

Finance and Resources Committee

10:00am, Tuesday, 21st November 2023

Treasury Management: Mid-Term Report 2023/24

Executive/routine
Wards

1. Recommendations

- 1.1 It is recommended that the Committee:
 - 1.1.1 notes the mid-year report on Treasury Management for 2023/24; and
 - 1.1.2 refers the report to City of Edinburgh Council for approval and subsequent remit by the City of Edinburgh Council to the Governance Risk and Best Value Committee for scrutiny.

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Treasury Management: Mid-Year Report 2023/24

Treasury Management: Mid-Year Report 2023/24

2. Executive Summary

- 2.1 The purpose of this report is to give an update on Treasury Management activity undertaken in the first half of 2023/24.
- 2.2 In accordance with the Strategy set in March 2023 the Council has completed no borrowing so far this financial year.
- 2.3 The investment return for 2023/24 is outperforming the Fund's benchmark, during a period of increasing interest rates while maintaining the security of the investments as a priority.

3 Background

- 3.1 The Council has adopted the CIPFA Code of Practice on Treasury Management in the Public Sector, and under the code, the mid-year report has been prepared setting out activity undertaken.

4 Main report

4.1 UK Interest Rates

- 4.1.1 During the last six months the major issue to the economy continued to be the elevated level of inflation. However the lower than expected inflation rate at the end of the quarter prompted the Bank of England to keep UK Bank Rate on hold at 5.25% in September after 14 consecutive hikes. Appendix 1 gives a summary of the first six months from the Council's Treasury Advisors

4.2 Debt Management

- 4.2.1 The Council continued to fund its borrowing requirement by reducing its investments with no borrowing undertaken in the first half of the year. Appendix 2 outlines the debt management activity during the period.
- 4.2.2 During the first half of the financial year a total of £8.5m in loans was advanced to Edinburgh Living to allow the purchase of affordable homes built by the Council.

4.3 Investment Out-turn

- 4.3.1 The Council's cash balances are pooled and invested via the Treasury Cash Fund subject to the limits set out in the Treasury Management Policy Statement. Appendix 3 provides detail on the Council's investments.
- 4.3.2 As can also be seen in Appendix 3 Treasury Cash Fund performance has outperformed its benchmark with absolute investment returns increasing due to the increases in UK interest rates.

5 Next Steps

- 5.1 The Treasury Team will continue to operate its Treasury Cash Fund with the aim of out-performing its benchmark and manage the Council's debt portfolio to minimise the cost to the Council while mitigating risk.
- 5.2 The Treasury Team will also continue to review the Council's borrowing requirements, taking into account the significant planned capital investment set out in the ten-year capital plan, and any opportunities that the market presents.

6 Financial impact

- 6.1 The Treasury Cash Fund has generated significant additional income for the Council.
- 6.2 Loan charges associated with the borrowing will be managed within the approved budget.

7 Equality and Poverty Impact

- 7.1 n/a

8 Climate and Nature Emergency Implications

- 8.1 The Council's Treasury Management Policy Statements specify a list of approved investment types, and this list does not include investment in equities (other than in Council companies) or Corporate Bonds (other than issued by financial institutions). As such the Council has no direct or indirect investments in fossil fuel companies.
- 8.2 However, the most recent version of the Treasury Management Code has placed a greater emphasis on ESG issues, suggesting in the Treasury Management Practices that:

"The organisation's credit and counterparty policies should set out its policy and practices relating to environmental, social and governance (ESG) investment considerations. This is a developing area, and it is not implied that the organisation's ESG policy will currently include ESG scoring or other real-time ESG criteria at individual investment level."

- 8.3 As the code notes, ESG within Treasury portfolios is a developing area, and further work on this will be carried out in conjunction with the Council's treasury advisors with the intention of including narrative on responsible investment in the 2024/25 Policy Statement.

9 Risk, policy, compliance, governance and community impact

- 9.1 To support Elected Members in discharging their duties in relation to the Council's Treasury Management activities, it is intended to make some structured training available in advance of the 2024/25 Strategy report.

