB borrowing (excluding debt relating to services transferred from Essex County Council on 1st April 1998) remained the same at £347.3m during quarter one. The average rate of borrowing at the end of the quarter was 3.46%. A profile of the repayment dates is shown in Graph 2 of Appendix 2.

9.5. The table below summarises the PWLB activities during the quarter:

Table 8: PWLB borrowing during quarter 1

Quarter	Borrowing at beginning of quarter (£m)	New Borrowing (£m)	Re-financing (£m)	Borrowing repaid (£m)	Borrowing at end of quarter (£m)
April to June 2023	347.3	0	0	(0)	347.3
Of which:					
General Fund	273.1	0	0	(0)	273.1
HRA	74.2	0	0	(0)	74.2

All PWLB loans held are at fixed rates and are repayable on maturity.

9.6. The level of PWLB borrowing at £347.3m is in line with the financing requirements of the capital investment programme and the revenue costs of this borrowing are fully accounted for in the revenue budget. The current level of borrowing is also in line with the Council's prudential indicators and is proportionate, prudent, affordable and sustainable.

9.7. These figures exclude debt held by Essex County Council of £9.2m relating to assets transferred on 1st April 1998, which this Council is responsible for servicing. The debt is recognised as a deferred liability on our balance sheet.

9.8. Interest rates from the PWLB fluctuated throughout the quarter in response to economic events: 10 year PWLB rates between 4.23% and 5.27%, 25 year PWLB rates between 4.58% and 5.44% and 50 year PWLB rates between 4.27% and 5.23%. These rates are after the PWLB 'certainty rate' discount of 0.20%.

9.9. No short term loans for cash flow purposes were taken out or repaid during the quarter. See Table 4 of Appendix 2.

Funding for Invest to Save Schemes

9.10. Capital projects have been completed on energy efficiency improvements at the new Beecroft Art Gallery, replacement lighting on Southend Pier and LED lighting at the Priory Park workshop which will generate on-going energy savings. These are invest-to-save projects and the predicted revenue streams cover as a minimum the financing costs of the project.

9.11. To finance these projects in total the Council has taken out interest free loans of £0.079m with Salix Finance Ltd which is an independent, not for profit company, funded by the Department for Energy and Climate Change that delivers interest-free capital to the public sector to improve their energy efficiency and reduce their carbon emissions. The loans are for a period of four and five years with equal instalments to be repaid every six months. There are no net revenue budget implications of this funding as there are no interest payments to be made and the revenue savings generated are expected to exceed the amount needed for the repayments. £0.001m of these loans were repaid during the period from April to June 2023.

9.12. At the meeting of Cabinet on 23rd June 2015 the LED Street Lighting and Illuminated Street Furniture Replacement Project was approved which was to be partly funded by 25 year reducing balance ‘invest to save’ finance from L1 Renewables Finance Limited. The balance outstanding at the end of quarter one was £8.20m. There were no repayments during the period from April to June 2023.

9.13. Funding of these invest to save schemes is shown in table 5 of Appendix 2.

10. Compliance with Treasury Management Strategy

10.1. The Council’s investment policy is governed by the CIPFA Code of Practice for Treasury Management in the Public Sector, which has been implemented in the Annual Treasury Management Investment Strategy approved by the Council on 23 February 2023. The investment activity during the quarter conformed to the approved strategy and the cash flow was successfully managed to maintain liquidity. See Table 7 of Appendix 2.

11. Reasons for Decisions

11.1. The CIPFA Code of Practice on Treasury Management recommends that Local Authorities should submit reports regularly. The Treasury Management Policy Statement for 2023/24 set out that reports would be submitted to Cabinet quarterly on the activities of the treasury management operation.

12. Other Options

12.1. There are many options available for the operation of the Treasury Management function, with varying degrees of risk associated with them. The Treasury Management Policy aims to effectively control risk to within a prudent level, whilst providing optimum performance consistent with that level of risk.

13. Financial Implications

13.1. The financial implications of Treasury Management are dealt with throughout this report.

14. Legal Implications

14.1. The Council has adopted the 'CIPFA Code of Practice for Treasury Management in the Public Sector' and operates its treasury management service in compliance with this Code.

15. Carbon Impact

15.1. None arising from this report.

16. Equalities

16.1. None arising from this report.

17. Consultation

17.1. The key Treasury Management decisions are taken in consultation with our Treasury Management advisers.

18. Background Papers

None.

19. Appendices

Appendix 1 – In-house Investment Position as at 30 June 2023

Appendix 2 – Treasury Management Performance for Quarter One - 2023/24