PAPER C2
Decision Report - Executive Decision
Forward Plan Reference: FP/23/04/05
Decision Date – 06/12/2023
Key Decision – No

Annual Treasury Mid-Year Report 2023-24

Executive Member(s): Cllr Liz Leyshon – Deputy Leader and Lead Member for Resources and Performance
Local Member(s) and Division: All
Lead Officer: Jason Vaughan – Executive Director Resources and Corporate Services (Section 151 Officer)
Author: Alan Sanford, Principal Investment Officer
Contact Details: alan.sanford@somerset.gov.uk or (01823) 359585

Summary / Background

1. In compliance with the requirements of the CIPFA Code of Practice this report provides Councillors with a summary report of the treasury management activity during the first six months of 2023-24. It gives a summarised account of Treasury Management activity and outturn for the first half of the year and ensures Somerset Council (SC) is embracing Best Practice in accordance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) recommendations. All treasury activity was conducted within the benchmarks set as Prudential limits for prudent and sustainable capital plans, financing, and investment. A risk-averse approach has been taken in relation to investment activity with priority being given to security and liquidity over yield. This report is for information only.

   On the 1st April, the debt and treasury investment portfolios of the 5 legacy Councils came together. Fuller details of the total inherited portfolios, and movements during the first six months of the year are shown below in tables 1 to 3 (debt), and 5 to 8 (investments).

   As at 1st April, the debt portfolio (Excluding loans between legacy Somerset Councils) stood at £750.7m at an average rate of 3.45%. The medium to longer-term loans, being £375.7m of Public Works Loan Board (PWLB), and

£60.5m of fixed rate market loans, seemed to dovetail well to give a reasonable overall maturity profile. However, £201.5m of the £206.5m short-term variable rate debt was maturing during the 2023-24 financial year, and £83m of the £108m LOBO (Lenders Option, Borrowers Option) loans would have an option to call during 2023-24, giving rise to significant interest rate risk when refinancing.

Investments (Excluding loans between legacy Somerset Councils) stood at £295.75m on 1st April at an average rate of 4.27%. This figure included approximately £13.9m of cash managed on behalf of the Local Enterprise Partnership (LEP), £8.5m of other external bodies (Exmoor National Park (ENP), South-West Councils (SWC), Society of County Treasurers (SCT) and the Police & Crime Commissioners Treasurers' Society (P&CCTS), £10.5m of earmarked funds held on behalf of others, and £53.3m held under S256 for NHS Somerset. Of this, £179.25m was cash investment, whilst the remaining £116.5m was held in Strategic Pooled Funds.

The main objective of treasury activity for the beginning of the year was to limit new medium to longer-term borrowing whilst reviews of both strategic pooled funds and non-treasury commercial investments were carried out.

Debt balances were reduced by aggregate repayment of short-term loans and the repayment of 3 x £5m LOBO loans that opted to raise the rate (we then exercised our option to repay).

Investment balances were also reduced, to fund the reduction in debt. Treasury Advisors Arlingclose had advised a 35-day limit for new bank deposits, so bank and Local Authority (LA) deposit maturities were allowed to run off as and when debt repayments were due.

The debt portfolio as at 30th September was £656.2m at an average rate of 3.92%. Short-Term variable debt was reduced by £79.5m, and 3 x £5m LOBO loans were repaid.

Of the circa £32.1m annual budgeted debt interest for the year, £12.9m has been incurred to 30th September. However, with little investment left to mature, more debt will be refinanced/taken in the second half of the year.

During the six months, gross investment balances averaged £294.6m (£177.19m net of funds held for others), yielding 4.81% for the period including Pooled

Funds. The cash return (net of Pooled Funds) of 4.58% was 0.22% lower than the average base rate, and 0.28% below the 1-month SONIA rate (a benchmark rate at which Banks will lend to each other). A below benchmark return is practically inevitable in a rapidly rising interest rate environment.

Income of £7,111,616 (£6,596,800 net of that apportioned to the LEP and external bodies) has been earnt in the period, more than originally budgeted for, as interest rates have risen much faster than anticipated. However, with reduced investment balances to provide income in the second half of the year, this will likely fall below budget by year-end.

All Treasury activities undertaken have been in full compliance with relevant legislation, codes, strategies, policies, and practices.

Recommendations

2. That the Executive approves the report as being in compliance with the CIPFA Code of Practice for Treasury Management and recommends it to Full Council at the next available meeting.