10 Background reading/external references

- 10.1 n/a

11 Appendices

Appendix 1: Economic Background

Appendix 2: Debt Management Activity

Appendix 3: Investment Out-turn

Appendix 4: Debt outstanding 30th September 2023

Appendix 1

Economic Background

Our Treasury Advisors, Arlingclose, summarised the financial markets and gilt yields over the first six months of the financial year as follows:

UK inflation remained stubbornly high over much the period compared to the US and euro zone, keeping expectations elevated of how much further the Bank of England (BoE) would hike rates compared to the regions. 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 0.2%. 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 data showed the unemployment 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. Adjusting for inflation, pay growth in real terms were positive at 1.2% and 0.6% for total pay and regular pay respectively.

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 largest downward contribution came from food prices. 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 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. As such, while consumer confidence continued

to improve over the period, the GfK measure hit -21 in September, it is likely this will reverse at some point. Higher rates will also impact business and according to S&P/CIPS survey data, the UK manufacturing and services sector contracted during the quarter with all measures scoring under 50, indicating contraction in the sectors.

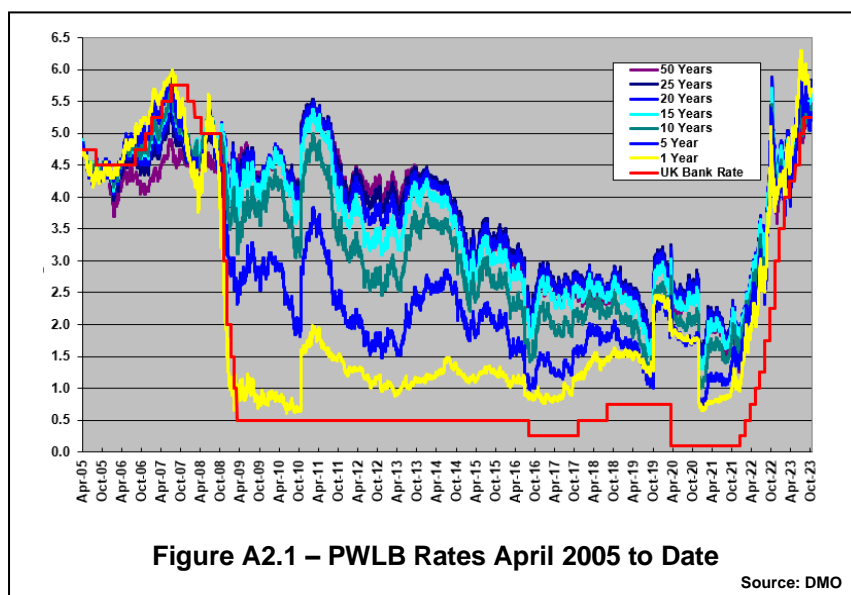
Financial market sentiment and bond yields remained volatile, with the latter generally trending downwards as there were signs inflation, while still high, was moderating and interest rates were at a peak.

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 4.73% over the period.

Appendix 2

Debt Management Activity

Figure A2.1 below shows the PWLB borrowing rates since April 2005.



Borrowing rates have continued to rise as concerns over sustained inflation persisted. The Debt Management Strategy for 2023/24 as outlined in the Strategy Report was to:

- continue to reduce investment balances to temporarily fund capital expenditure; and
- continue to lock out the risk on projects when the timing of capital expenditure becomes certain and if there are any short-term dips in interest rates.

No significant short-term dips were forthcoming in the first half of the financial year. The Council has therefore continued to reduce its investment balances to temporarily fund capital expenditure. While Chart A3.1 shows that the Council still had a significant cash balance at the end of September, it is anticipated that this balance will reduce substantially over the course of the second half of the financial year. While the current strategy can continue for the time being, it is not sustainable beyond this financial year.

During September and October a bank gave notification of an increase to the interest rate payable on two £10m Lender Option Borrower Option (LOBO) Market Loans. The Council exercised its option to repay the loans without penalty.

During the first six months of the financial year, there were three Edinburgh Living settlements. A total of £8.5m in loans was advanced to Edinburgh Living to allow the purchase of affordable homes built by the Council. All of the loans were funded from PWLB Borrowing which had been taken out in March 2022 to mitigate interest rate risk for Edinburgh Living.

Appendix 3

Investment Out-turn

The Council's cash balances are pooled with the sterling cash of Lothian Pension Fund and invested via the Treasury Cash Fund subject to the limits set out in the Cash Fund Treasury Management Policy Statement. Figure A3.1 below shows the daily investment in the Cash Fund since April 2009. The Treasury Management strategy is to ensure that surplus funds are invested in accordance with the list of approved organisations for investment, minimising the risk to the capital sum and optimising the return on these funds consistent with those risks.

