# SWANAGE TOWN COUNCIL

# Annual Treasury Report 2023/24

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## 1. Background

The Council's Treasury Management Strategy for 2023/24 is underpinned by having due regard to the Chartered Institute of Public Finance and Accountancy's Guidance for Smaller Public Organisations on the Application of the CIPFA Code of Practice for Treasury Management *in the Public Services: Code of Practice (2014 Edition) and Cross-Sectoral Guidance Notes 2017 Edition* (the CIPFA Code) and the Department for Levelling Up, Housing and Communities (DLUHC) *Guidance on Local Authority Investments,* updated February 2018. The Code recommends that members approve a treasury management annual report after the end of each financial year. This report fulfils the Authority's obligation to have regard to the CIPFA Code and any other appropriate guidance.

The Authority's Treasury Management and Investment Strategy for 2023/24 was approved by full Council on 16th January 2023 which can be accessed on [https://www.swanage.gov.uk/Publications-Finance.aspx](https://www.swanage.gov.uk/Publications-Finance.aspx)

The Authority has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

## 2. External Context

**Economic background:** UK inflation continued to decline from the 8.7% rate seen at the start of 2023/24. By the last quarter of the financial year headline consumer price inflation (CPI) had fallen to 3.4% in February, but was still above the Bank of England's 2% target at the end of the period. The core measure of CPI, i.e. excluding food and energy, also slowed in February to 4.5% from 5.1% in January, a rate that had stubbornly persisted for three consecutive months.

The UK economy entered a technical recession in the second half of 2023, as growth rates of -0.1% and -0.3% respectively were recorded for Q3 and Q4. Over the 2023 calendar year GDP growth only expanded by 0.1% compared to 2022. Of the recent monthly data, the Office for National Statistics reported a rebound in activity with the economy expanding 0.2% in January 2024. While the economy may somewhat recover in Q1 2024, the data suggests that prior increases in interest rates and higher price levels are depressing growth, which will continue to bear down on inflation throughout 2024.

Labour market data provided a mixed message for policymakers. Employment and vacancies declined, and unemployment rose to 4.3% (3mth/year) in July 2023. The same month saw the highest annual growth rate of 8.5% for total pay (i.e. including bonuses) and 7.8% for regular pay growth (i.e. excluding bonuses). Thereafter, unemployment began to decline, falling to 3.9% (3mth/year) in January and pay growth also edged lower to 5.6% for total pay and 6.1% for regular pay, but remained above the Bank of England's forecast.

Having begun the financial year at 4.25%, the Bank of England's Monetary Policy Committee (MPC) increased Bank Rate to 5.25% in August 2023 with a 3-way split in the Committee's voting as the UK economy appeared resilient in the face of the dual headwinds of higher inflation and interest rates. Bank Rate was maintained at 5.25% through to March 2024. The vote at the March meeting was 8-1 in favour of maintaining rates at this level, with the single dissenter preferring to cut rates immediately by 0.25%. Although financial markets shifted their interest rate expectations downwards with expectations of a cut in June, the MPC's focus remained on assessing how long interest rates would need to be restrictive in order to control inflation over the medium term.

In the Bank's quarterly Monetary Policy Report (MPR) released in August 2023, the near-term projection for services price inflation was revised upwards with goods price inflation widespread across products, indicating stronger domestic inflationary pressure with second-round effects in domestic prices and wages likely taking longer to unwind than they did to emerge. In the February 2024 MPR the Bank's expectations for the UK economy were positive for the first half of 2024, with a recovery from the mild recession in calendar H2 2023 being gradual. Headline CPI was forecast to dip below the 2% target quicker than previously thought due to declining energy prices, these effects would hold inflation slightly above target for much of the forecast horizon.

Following this MPC meeting, Arlingclose, the authority's treasury adviser, maintained its central view that 5.25% remains the peak in Bank Rate and that interest rates will most likely start to be cut later in H2 2024. The risks in the short-term are deemed to be to the downside as a rate cut may come sooner than expected, but then more broadly balanced over the medium term.