Reasons for recommendations

3. The Local Government Act 2003 requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services.

4. The Code requires Full Council to receive as a minimum, an annual strategy and plan in advance of the year, a mid-year review, and an annual report after its close. This is the mid-year review for the 2023-24 financial year.

Other options considered

5. None. The adoption of the Treasury Management mid-year review for 2023-24 is a regulatory requirement.

Links to Council Plan and Medium-Term Financial Plan

6. Effective Treasury Management provides support to the range of business and service level objectives that together help to deliver the Somerset County Plan.

Financial and Risk Implications

7. There are no specific financial or risk implications associated with this outturn report. The risks associated with Treasury Management are dealt with in the Annual Treasury Management Strategy, Annual Investment Strategy, and Treasury Management Practice (TMPs) documents.

Legal Implications

8. Treasury Management must operate within specified legal and regulatory parameters as set out in the summary, and in more detail in the TMPs.

HR Implications

9. There are no HR implications.

Other Implications:

Equalities Implications

10. There are no equalities implications.

Community Safety Implications

11. There are no community safety implications.

Climate Change and Sustainability Implications

12. There are no climate change or sustainability implications.

Health and Safety Implications

13. There are no health and safety implications.

Health and Wellbeing Implications

14. There are no health and wellbeing implications.

Social Value

15. Not applicable

Scrutiny comments / recommendations:

16. The Audit Committee is the body responsible for ensuring effective scrutiny of the treasury management strategy and policies. They approved the Treasury Management strategy for the year and have recently approved updated Treasury Management Practices.

Background

17.1 Economic Background

UK inflation remained stubbornly high over much the period, keeping expectations of how much further the Bank of England (BoE) would hike rates elevated. However, inflation data published in the latter part of the period undershot expectations, causing financial markets to reassess the peak in BoE Bank Rate. This was followed very soon after by the BoE deciding to keep Bank Rate on hold at 5.25% in September, against expectation for another 0.25% rise.

Economic growth in the UK remained relatively weak over the period. In calendar Q2 2023, the economy expanded by 0.4%, beating expectations of a 0.2% increase. However, monthly GDP data showed a 0.5% contraction in July, the largest fall to date in 2023 and worse than the 0.2% decline predicted which could be an indication the monetary tightening cycle is starting to cause recessionary or at the very least stagnating economic conditions.

July unemployment data showed the rate increased to 4.3% (3mth/year) while the employment rate rose to 75.5%. Pay growth was 8.5% for total pay (including bonuses) and 7.8% for regular pay, which for the latter was the highest recorded annual growth rate.

Inflation continued to fall from its peak as annual headline CPI declined to 6.7% in July 2023 from 6.8% in the previous month against expectations for a tick back up to 7.0%. The core rate also surprised on the downside, falling to 6.2% from 6.9% compared to predictions for it to only edge down to 6.8%.

The Bank of England's Monetary Policy Committee continued tightening monetary policy over most of the period, taking Bank Rate to 5.25% in August. Against expectations of a further hike in September, the Committee voted 5-4 to maintain Bank Rate at 5.25%. Each of the four dissenters were in favour of another 0.25% increase.

Financial market Bank Rate expectations moderated over the period as falling inflation and weakening data gave some indication that higher interest rates were working. Expectations fell from predicting a peak of over 6% in June to 5.5% just ahead of the September MPC meeting, and to then expecting 5.25% to be the peak by the end of the period.

Following the September MPC meeting, Arlingclose, the authority's treasury adviser, modestly revised its interest rate forecast to reflect the central view that 5.25% will now be the peak in Bank Rate. In the short term the risks are to the upside if inflation increases again, but over the remaining part of the time horizon the risks are to the downside from economic activity weakening more than expected. The lagged effect of monetary policy together with the staggered fixed term mortgage maturities over the next 12-24 months means the full impact from Bank Rate rises are still yet to be felt by households.

The US Federal Reserve increased its key interest rate to 5.25-5.50% over the period, pausing in September following a 0.25% rise the month before, and indicating that it may have not quite completed its monetary tightening cycle.

The European Central Bank increased its key deposit, main refinancing, and marginal lending interest rates to 4.00%, 4.50% and 4.75% respectively in September, and hinted these levels may represent the peak in rates but also emphasising rates would stay high for as long as required to bring inflation down to target.

Financial market sentiment and bond yields remained volatile throughout the period but had trended downwards in September as there were signs inflation, while still high, was moderating and interest rates were at a peak.