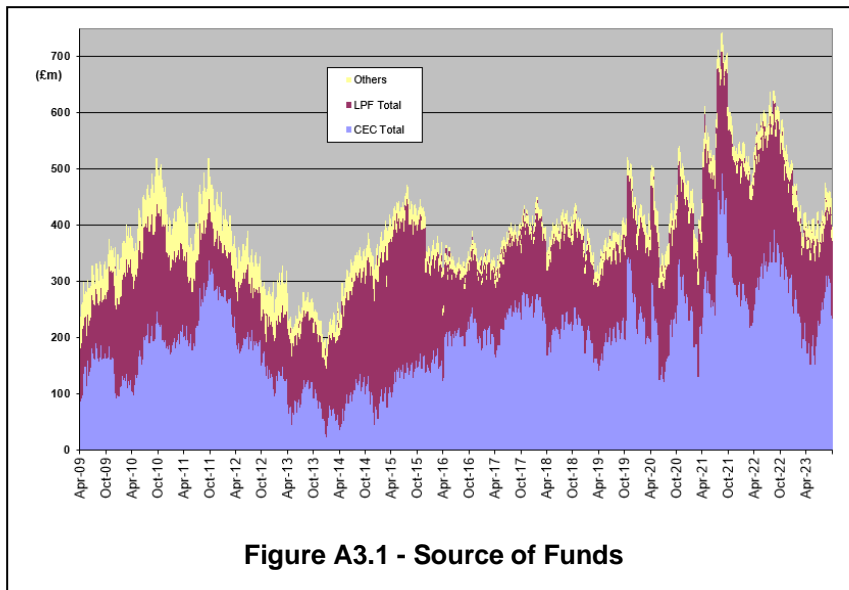
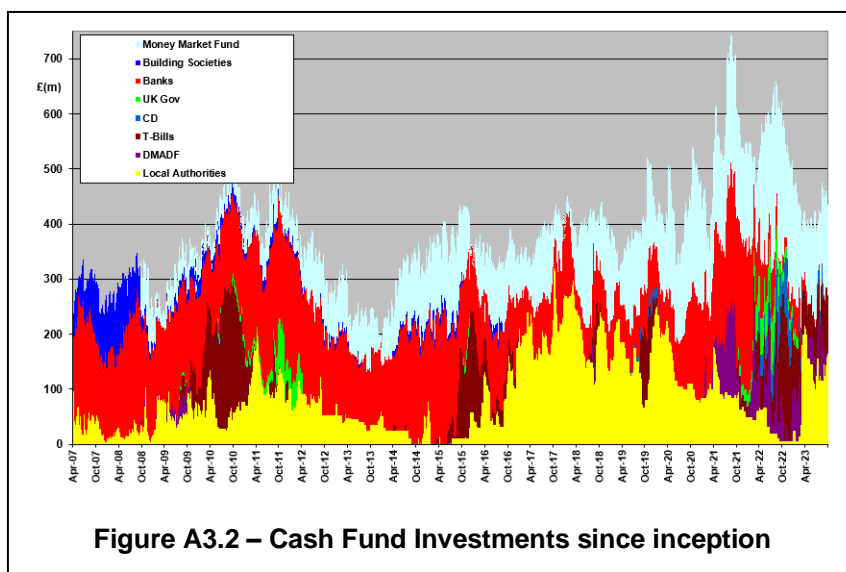
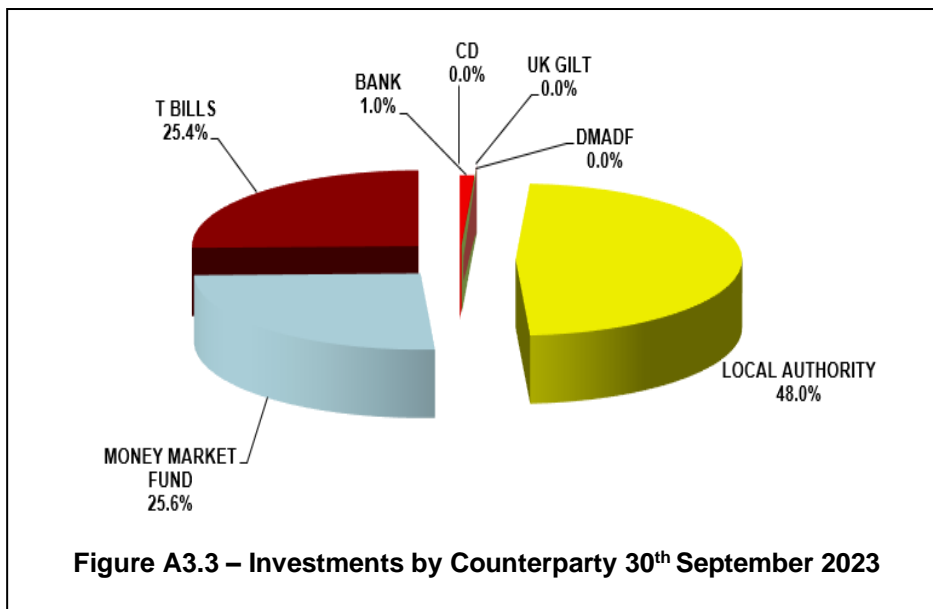


