Chichester District Council

Corporate Governance and Audit Committee 30 October 2023

2023-2024 Treasury Management half-yearly update

1. Contacts

Report Authors:

Helen Belenger – Divisional Manager Financial Services
Telephone: 01243 521045 E-mail: hbelenger@chichester.gov.uk

Matthew Gammon – Capital Accountant, Financial Services
Telephone: 01243 523350 E-mail: mgammon@chichester.gov.uk

Kevin Gillett – Valuation & Estates Manager
Telephone: 01243 534727 E-mail: kgillett@chichester.gov.uk

2. Recommendation

2.1 The Committee is requested to consider the Treasury activity summarised in this report and provide comments to the Cabinet as necessary.

3. Background

3.1 This report provides the Committee with a summary of treasury management activity and regulatory developments for the year to date.

3.2 The Authority's treasury management strategy for 2023/24 was approved by Council in March 2023. The Authority continues to invest in line with this policy and the investment position on 30 September 2023 is shown below.

Table 1: Treasury Management Summary

Investments £000	**Balance 31/03/2023**	**Movement**	**Balance 30/9/2023**
Short term Investments Money Market Funds	33,000 23,900	10,000 4,700	43,000 28,600
Total liquid investments	56,900	**14,700**	**71,600**
Long term Investments Pooled Funds – External Pooled funds – Local Authority Property fund	30,000 10,000	- -	30,000 10,000
Total investments	96,900	**14,700**	**111,600**

Note: the figures in the table above exclude any movements in Fair value.

4. 2022-23 Treasury Summary

4.1 Treasury activity during the first six months of the year focussed on using Money market Funds for short term liquidity.

4.2 Lending to Local Authorities started to play a larger part in our treasury activity due to the rising interest rates and the benefit of fixed terms being offered. However, with the growing trend to request deals well in advance of the actual investment date, we are looking elsewhere to determine other avenues of investment.

4.3 Appendix B contains the usual suite of benchmarking data for the Council's Treasury portfolio as of 30 September 2023.

5. Other Non-Treasury Holdings and Activity

5.1 Although not classed as treasury management activity, the CIPFA Code requires the Authority to report on investments held for policy reasons outside of normal treasury management.

5.2 The Authority holds approximately £13.2m of investments in directly owned property, a drop of £722k from March 22. This is due to new identified risk to existing tenants due to a downward trending retail market that affected the revaluations of the investment properties.

5.3 As the property market emerges from the recovery stage and begins to return to some sense of normality, the changing landscape continues to evolve. The Council's commercial property investments must therefore react and adapt to maintain revenue, and where possible, maximise alternative income opportunities.

5.4 Business and consumer sentiment and confidence is a key driver of the commercial property investment markets, given the importance of occupier occupational demand.

5.5 It therefore remains difficult to determine the long-term impact on our investment portfolio with any certainty and limited tangible evidence to support it, with some property sectors proving to be more robust than others. For example, continued high demand for industrial premises contrasts with downward pressure on high street retail rents and an increased risk of tenant default, whilst sentiment for out-of-town retail is marginally more positive. Investment yields need to reflect the added risk to future income streams and that will ultimately result in lower capital values

5.6 Presently two of the Council's Investment Properties have a market value that is less than the original purchase price. In aggregate the carried loss on these two properties is £1.56m, representing 29% of the original investment cost of £5,325k. Putting this into context, the income received annual from our investment properties is around £0.9m per annum and any carried gains or losses are only crystallised as and when the Council disposes of the property. At present, the Council has no need to, or intention of, disposing of these commercial investments.

6. Compliance Report

6.1 How treasury activity complied with the main 2023-24 treasury limits is disclosed at appendix C.

7. Other Developments

This section updates the Committee on relevant developments since the last report in earlier this year.

Investments in external funds

7.1 Officers monitor longer term cash projections to identify if longer term, higher yielding investments are possible.

8. Estimates of 2023/24 income

8.1 The Authority's 2023/24 budget was set (in March 2023) against a very different economic backdrop than is presently being experienced. As a result, the budget figures are no longer representative of the actual interest being paid following some strong fiscal tightening by the Bank of England since the start of the year.

8.2 The figures in table 2 for external pooled funds are based on announced dividends to the end of the period, some of which will not be received until a month or two later.