Gilt yields fell towards the end of the period. The 5-year UK benchmark gilt yield rose from 3.30% to peak at 4.91% in July before trending downwards to 4.29%, the 10-year gilt yield rose from 3.43% to 4.75% in August before declining to 4.45%, and the 20-year yield from 3.75% to 4.97% in August and then fell back to 4.84%. The Sterling Overnight Rate (SONIA) averaged 4.71% over the period.

Gilt yields have a direct correlation to Public Works Loan Board (PWLB) rates. Rates drifted sideways from April to June, and after a slight peak, returned to April levels in July. As the inflationary picture became clearer, rates climbed steeply at the back end of August and through September. This is clearly shown in Tables 2 and 3 and the graph in Appendix A.

Sterling Overnight Interbank Average (SONIA) money market rates moved up during the period, anticipating gradual base rate rises.

The 1-month, 3-month, 6-month, and 12-month SONIA rates averaged -4.86%, 5.16%, 5.45%, and 5.77% respectively over the period, and ended the period at 5.22%, 5.51%, 5.63%, and 5.77% respectively.

Lending, and conversely borrowing rates between Local Authorities have unusually been elevated in relation to market rates, as demand has generally outstripped supply. The issuance and talk of Section 114 notices has meant lenders have a stronger hand and have become more selective about who they lend to. Some have declined to lend to Somerset Council. The effect that economic conditions had on money market rates during the period, can be seen in Table 1, Appendix A.

17.2 Debt Management

The Council's need to borrow for capital purposes is determined by the capital programme. Council Members are aware of the major projects identified within the Capital Programme approved in February 2023. This was followed by revised programmes for the General Fund and HRA that were approved at full Council in September which included the slippage in capital spend from all five legacy Councils.

The opening General Fund CFR for Somerset Council is £924.27m and the HRA £182.2m. These figures represent the underlying need to borrow for capital for the new authority. It is expected that further borrowing of £136.7m for the General Fund will be required over the period of the new programme.

On top of possible new borrowing, £203.5m of short-term borrowing and £17.2m of PWLB loans were due to mature during the year; and as interest rates were expected to move higher, the possibility that LOBOs would exercise their options became more likely.

Table 1 – Legacy Debt Portfolios by Council 31st March 2023

£m	**MDC**	**SDC**	**SWT**	**SSDC**	**SCC**	**Total**
Intra Unitary	0.00	34.00	6.00	13.00	00.0	**53.00**
Local Authority	0.00	10.00	78.00	118.50	0.00	**206.50**
PWLB	62.79	66.35	87.50	0.00	159.05	**375.69**
Fixed rate bank	0.00	0.00	3.00	0.00	57.50	**60.50**
LOBO bank	0.00	0.00	0.00	0.00	108.00	**108.00**
Total	**62.79**	**110.35**	**174.50**	**131.50**	**324.55**	**803.69**

Table 2 – Debt Portfolio movement 31st March 2023 to 30th September

General Fund	Balance on 01-04-2023 £m	Debt Matured / Repaid £m	New Borrowing £m	Balance on 30-09-2023 £m	Increase/ Decrease in Borrowing £m
Intra-Unitary Loans	53.00	-53.00	0.00	0.00	-53.00
Short Term Borrowing	191.50	-171.50	97.00	117.00	-74.50
PWLB	239.84	0.00	0.00	239.84	0.00
LOBOs	108.00	-15.00	0.00	93.00	-15.00
Fixed Rate Loans	57.50	0.00	0.00	57.50	0.00
Total General Fund	**649.84**	**-239.50**	**97.00**	**507.34**	**-142.50**
HRA					
Short Term Borrowing	15.00	-5.00	0.00	10.00	-5.00
PWLB	135.85	0.00	0.00	135.85	0.00
LOBOs	0.00	0.00	0.00	0.00	0.00
Fixed Rate Loans	3.00	0.00	0.00	3.00	0.00
Total HRA	**153.85**	**-5.00**	**0.00**	**148.85**	**-5.00**
Total	**803.69**	**-244.50**	**97.00**	**656.20**	**-147.50**

Table 3 – Debt Interest

	01-04-2023 Rate %	30-09-2023 Rate %	Increase/ Decrease Rate %
Short Term Borrowing	2.47	4.43	+1.96
PWLB	3.42	3.42	0.00
LOBOs	4.74	4.75	+0.01
Fixed Rate Loans	4.70	4.70	0.00
Total Borrowing	**3.45**	**3.92**	**+0.47**

A key determinant of borrowing strategy was to be the review of the £116.5m of pooled funds held, and the circa £250m non-treasury investment portfolio. The strategy was therefore to refinance or take any required new debt whilst balancing the needs of budgets and introducing the least possible risk into the long-term debt portfolio.