Figure A3.2 shows in detail the distribution on Cash Fund investments since inception in 2007.



This shows that a larger proportion of the Cash Fund was represented by loans to other local authorities than in the previous financial year. This was predominately due to English authorities holding cash relating to COVID support in 2022/23 which had not yet been repaid to the Government. Figure A3.3 shows the Cash Fund investment distribution at the end of September.



At the end of September nearly half of the Cash Fund’s assets were invested in fixed term and notice loans to other local authorities. The interest rate on the notice loans (which had a notice period of between 14 and 35 days) change the day after any decision by the Bank of England’s Monetary Policy Committee’s (MPC) on UK Bank Rate. This has given the Cash Fund a level of protection against the increases in UK Bank Rate.

Figure A3.4 below summarises the investment maturity by sector including distinguishing between Local Authority fixed and notice deposits as well as between Scottish and English Authorities.

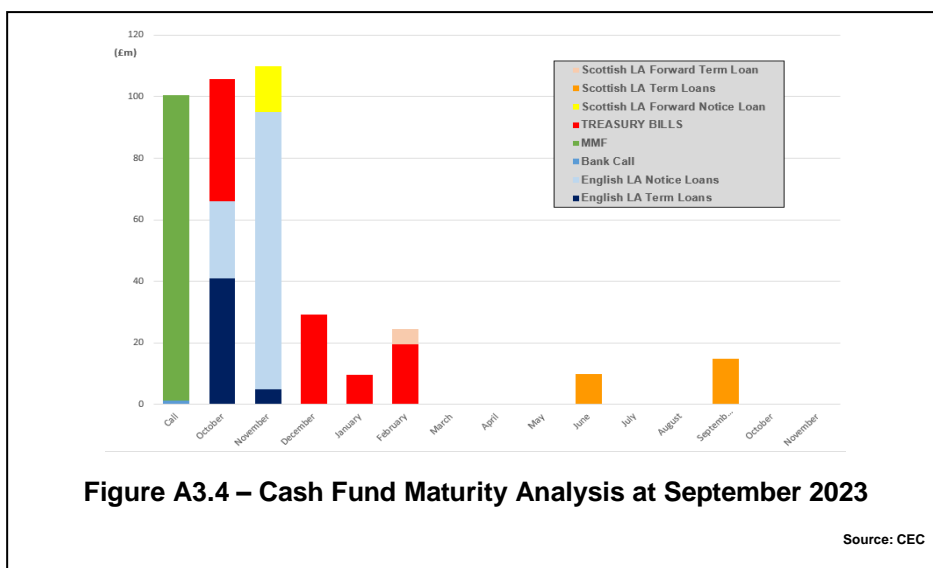


Figure A3.4 – Cash Fund Maturity Analysis at September 2023

Source: CEC

Local Authority Creditworthiness

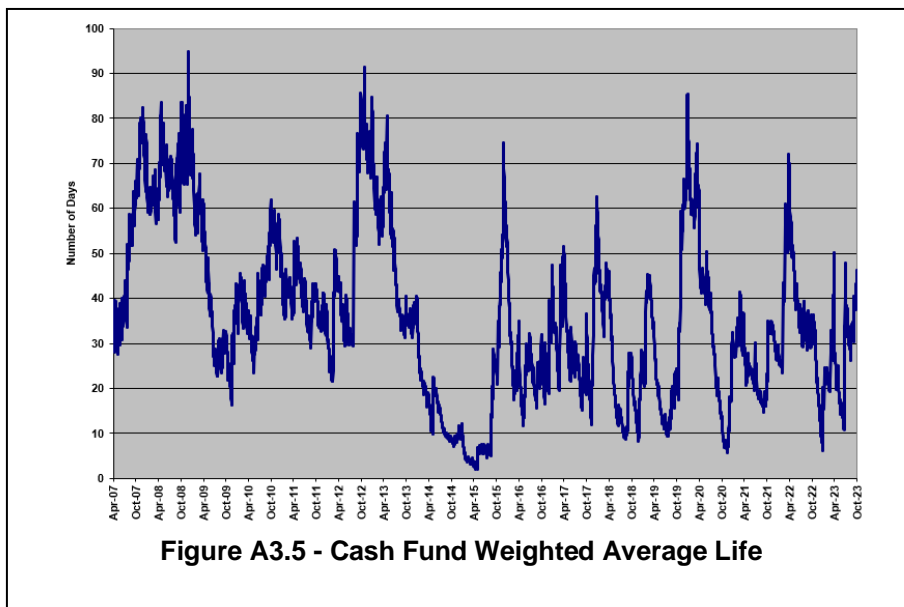
Given that half of the Cash Fund is held with other local authorities and there has been significant press comment around a small number of authorities “effectively going bankrupt”, it is appropriate to review the Council’s view on local authority creditworthiness.