8.3 The actual income will ultimately depend on many factors including but not limited to the present fiscal and economic outlook, the fund's sectoral asset allocation, securities held/bought/sold and, in the case of equities, the enforced or voluntary dividend cuts or deferral.

Table 2: Income by investment type to end of September 2023

	To date £'000	Full year Estimate £'000	Budget £'000	Comments
Local Authority Property Fund	£109	£417	£420	
Pooled Funds	£435	£1,253	£1,670	Dividend frequencies vary by fund.
Internal Funds	£603	£1,770	£807	The actual returns are highly dependent on the future direction and ceiling of interest rates. The estimate is based on an average return of 5% on £70m for 6 months from September 2023.
Total	£1,147	£3,440	£2,897	

9. Alternatives Considered

9.1 None

10. Resource and Legal Implications

10.1 The Council is required by the Accounts and Audit Regulations to comply with CIPFA's Code of Practice for Treasury Management and the Prudential Code for Capital Finance.

11. Consultation

11.1 Not relevant.

12. Community impact and corporate risks

12.1 Not relevant

13. Other Implications

	Yes	No
Crime and Disorder		X
Climate Change and Biodiversity		X
Human Rights and Equality Impact		X
Safeguarding and Early Help		X
General Data Protection Regulations (GDPR)		X
Health and Wellbeing		X
Other		X

14. Appendices

A - Movements in Fund fair values and income – Pooled Funds
B - Benchmarking indicators
C - Compliance report
D – Non-Treasury investments
E – Outlook for the remainder of 2023-24

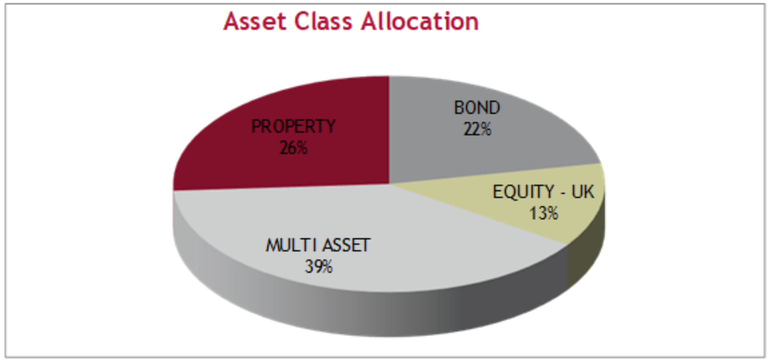
15. Background Papers

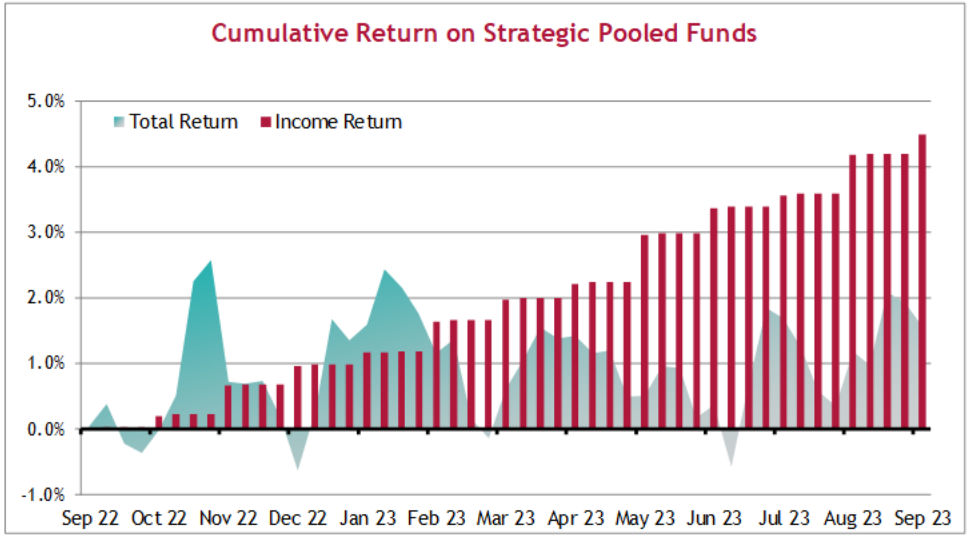
15.1 None.