There was a substantial rise in the cost of both short- and long-term borrowing over the period, with. Bank Rate rising by 1% from 4.25% at the beginning of April to 5.25% at the end of September.

UK gilt yields were volatile, mainly facing upward pressure since early April following signs that UK growth had been more resilient, inflation stickier than expected, and that the Bank of England saw persistently higher rates through 2023-24 as key to dampening domestic demand. Gilt yields, and consequently PWLB borrowing rates, rose and broadly remained at elevated levels.

With borrowing rates rising and then plateauing during the period, it was deemed to be more cost effective in the short-term to use internal resources, and or to borrow short (1-2 years) via the LA market. As medium-term PWLB loans (6-10 years) were generally lower than short and long-term rates, a proportion of loans from the PWLB in this period could provide a suitable balance to the risk of holding too much short-term borrowing, or in the event that the intra-LA market suffered a lack of liquidity.

During the period, investments were allowed to mature, to pay down short-term borrowing maturities, to reduce the need to refinance. £176.5m of short-term loans were repaid, with 12 new short-term loans totalling £97m being taken out. 3 x £5m LOBOs were repaid after the option to raise their rate was exercised. No new PWLB loans were taken as rates remained elevated.

The overall rate paid on SC loans remained unchanged for the PWLB portfolio of £375.696m, at 3.42%. The average Market Loan rate at 30th September (LOBOs + Barclays, total £153.5m) was 4.75%, rising slightly as loans with lesser rates were repaid. The cost of refinancing short-term debt meant an average of 4.43% at period-end, a rise of 1.96%, albeit on reduced balances. The combined average rate was 3.92% on £656.2m.

Initial budgeted debt interest for the year for the general fund was £32.12m, meaning that the £10.56m paid to date is £5.5m under budget. However, with little investment to mature, more debt will be refinanced/taken in the second half of the year, and it will be more expensive. This will likely eat into any underspend by year-end.

17.3 Investment Activity

The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

Security of capital remained the Council's main investment objective. This was achieved by following the counterparty policy as set out in the Annual Investment Strategy, and by the approval method set out in the Treasury Management Practices. Counterparties having approval for use during the period are listed in Table 4 below. Those used during the first half of the year are denoted with a star. Few Banks have been used during this period, as Arlingclose restricted their maximum duration advice on all counterparties to 35 days, and maturities were used to pay down debt.

Table 4 - Approved Counterparties

Bank or Building Society		**Sterling LVNAV Money Market Funds**	
Australia & NZ Bank	*	Deutsche MMF	*
Bank of Scotland		Invesco Aim MMF	*
Bank of Montreal		Federated Prime MMF	*
Bank of Nova Scotia		Insight MMF	*
Barclays Bank Plc		Aberdeen Standard MMF	*
Canadian Imperial Bank of Commerce		LGIM MMF	*
Commonwealth Bank of Australia		SSGA MMF	*
DBS Bank Ltd	*	Aviva MMF	*
DZ Bank		**Other Counterparties**	
HSBC Bank		Other Local Authorities (Number of Deals)	* (12)
Landesbank Hessen- Thuringen	*	Debt Management Office	
Lloyds Bank	*	**Strategic Pooled Funds**	
National Australia Bank		CCLA Property Fund	*
National Bank of Canada	*	RLAM Bond Fund	*
National Westminster	*	M&G Bond Fund	*
Nationwide BS		Aegon Diversified Fund	*
Nordea Bank	*	CCLA Diversified Fund	*
OP Corporate Bank		Fidelity Equity Fund	*
Oversea-Chinese Banking Corporation (Singapore Bank)		Columbia Threadneedle Bond Fund	*
Rabobank		Ninety-One Diversified Fund	*
Royal Bank of Scotland		Paydon & Rygel Bond Fund	*

Santander UK	*	RLAM Short-Term Fund	*
Standard Chartered Bank	*	Schroder Equity Fund	*
Handelsbanken Plc		UBS Equity Fund	*
Bank or Building Society (Continued)			
Toronto-Dominion Bank	*		
United Overseas Bank			

SC has continuously monitored counterparties, and all ratings of proposed counterparties have been subject to verification on the day, immediately prior to investment. Other indicators considered have been:

- Credit Default Swaps and Government Bond Spreads.
- GDP and Net Debt as a Percentage of GDP for sovereign countries.
- Likelihood and strength of Parental Support.
- Banking resolution mechanisms for the restructure of failing financial institutions i.e. bail-in.
- Share Price
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.