The Council has generally taken the view that investment with another local authority represents pseudo-sovereign investment risk, and in any case the loans are secured against all the revenues of the borrowing authority. Within the investment limits set by Elected Members in the Treasury Management Policy Statements, the actual investments undertaken are further restricted by the Treasury Management Strategy Panel consisting of senior officers in Finance. This has included not lending to local authorities which had significant exposure to commercial investments, particularly commercial properties and other investments outwith their own geographical area purchased to generate an income but funded by borrowing.

Scottish authorities have not made the type of commercial investments which some Councils south of the border have made. That is not to say that Scottish local authorities are not facing significant challenges and funding gaps themselves, but they aren’t caught up in the particular issues relating to commercial investments.

We continue to believe that it is extremely unlikely that a local authority would be allowed to fail or that the Council would lose money lending to any local authority. However, we consider it prudent to be wary of lending to Councils with substantial commercial investments at present.

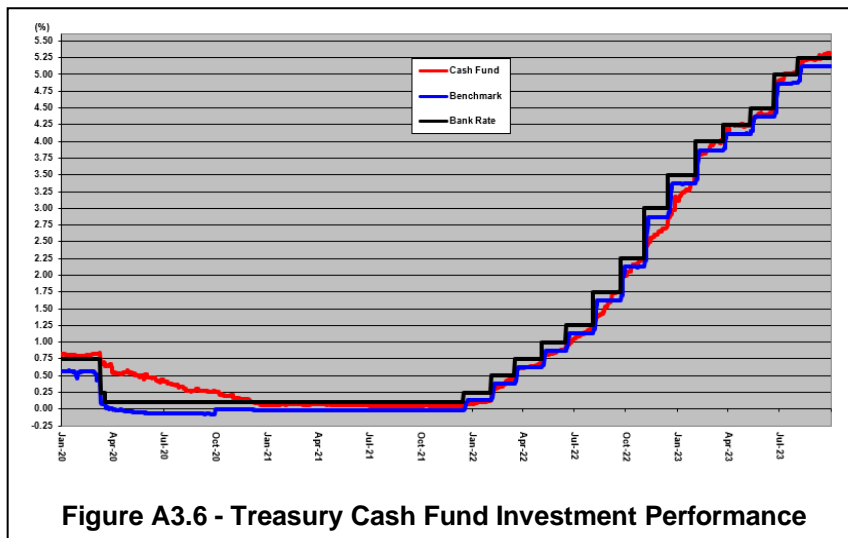
Figure A3.5 shows the weighted average life of the Cash Fund which was 45 days at the end of September.