The US Federal Reserve also pushed up rates over the period, reaching a peak range of between 5.25-5.50% in August 2023, where it has stayed since. US policymakers have maintained the relatively dovish stance from the December FOMC meeting and at the meeting in March, economic projections pointed to interest rates being cut by a total of 0.75% in 2024.

Following a similarly sharp upward trajectory, the European Central Bank hiked rates to historically high levels over the period, pushing its main refinancing rate to 4.5% in September 2023, where it has remained. Economic growth in the region remains weak, with a potential recession on the cards, but inflation remains sticky and above the ECB's target, putting pressure on policymakers on how to balance these factors.

**Financial markets:** Sentiment in financial markets remained uncertain and bond yields continued to be volatile over the year. During the first half of the year, yields rose as interest rates continued to be pushed up in response to rising inflation. From October they started declining again before falling sharply in December as falling inflation and dovish central bank attitudes caused financial markets to expect cuts in interest rates in 2024. When it emerged in January that inflation was stickier than expected and the BoE and the Federal Reserve were data dependent and not inclined to cut rates soon, yields rose once again, ending the period some 50+ bps higher than when it started.

Over the financial year, the 10-year UK benchmark gilt yield rose from 3.44% to peak at 4.75% in August, before then dropping to 3.44% in late December 2023 and rising again to 3.92% (28th March 2024). The Sterling Overnight Rate (SONIA) averaged 4.96% over the period to 31st March.

**Credit review:** In response to an improving outlook for credit markets, in January 2024 Arlingclose moved away from its previous temporary stance of a 35-day maximum duration and increased its advised recommended maximum unsecured duration limit on all banks on its counterparty list to 100 days.

Earlier in the period, S&P revised the UK sovereign outlook to stable and upgraded Barclays Bank to A+. Moody's also revised the UK outlook to stable, Handelsbanken's outlook to negative, downgraded five local authorities, and affirmed HSBC's outlook at stable while upgrading its Baseline Credit Assessment. Fitch revised UOB's and BMO's outlooks to stable.

In the final quarter of the financial year, Fitch revised the outlook on the UK sovereign rating to stable from negative based on their assessment that the risks to the UK's public finances had decreased since its previous review in October 2022, the time of the mini- budget.

Moody's, meanwhile, upgraded the long-term ratings of German lenders Helaba, Bayern LB and LBBW on better solvency and capital positions, despite challenges from a slowing German economy and exposure to the commercial real estate sector. Moody's also upgraded or placed on review for an upgrade, Australian banks including ANZ, CBA NAB and Westpac on the back of the introduction of a new bank resolution regime.

Credit default swap prices began the financial year at elevated levels following the fallout from Silicon Valley Bank and collapse/takeover of other lenders. From then the general trend was one of falling prices and UK lenders' CDS ended the period at similar levels to those seen in early 2023. Earlier in the year some Canadian lenders saw their CDS prices rise due to concerns over a slowing domestic economy and housing market, while some German lenders were impacted by similar economic concerns and exposure to commercial real estate towards the end of the period, with LBBW remaining the most elevated.

Heightened market volatility is expected to remain a feature, at least in the near term and, credit default swap levels will be monitored for signs of ongoing credit stress. As ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remain under constant review.

## Local Context

On 31st March 2023 the Authority held investments valued at £6.1m, with usable reserves and working capital being the underlying resources available for investment. On 31st March 2024, the Authority held investments valued at £6.2m. These year-end values include unrealised gains from the Council's strategic investments, being £0.28m in 2023 and £0.18m in 2024.

## 3. Borrowing Strategy and Debt Management

The Authority is debt free. Usable reserves are forecast to fall to £0.85m by March 2027, as capital receipts and earmarked reserves are used to finance the Council's extensive capital programme. The 2024/25 capital expenditure plans and treasury strategy implied a need to borrow at the end of the 3-year forecast period, however this will be reviewed during the course of the 2024/25 financial year as plans for the Green Seafront Enhancement Scheme are developed.

## 4. Treasury Investment Activity

CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes on 20th December 2021. These define treasury management investments as investments that arise from the organisation's cash flows or treasury risk management activity that ultimately represent balances that need to be invested until the cash is required for use in the course of business.