Counterparty Update

Following concerns of a wider financial crisis after the collapse of Silicon Valley Bank, and the purchase of Credit Suisse by UBS, in March our advisors Arlingclose reduced the advised maximum duration limit for all banks on its recommended counterparty list to 35 days. This stance was maintained to the end of the period.

During the second quarter of the period, Moody's revised the outlook on Svenska Handelsbanken to negative from stable, citing concerns around the Swedish real estate sector.

Having put the US sovereign rating on Rating Watch Negative earlier in the period, Fitch took further action in August, downgrading the long-term rating to

AA+, partly around ongoing debt ceiling concerns but also an expected fiscal deterioration over the next couple of years.

Following the issue of a Section 114 notice, in September Arlingclose advised against undertaking new lending to Birmingham City Council, and later in the month cut its recommended duration on Warrington Borough Council to a maximum of 100 days.

The Council continued to monitor and assess credit default swap levels for signs of ongoing credit stress. Heightened market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Council's counterparty list recommended by treasury management advisors Arlingclose remain under constant review.

Liquidity

In keeping with guidance from the Department for Levelling-Up, Housing and Communities (DLUHC) the Council maintained a sufficient level of liquidity through the use of call accounts, Money Market Funds, and short-term deposits.

122 cash deposits totalling just over £859m were made during the first half of the year, mostly placed with Money Market Funds with daily liquidity.

SC, in managing an average of approximately £117.5m of money held on behalf of external bodies, has needed to retain more liquidity than normal, as forecasting and timing of Capital and LEP spending has been difficult. Deposits were kept short in line with Arlingclose advise, and also because debt maturities were repaid, and to cover the possibility of LOBOs calling and being repaid.

Yield

There were three increases in Bank Rate over the period under review from 4.25% to 5.25%. Short-dated cash rates, which had ranged between 4.17% for overnight money, and 4.89% for 12-month money at the beginning of the period, rose by around 1% for overnight maturities and by nearly 0.88% for 12-month maturities.

At certain points during the summer the market expected base rate to rise to over 6%, but as inflationary worries eased in September, markets paused to reassess, and it was thought that a base rate of 5.25% was at, or at the very least, near the top of the rate cycle.

Cash

As at 30th September Cash investment stood at £66.45m averaging just over £178m for the year-to-date. Cash had an average return for the year-to-date of 4.58%. The return of 4.58% was 0.22% lower than the average base rate, and 0.58% below the 3-month SONIA rate (a benchmark rate at which Banks will lend to each other). A below benchmark return is practically inevitable in a rapidly rising interest rate environment.

A total of just under £4.09m (£3.575m net of that paid to the LEP and external bodies) has been earned in Cash interest in the first six months of the year Cash administration charges and other Treasury Management fees brought in approximately £50k of income in the period.

Pooled Funds

As at 31st March 2023, combined, the 5 Councils held £116.5m in Pooled Funds. The list below shows the funds, the categories, and the original investment value of each fund.

Cash Plus Funds
Payden & Rygel Sterling Reserve Fund - £2m
Royal London Short-Term Fixed Income Enhanced Fund - £2m

Fixed Income
Columbia Threadneedle Strategic Bond Fund - £7m
M&G £ Corporate Bond Fund - £15m
RLAM Investment Grade Short Dated Credit Fund - £15m

Equity
Fidelity Global enhanced income (Global Equity) - £250,000
Schroder Income Maximiser Fund - £16.25m
UBS Global Income Fund - £5m

Property
CCLA Property Fund - £31m

Multi-Asset

Aegon Diversified Monthly Income Fund - £7m
CCLA Diversified Income Fund - £3m
Ninety One Diversified - £13m

For existing longer-term investors in fixed income securities, the prospect of a higher-for-longer rate environment weighed on sentiment. Yields rose in Q2 2023 on the expectation that central banks would continue hiking rates but fell in August as investors grew confident that policy rates were close to their peak. This affected capital values of the Council's longer-dated bond funds during the six-month period and, to a lesser extent, the multi-asset funds where there was some offset from equity performance.