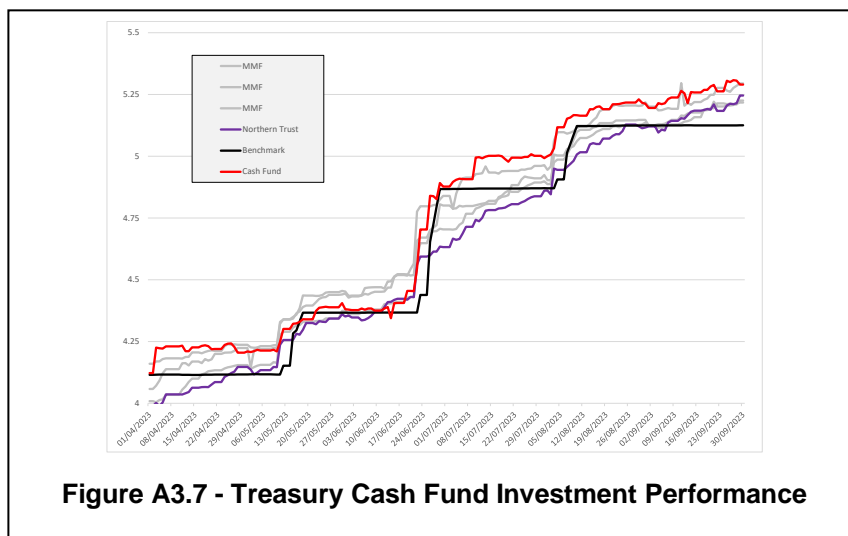
As shown in Figure A3.4 above, the duration added to the portfolio has been taken using UK Government Treasury Bills and loans to other Scottish Local Authorities.

Cash Fund Performance

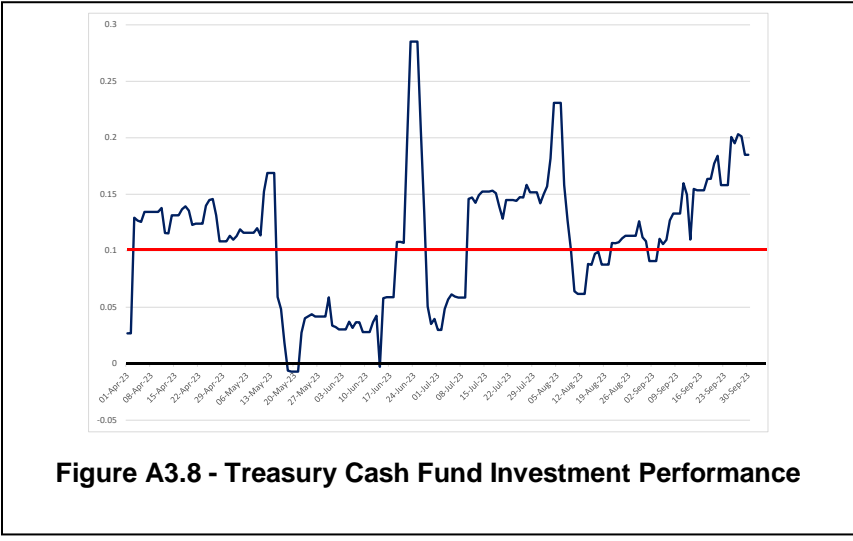
The benchmark set for the Cash Fund is 7-Day Compounded SONIA less 6.25bps. The annualised rate of return for the Cash Fund for the six months to September 2023 was 4.78% against a benchmark return of 4.67%. Figure A3.6 below shows the daily investment performance of the Cash Fund against its benchmark since April 2011. This shows the effect of the 14 consecutive increases of between 0.25% and 0.75% in UK Bank Rate.



To show the performance in the first half of the financial year more clearly, Figure A3.7 below shows the Cash Fund daily return (net of fees) against the three private sector Money Market Funds which the Cash Fund uses for liquidity and the Short-Term Investment Fund from Northern Trust which is the Global Custodian for Lothian Pension Fund.