The Authority holds significant invested funds, representing balances and reserves held. During the year the Authority's cash investment balances remained relatively stable, with fluctuations in the value of its long-term strategic investments. The investment position is shown in table 1 below.

Table 1: Treasury Investment Position

| Investment Portfolio | 31.03.23 Balance £ | Net Movement £ | 31.03.24 Balance £ | 31.03.24 Income Return % |
|---|---|---|---|---|
| Banks and building societies (unsecured) | 577,650 | -493,838 | 83,812 | |
| Money Market Funds | 750,000 | 0 | 750,000 | |
| UK Govt – DMO Deposit/Gilts | 493,475 | 706,525 | 1,200,000 | |
| **Total Internal Investments** | **1,821,125** | **212,687** | **2,033,812** | **5.04%** |
| *Investments in Pooled Funds: | | | | |
| Property | 2,989,907 | -116,662 | 2,873,245 | |
| Bond | 422,379 | 18,484 | 440,863 | |
| Multi Asset | 870,524 | -4,181 | 866,343 | |
| **Total External Funds** | **4,282,810** | **-102,359** | **4,180,451** | **4.90%** |
| **TOTAL INVESTMENTS** | **6,103,935** | **110,328** | **6,214,263** | **4.94%** |

*Funds stated at Fair Value-Issued by Arlingclose

Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

Bank Rate increased by 1% over the period, from 4.25% at the beginning of April 2023 to 5.25% by the end March 2024. Short term rates peaked at 5.7% for 3-month rates and 6.7% for 12-month rates during the period, although these rates subsequently began to decline towards the end of the period. Money Market Rates also rose and were 5.26%. by the end of March 2024.

£4m that is available for longer-term investment is invested in corporate bonds, pooled property & multi-asset funds.

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 2 below, which only includes the Council's internally managed investments.

Table 2: Investment Benchmarking-Treasury investments managed in-house

| | Credit Score | Credit Rating | Bail-in Exposure | Weighted Average Maturity (days) | Rate of Return |
|---|---|---|---|---|---|
| 31.03.2023 | 5.09 | A+ | 73% | 52 | 3.73% |
| 31.03.2024 | 4.23 | AA- | 41% | 16 | 5.04% |
| Similar LAs | 4.96 | A+ | 46% | 67 | 5.34% |
| All LAs | 4.82 | A+ | 61% | 9 | 5.17% |

**Externally Managed Pooled Funds**

£4.18m (£4m book value) of the Authority's investments are held in externally managed strategic pooled funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. In terms of measuring the performance of these funds, the current value is used.

2023/24 was characterised by significant volatility in bond markets. Adjusting to central banks' intention of keeping policy rates unchanged amid persistently higher core inflation, tight labour markets and resilient growth, global bond yields rose (i.e. bond prices fell), the August-October 2023 period being a particularly weak one for bond markets with falling prices negatively impacting credit market sentiment and bond fund performance as well as weighing on multi-asset fund returns. November and December saw a turnaround with a significant fall in US and global bond yields (i.e. bond prices rising), the catalyst being a signal from the US Federal Reserve that it was prepared to cut rates in 2024. The 10-year UK gilt yield, which had increased nearly 1.25% since the beginning of the financial year fell back to 3.44% by the end of December, close to its 1st April level. Thereafter, the first quarter of 2024 proved more difficult for government bonds as stubborn inflation led fixed income markets to question if the expectation of the number of rate cuts over 2024 and the accompanying fall in yields had been overdone.

Strong demand for credit resulted in the tightening of credit spreads which was supportive of high yield corporate bonds and emerging market debt.

By contrast, shrugging off geopolitical concerns, global equities were buoyed by healthy corporate earnings, resilient economic data and moderating inflation and the view that central banks had reached the peak of their rate tightening cycles. A number of indices, including the S&P 500 and Nasdaq, posted record highs driven by AI exuberance. The performance of the S&P 500 was primarily driven by its top seven tech-related mega-cap growth stocks (these securities do not heavily feature in equity income funds). After an initial period of caution due to the likelihood of recession, the UK economy fared better than anticipated with a shallow recession, falling inflation and improved consumer confidence providing support for UK equities, with stocks trading at attractive valuations relative to their global peers. The FTSE All-Share was one of the top performing stock markets in September and December 2023. The total return on the FTSE All Share index for the 12 months ending March 2024 was 8.2%, FTSE 100 was 8.1% and MSCI All World was 25.7%.