Investor sentiment for UK commercial property was more settled than in Q3 and Q4 of 2022 when the sharp rise in bond yields resulted in a big fall in property valuations. There were signs of returning investor interest, occupier resilience and a perception that the downturn in commercial real estate may be bottoming out. It helped rental income and led to some stabilisation in capital values. However, the combination of high interest rates and bond yields, higher funding costs and the prospect of sluggish economic growth continue to constrain the outlook for commercial property.

The combination of the above continues to have a negative effect on the combined value of the Council's strategic funds. As at 30th September 2023 the Net Asset Value of all the funds was £100,885,869. The unrealised losses (no actual losses would be incurred until assets were sold) are evenly spread across all funds and categories, with the exception of the Cash Plus funds. The average yield at 30th September was 5.22%

The review of strategic pooled funds has concluded that a large proportion of holdings will be sold as and when appropriate, taking into account potential losses incurred, ongoing diversification of portfolio, and liquidity of assets. It has not yet been fully decided as to what if any level of holdings will be retained.

<u>Combined</u>

Combined return for the period has been 4.81% on an average balance of £294.6m. This figure includes approximately £13.9m of cash managed on behalf of the Local Enterprise Partnership (LEP), £10.5m of Earmarked Funds held on behalf of other decision-making bodies, £84.3m held as S256 money for NHS Somerset, and £8.8m of other external bodies (e.g. Exmoor National

Park (ENP), and South West Councils (SWC)). Total investment income was just over £7.11m (£6.60m net of external investors).

Initial budgeted income for the year to date was £13m, meaning that the £6.60m (net of that paid to external bodies) is on budget. However, with reduced investments to provide income, this will likely fall below budget by year-end.

Figures below highlight Legacy investment portfolios by Council, Table 5, Investment figures and returns for period, Table 6, Balances by type – Table 7, and a breakdown of investment balances by source – Table 8: -

Table 5. Legacy Investment Portfolios by Council 31st March 2023

£m	**MDC**	**SDC**	**SWT**	**SSDC**	**SCC**	**Total**
Money Market Funds	15.20	4.40	0.00	0.00	16.75	**36.35**
Notice Bank Accounts	0.00	1.60	0.00	0.00	0.00	**1.60**
Bank deposits	5.00	0.00	0.00	0.00	70.00	**75.00**
Intra unitary deposits	5.00	0.00	0.00	0.00	48.00	**53.00**
Time Deposits - LAs	0.00	0.00	1.30	0.00	65.00	**66.30**
Strategic Funds*	0.00	31.00	17.00	23.50	45.00	**116.50**
Total	**25.20**	**37.00**	**18.30**	**23.50**	**244.75**	**348.75**

- Strategic Funds are shown at cost.
- On 1st April £53m of Intra-Unitary deposits were effectively quashed, so leaving a balance of £295.75m

Table 6 – Investment figures and returns for period.

	Balance 1 April 2023 £m	Rate of Return at 1 April 2023 %	Balance as at 30 Sept 2023 £m	Rate of Return at 30 Sept 2023 %	Average Balance April to Sept £m	Average Rate April to Sept %
Cash	179.25	3.81*	64.50	5.18	178.09	4.58
Pooled Funds	116.50	4.89	116.50	5.22	116.50	5.17
Total Lending	**295.75**	**4.27**	**182.95**	**5.20**	**294.59**	**4.81**

*Somerset County Council rate

Table 7 – Investment balances by type

	1 April 2023 £m	30 Sept 2023 £m	Change £m
Money Market Funds	36.35	26.45	-9.90
Bank Call Accounts	0.00	0.00	0.00
Bank Notice Accounts	1.60	20.00	+18.40
Time Deposits – Banks	75.00	0.00	-75.00
Time Deposits – LAs	66.30	20.00	-46.30
Pooled Funds	116.50	116.50	0.00
Total Investments	**295.75**	**182.95**	**-112.80**

Table 8 – Breakdown of investment balances by source

	01 April 2023 £m	30 Sept 2023 £m	Change £m
ENPA/SWC/SCT/P&CCTS	8.15	8.51	+0.36
LEP	15.36	12.45	-2.91
Earmarked Funds held on behalf of other decision-making bodies	10.89	10.02	-0.87
NHS Somerset S256	97.74	53.27	-44.47
Total external	**132.14**	**84.25**	**-47.89**
SC	163.61	98.70	-64.91
Total	**295.75**	**182.95**	**-112.80**

17.4 Compliance and Prudential Indicators

All treasury management activities undertaken during the first 6-months have complied fully with the CIPFA Code of Practice and the Councils approved Treasury Management Strategy.