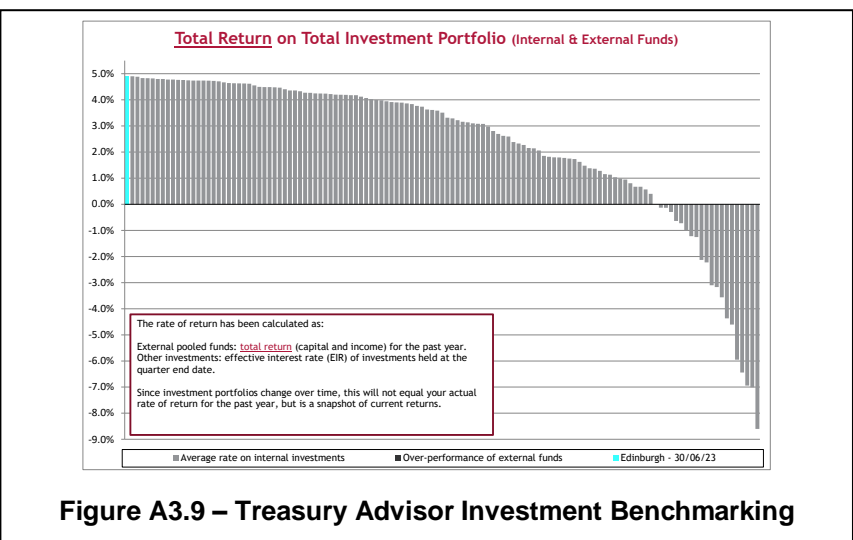


Over the quarter as a whole, this shows very good performance against private sector funds with a similar liquidity requirement. In the Lothian Pension Fund mandate, LPF have set a 10bp outperformance target relative to the benchmark. Figure A3.8 below shows the Cash Fund relative performance against the benchmark with the LPF target highlighted in red.



Over a couple of days in May and June, the Cash Fund has been above benchmark for the whole six months, in spite of three increases in UK Bank Rate, and has been above the LPF performance hurdle for most of the period.

The Council supplies data on its Cash Fund investment to the Council's Treasury Advisors to allow their analysis of the Council's portfolio and performance. The advisors provide a credit analysis at the end of each quarter and Figure A3.9 below shows the investment return at the end of June for their client universe. While it is only a snapshot at the end of the quarter, it does show that the combination of the local authority notice accounts and fixed term duration decisions have been effective.



Appendix 4

Debt outstanding 30th September 2023

Market Debt (non LOBO)

Loan Type	Start Date	Maturity Date	Principal Outstanding (£)	Interest Rate (%)	Annual Interest (£)
M	08/10/2020	08/10/2045	55,596,558.81	2.613	1,464,544.90
M	30/06/2005	30/06/2065	5,000,000.00	4.4	220,000.00
M	07/07/2005	07/07/2065	5,000,000.00	4.4	220,000.00
M	21/12/2005	21/12/2065	5,000,000.00	4.99	249,500.00
M	28/12/2005	24/12/2065	12,500,000.00	4.99	623,750.00
M	14/03/2006	15/03/2066	15,000,000.00	5	750,000.00
M	18/08/2006	18/08/2066	10,000,000.00	5.25	525,000.00
M	01/02/2008	01/02/2078	10,000,000.00	3.95	395,000.00
			118,096,558.81		

Market Debt (LOBO)

Loan Type	Start Date	Maturity Date	Principal Outstanding (£)	Interest Rate (%)	Annual Interest (£)
M	12/11/1998	13/11/2028	3,000,000.00	4.75	142,500.00
M	15/12/2003	15/12/2053	10,000,000.00	5.25	525,000.00
M	18/02/2004	18/02/2054	10,000,000.00	4.54	454,000.00
M	28/04/2005	28/04/2055	12,900,000.00	4.75	612,750.00
M	01/07/2005	01/07/2065	10,000,000.00	3.86	386,000.00
M	24/08/2005	24/08/2065	5,000,000.00	4.4	220,000.00
M	13/09/2005	14/09/2065	5,000,000.00	3.95	197,500.00
M	03/10/2005	05/10/2065	5,000,000.00	4.375	218,750.00
M	23/12/2005	23/12/2065	10,000,000.00	4.75	475,000.00
M	06/03/2006	04/03/2066	5,000,000.00	4.625	231,250.00
M	17/03/2006	17/03/2066	10,000,000.00	5.25	525,000.00
M	03/04/2006	01/04/2066	10,000,000.00	4.875	487,500.00
M	03/04/2006	01/04/2066	10,000,000.00	4.875	487,500.00
M	03/04/2006	01/04/2066	10,000,000.00	4.875	487,500.00
M	07/04/2006	07/04/2066	10,000,000.00	4.75	475,000.00
M	05/06/2006	07/06/2066	20,000,000.00	5.25	1,050,000.00
M	05/06/2006	07/06/2066	16,500,000.00	5.25	866,250.00
			162,400,000.00		