The market background for commercial property improved marginally in 2023 and was more stable, in contrast to the very challenging backdrop of 2022. Low transactional volumes were a constraint on valuations and made prospective sellers and buyers more cautious. Although many sectors lacked momentum, there was growing confidence in the longer-term outlook as occupier demand and rental markets held up. Industrial and retail warehousing sectors remained strong, but the retail and offices sectors remained weak, the latter continuing to be hindered by low occupancy from hybrid working practices.

Dividends continued to be received from the Authority's bond, multi-asset and property funds, the payout increasing for all funds in the portfolio.

The change in the Authority's funds' capital values and income earned over the 12-month period is shown in Table 3 below.

Table 3: Strategic Investment Returns – 12 months to 31st March 2024

| Fund Name | Book Value £m | Current Value £ | Capital Growth £ | Dividends Earned £ | Capital Return % | Income Return % | Total Return % |
|---|---|---|---|---|---|---|---|
| CCLA-LAMIT Property Fund | 2.50 | 2,873,245 | -116,662 | 150,525 | -3.90% | 5.03% | 1.13% |
| M & G Strategic Corporate Bond Fund | 0.50 | 440,863 | 18,484 | 20,553 | 4.38% | 4.87% | 9.24% |
| Ninety-One Diversified Income Fund | 1.00 | 866,343 | -4,181 | 40,315 | -0.48% | 4.63% | 4.15% |
| Total | 4.00 | 4,180,451 | -102,359 | 211,393 | -2.39% | 4.94% | 1.60% |

Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's medium- to long-term investment objectives are regularly reviewed. Upon reviewing these investments, the Finance & Governance Committee determined to withdraw 1/5th of the units held in the CCLA LAMIT property fund in preparation of financing the capital programme over the next three financial years. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates.

Due to accounting practices, these funds are currently stated at cost price in the Council's Annual Return, £4m in total, and as such these funds have an overall unrealised gain of £0.18m at 31st March 2024. Two of the funds are showing an unrealised loss. Unrealised capital losses, or gains, will not have an impact on the General Fund until such a time as the Council redeems all or part of the units held in the funds.

## Treasury Performance

The budget for investment income in 2023/24 was £185,000, with actual income of £307,002. This is primarily due to the Council retaining a higher level of reserves than estimated, due to delays in implementing its extensive capital programme, combined with higher interest rates on its short-term investments than forecast. During the year a Treasury Risk Management Reserve was established in order to protect against any potential capital loss impacting the general fund at the point when strategic investments are redeemed. In compliance with the reserve policy, investment income received above budget will be appropriated to the reserve. In 2023/24 this amounted to £122,002.

**ESG policy:** Although the Council has not adopted an Environmental, social and governance (ESG) policy, it is recognised that ESG factors should be considered when placing new investments. The 2023/24 TMISS stated that when investing in banks and funds, the Council will aim to prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code. In 2023/24 all investments held by the Council complied with this assertion.

## Non-Treasury Investments

The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return.

The Council did not invest in non-treasury investments during the year.

## 5. Compliance & Treasury Management Indicators

This report provides members with a summary report of the treasury management activity during 2023/24, having due regard to both the CIPFA Code of Practice and DLUHC Guidance. A prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

The Authority measures and manages its exposures to treasury management risks using the following indicators.

**Security:** The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating 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.

| Credit Risk Indicator | 31.3.24 Actual | 2023/24 Target | Complied? |
|---|---|---|---|
| Portfolio average credit rating | AA- | A | Yes |

**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.

| Liquidity Risk Indicator | 31.3.24 Actual | 2023/24 Target | Complied? |
|---|---|---|---|
| Total cash available within 3 months | £2m | £0.75m | Yes |

The Authority can confirm that during 2023/24 it complied with its **Treasury Management Policy Statement** and **Treasury Management Practices**.