SC has continuously proactively assessed and implemented mitigation for the risks that have materialised in the new investment environment. Controls/procedures are constantly being assessed and introduced/adapted where needed and embedded into practices to further mitigate risks to SC investment and borrowing portfolios.

SC has complied with its Prudential Indicators for 2023-24. Those indicators agreed by Full Council and actual figures as at 30th September are included below:

	2023-24 £m	As at 30-09 £m
Authorised limit (borrowing only)	1,039.4	670.1
Operational boundary (borrowing only)	1,004.4	670.1

Maturity structure of borrowing

	Upper Limit	Lower Limit	As at 30-09-23
Under 12 months	50%	15%	32.49%
>12 months and within 24 months	25%	0%	7.76%
>24 months and within 5 years	25%	5%	11.76%
>5 years and within 10 years	25%	0%	7.12%
>10 years and within 20 years	25%	0%	5.55%
>20 years and within 30 years	20%	0%	6.36%
>30 years and within 40 years	30%	10%	22.36%
>40 years and within 50 years	15%	0%	6.15%
50 years and above	5%	0%	0.45%

	2023-24 £m	As at 30-09 £m
Prudential Limit for principal sums invested for periods longer than 365 days	160	116.5

Credit Risk Indicator

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating / credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk (in conjunction with Arlingclose) and will be calculated quarterly.

Credit risk indicator (Number to be below target)	**Target**	**Actual**
Portfolio average credit rating (score)	A (6)	A+ (4.65)

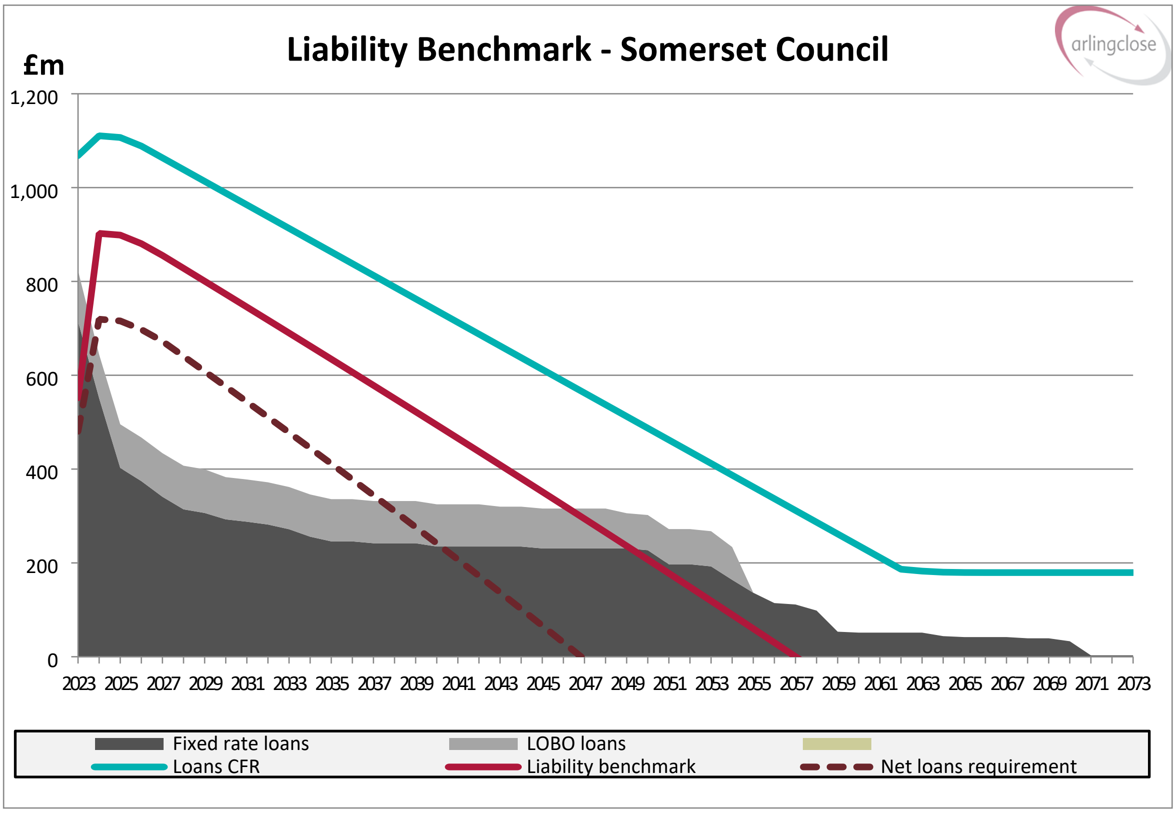
Liability Benchmark

This new indicator compares the Council's actual existing borrowing against a liability benchmark that has been calculated to show the lowest risk level of borrowing. 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. It 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 a pre-determined minimum level required to manage day-to-day cash flow (including allowances for certain contingencies).