Appendix A: Movements in Fund fair values and income – Pooled Funds

Exhibit A1: Performance in 23-24

STRATEGIC POOLED FUND PORTFOLIO			CHICHESTER				From: 30/09/2022		To: 30/09/2023	
FUND NAME	**ASSET CLASS**	**No of Units Held in Period**	**Current Value £**	**Capital Growth £**	**Dividends Earned £**	**Holding Period (yrs)**	**Capital Return**	**Income Return**	**Total Return**	**Volatility**
AEGON (KAMES) DIVERSIFIED MONTHLY INCOME FUND	MULTI ASSET	4,418,978	4,154,723	156,083	222,575	1.0	3.90%	5.57%	9.47%	8.0%
CCLA - DIVERSIFIED INCOME FUND	MULTI ASSET	3,912,347	5,501,152	-39,123	183,880	1.0	-0.71%	3.32%	2.61%	6.3%
CCLA - LAMIT PROPERTY FUND	PROPERTY	3,268,201	9,168,938	-2,021,382	419,179	1.0	-18.06%	3.75%	-14.32%	8.9%
M&G STRATEGIC CORPORATE BOND FUND	BOND	3,975,350	3,295,963	171,338	153,150	1.0	5.48%	4.90%	10.38%	8.0%
NINETY ONE (INVESTEC) DIVERSIFIED INCOME FUND	MULTI ASSET	4,843,652	4,279,561	18,672	172,017	1.0	0.44%	4.04%	4.48%	4.1%
SCHRODER INCOME MAXIMISER FUND	EQUITY - UK	11,187,364	4,440,265	495,600	323,237	1.0	12.56%	8.19%	20.76%	14.6%
THREADNEEDLE STERLING SHORT-DATED CORPORATE BOND FUND	BOND	2,332,345	2,126,539	99,332	62,579	1.0	4.90%	3.09%	7.99%	4.0%
THREADNEEDLE STRATEGIC BOND FUND	BOND	2,561,534	2,305,380	51,231	96,232	1.0	2.27%	4.27%	6.54%	6.6%
GRAND TOTAL			35,272,520	-1,068,250	1,632,850	1.0	-2.94%	4.49%	1.55%	4.8%
		Unrealised capital loss since purchase:	-4,727,523		Annualised income return:		4.49%			





Appendix B: Treasury Management – Benchmarking indicators

Return

Measure	Qtr 3 22-23	Qtr. 4 22-23	Qtr 1 23-24	Qtr. 2 23-24	Non-met districts Q4 average	Rating
Internal investment return %	3.30	3.98	4.44	5.12	4.95	GREEN
External funds – income return %	4.06	4.08	4.26	4.60	4.45	GREEN
External funds – capital gains/losses %	(10.92)	(10.37)	(8.49)	(3.05)	(7.24)	GREEN
Total treasury Investments – income return %	0.12	0.73	1.38	3.94	3.47	GREEN

On 16th October 2023, the cumulative carried loss on the Council's pool funds was £4.9m

It remains true that that the best external portfolio over the long term is a mix of asset classes, not a single investment in one fund/ asset class.

Security

	Average Credit Score Time weighted (lower = better)	Average Credit Rating Time weighted	Bail-in exposure (lower = better)	
31 March 2023	4.83	A+	42%	
30 September 2023	4.84	A+	40%	GREEN
Similar Local Authorities	4.29	AA-	56%	

Liquidity

	7 day liquidity	100 day liquidity	Average maturity	
31 March 2023	26%	34%	80	
30 September 2023	27%	41%	92	Amber
Similar Local Authorities	41%	59%	63	

The increase in average days to maturity is due to a move to longer term investments due to the rise in interest rates and projected lowering of interest rates in the future.

Appendix C – Compliance report

Compliance with investment limits

Sector	Time limit	Counterparty limit	Sector limit	Complied/ Exception Ref
The UK Government	50 years	Unlimited	n/a	GREEN
Local authorities & other government entities	10 years	£7m	Unlimited	GREEN
Secured investments	10 years	£7m	Unlimited	GREEN
Banks (unsecured)	13 months	£3.5m	Unlimited	GREEN
Building societies (unsecured)	13 months	£3.5m	£7m	GREEN
Money market funds	n/a	£7m or 0.5% of fund value	Unlimited	GREEN
Strategic pooled funds (excluding LAPF)	n/a	£7m	£50m	GREEN
Strategic pooled funds (CCLA - LAPF)	n/a	£15m	£15m	GREEN
Real estate investment trusts	n/a	£2m	£4m	GREEN
Other investments	2 years	£3.5m	£7m	GREEN

Interest rate exposure

This indicator is set to control the Authority's exposure to interest rate risk. To measure this, the council calculates the effect of a 1% change in interest rates and has set a reportable exception level where the impact of this exceeds 50% of the council's individual counterparty limit (£3m).