The concept is that the chart below allows a comparison of current borrowing against the need to borrow, looking at both the amount (on the y axis) and the term (on the x axis). Where actual loans exceed the Liability Benchmark, the authority can make long-term investments for cash flow management or repay loans early; where the Liability Benchmark exceeds loans, the authority can take long-term borrowing or sell investments.

There is no requirement to borrow exactly to the Liability Benchmark, but a decision to borrow more or less, or longer or shorter, than the Liability Benchmark implies a deliberate decision to accept additional risk. This may be entirely appropriate if it is accompanied by a reduction in cost, for example through short-term borrowing at lower margins. The Liability Benchmark provides the tool for local authorities to measure this risk and make such risk/reward decisions openly and explicitly.

The graph clearly shows there is a need to borrow quite significant sums out to a period of 12 or so years. Another course of action would be to sell investments, or more probably, a combination of the two.



17.5 Outlook for Quarters 3 & 4

UK inflation and wage growth remain elevated, but the August CPI data suggested that inflation was falling more rapidly. The UK economy has so far been resilient. However, recent data indicates a further deceleration in business and household activity growth as higher interest rates start to bite.

In a narrow 5-4 vote, the MPC took the opportunity to hold rates at 5.25% in September, a level many now see as the peak.

Policy rates are expected to remain at the peak for another 10-12 months. It is anticipated that the MPC will cut rates in the medium term to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering second round effects.

Arlingclose see rate cuts from Q3 2024 to a low of around 3% by early 2026. • The immediate risks around Bank Rate lie to the upside, but these diminish over the next few quarters and shift to the downside before balancing out, due to the weakening UK economy and dampening effects on inflation.

Arlingclose expects long-term gilt yields to eventually fall from current levels reflecting the lower medium-term path for Bank Rate. However, yields will remain relatively higher than in the past, partly due to quantitative tightening, with continued elevated volatility.

With many Councils facing overspends in 2023-24, there is likely to be reduced liquidity in the LA to LA cash market, particularly around financial year-end. Those with cash to lend will be able to be more selective about who they lend to. Many have already declined to lend to Somerset Council due to adverse financial publicity.

Whilst other sources of borrowing will be pursued, it is likely that the PWLB will be substantially used towards the end of the year.

Table 9 – Base Rate forecast to 2026.

	Dec 23	Mar 24	Jun 24	Sep 24	Dec 24	Mar 25
Upside Risk	0.00	0.25	0.50	0.75	0.75	0.75
Base Rate	5.25	5.25	5.25	5.00	4.75	4.25
Downside Risk	0.00	-0.25	-0.50	-0.75	-1.00	-1.00

	Jun 25	Sep 25	Dec 25	Mar 26	Jun 26	Sept 26
Upside Risk	0.75	0.75	0.75	0.75	1.00	1.00
Base Rate	4.00	3.75	3.50	3.25	3.00	3.00
Downside Risk	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00

Background papers

18. Treasury Management Strategy Statement 2023-24 and appendices. These were approved by Full Council prior to the start of the 2023-24 financial year.

Note: For sight of individual background papers please contact the report author.

Report Sign-Off

	Officer Name	Date Completed
Legal & Governance Implications	David Clark	27/11/23
Communications	Peter Elliot	24/10/23
Finance & Procurement	Jason Vaughan	25/10/23
Workforce	Alyn Jones	27/11/23
Asset Management	Oliver Woodhams	23/10/23
Executive Director / Senior Manager	Jason Vaughan	25/10/23
Strategy & Performance	Alyn Jones	27/11/23
Executive Lead Member	Liz Leyshon	27/11/23
Consulted:	Councillor Name	
Local Division Members	N/A	
Opposition Spokesperson	Mandy Chilcott	Sent 27/11/23
Scrutiny Chair	Bob Filmer	Sent 27/11/23
Audit Chair	Mike Hewitson	Sent 27/11/23