	31/3/23 Actual	2023/24 Limit	
Upper limit on one-year revenue impact of a 1% change in interest rates	£0.50m	£3m	GREEN

This limit is only calculated as at 31 March each year.

Principal Sums Invested for Periods Longer than 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 long-term principal sums invested to final maturities beyond the period end were:

	2023/24 expected	2024/25 forecast	2025/26 forecast
Actual principal invested beyond year end	£40m	£40m	£40m
Limit on principal invested beyond year end	£80m	£80m	£80m
	Complied	Complied	Complied

Appendix D: Non-Treasury investment indicators

The Council has set the following indicators to measure its exposure to risk associated with non-treasury investments.

Measure	Description	30 September 2023
Commercial income to net service expenditure	This indicator measures the Council's dependence on income from its commercial property investments as a proportion of the net cost of services	This indicator is only calculated and reported as at 31 March each year.
Net operating surplus	This indicator measures the contribution received from the investment portfolio at a net level (income less costs) over time.	This indicator is only calculated and reported as at 31 March each year
Vacancy levels and tenant exposure	Monitoring vacancy levels to ensure the property portfolio is being managed productively.	Voids at 30th September 2023: 18% Voids at 30th September 2022: 7.5% The increase is due to taking possession of the recently developed St James Industrial Estate in March 2023, accordingly we have an additional 30 units which are not yet fully occupied.
Exposure to credit default events for loans made	This will measure the Council's exposure to loss through default for non-treasury loans made to third parties	None
Market value of commercial properties	This indicator will track the Council's ability to recover its investment in any commercial investment should the need arise.	See main report section 5

Appendix E

Economic Outlook – Summarised by officers from Arlingclose commentary, September 2023

	Current	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26
Official Bank Rate													
Upside risk	0.00	0.25	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	1.00	1.00
Central Case	5.25	5.25	5.25	5.25	5.00	4.75	4.25	4.00	3.75	3.50	3.25	3.00	3.00
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00

Arlingclose expects Bank Rate's to stay at 5.25 till 2024 and then steadily come down to hit 3.00 by Jun 26.

The MPC held Bank Rate at 5.25% in September. We believe this is the peak for Bank Rate. 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. We 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.

Background

UK inflation and wage growth remain elevated, but the August CPI data suggested that inflation was falling more rapidly. In a narrow 5-4 vote, the MPC took the opportunity to hold rates at 5.25%, a level we see as the peak. Near-term rate cuts are unlikely, although downside risks will increase as the UK economy inevitability slides into recession.

While the MPC vote was close, and the minutes contained the warning about the need for further tightening if inflationary pressures persist, both the decline in closely watched inflation measures and confidence that wage growth had peaked, clearly allowed policymakers to focus on the weaker activity data.

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. Global demand will be soft, so offer little assistance in offsetting weakening domestic demand. A recession remains a likely outcome.

Employment demand has weakened and unemployment has increased, although the tight labour market has resulted in higher nominal wage growth. Anecdotal evidence suggests slowing recruitment and wage growth, and we expect unemployment to rise.

Consumer confidence has improved due to signs of real wage growth amid strength in the labour market, but household spending will remain weak as mortgaged households suffer higher interest payments and unemployment rises. Business investment/spending will fall back due to higher borrowing costs and weaker demand.

Inflation will fall continue to fall over the next 12 months, albeit with upside risk. The MPC's attention will remain on underlying inflation measures and wage data. Policy rates will remain at the peak for another 10-12 months, until the MPC is comfortable the risk of further second round effects have diminished.

Maintaining monetary policy in restrictive territory for so long, when the economy is already struggling (as the recent PMI data indicate), will require significant policy loosening in the future to boost demand and inflation.

Global bond yields remain volatile. Like the UK, the Federal Reserve and other central banks see persistently higher policy rates through 2023/2024 as key to dampening domestic inflationary pressure. Data points will therefore prompt changes in bond yields as global interest rate expectations shift.