PWLB Loans

Loan Type	Start Date	Maturity Date	Principal Outstanding (£)	Interest Rate (%)	Annual Interest (£)
M	13/10/2009	13/10/2023	5,000,000.00	3.87	193,500.00
M	05/12/1995	15/11/2023	10,000,000.00	8	800,000.00
M	10/05/2010	10/05/2024	10,000,000.00	4.32	432,000.00
M	28/09/1995	28/09/2024	2,895,506.10	8.25	238,879.25
M	14/05/2012	14/11/2024	10,000,000.00	3.36	336,000.00
A	14/12/2009	14/12/2024	1,261,924.56	3.66	46,186.44
M	17/10/1996	25/03/2025	10,000,000.00	7.875	787,500.00
M	10/05/2010	10/05/2025	5,000,000.00	4.37	218,500.00
M	16/11/2012	16/05/2025	20,000,000.00	2.88	576,000.00
M	13/02/1997	18/05/2025	10,000,000.00	7.375	737,500.00
M	20/02/1997	15/11/2025	20,000,000.00	7.375	1,475,000.00
A	01/12/2009	01/12/2025	2,949,808.77	3.64	137,696.63
M	21/12/1995	21/12/2025	2,397,960.97	7.875	188,839.43
M	21/05/1997	15/05/2026	10,000,000.00	7.125	712,500.00
M	28/05/1997	15/05/2026	10,000,000.00	7.25	725,000.00
M	29/08/1997	15/11/2026	5,000,000.00	7	350,000.00
M	24/06/1997	15/11/2026	5,328,077.00	7.125	379,625.49
M	07/08/1997	15/11/2026	15,000,000.00	6.875	1,031,250.00
M	13/10/1997	25/03/2027	10,000,000.00	6.375	637,500.00
M	22/10/1997	25/03/2027	5,000,000.00	6.5	325,000.00
M	13/11/1997	15/05/2027	3,649,966.00	6.5	237,247.79
M	17/11/1997	15/05/2027	5,000,000.00	6.5	325,000.00
M	13/12/2012	13/06/2027	20,000,000.00	3.18	636,000.00
M	12/03/1998	15/11/2027	8,677,693.00	5.875	509,814.46
M	06/09/2010	06/09/2028	10,000,000.00	3.85	385,000.00
M	14/07/2011	14/07/2029	10,000,000.00	4.9	490,000.00
E	14/07/1950	03/03/2030	1,642.80	3	54.97
M	14/07/2011	14/07/2030	10,000,000.00	4.93	493,000.00
E	15/06/1951	15/05/2031	1,874.74	3	61.52
M	06/09/2010	06/09/2031	20,000,000.00	3.95	790,000.00
M	15/12/2011	15/06/2032	10,000,000.00	3.98	398,000.00
M	15/09/2011	15/09/2036	10,000,000.00	4.47	447,000.00
M	22/09/2011	22/09/2036	10,000,000.00	4.49	449,000.00
M	10/12/2007	10/12/2037	10,000,000.00	4.49	449,000.00
M	08/09/2011	08/09/2038	10,000,000.00	4.67	467,000.00
M	15/09/2011	15/09/2039	10,000,000.00	4.52	452,000.00
M	06/10/2011	06/10/2043	20,000,000.00	4.35	870,000.00
M	09/08/2011	09/02/2046	20,000,000.00	4.8	960,000.00
M	23/01/2006	23/07/2046	10,000,000.00	3.7	370,000.00
M	23/01/2006	23/07/2046	10,000,000.00	3.7	370,000.00
M	19/05/2006	19/11/2046	10,000,000.00	4.25	425,000.00
M	07/01/2008	07/01/2048	5,000,000.00	4.4	220,000.00
A	24/03/2020	24/03/2050	13,604,358.63	1.64	228,123.52
A	26/03/2020	26/03/2050	4,524,708.68	1.49	68,965.87

A	26/03/2021	26/03/2051	9,675,888.09	1.75	167,106.12
A	12/07/2021	12/07/2051	37,943,439.35	1.78	689,262.84
M	27/01/2006	27/07/2051	1,250,000.00	3.7	46,250.00
M	16/01/2007	16/07/2052	40,000,000.00	4.25	1,700,000.00
M	30/01/2007	30/07/2052	10,000,000.00	4.35	435,000.00
M	13/02/2007	13/08/2052	20,000,000.00	4.35	870,000.00
M	20/02/2007	20/08/2052	70,000,000.00	4.35	3,045,000.00
M	22/02/2007	22/08/2052	50,000,000.00	4.35	2,175,000.00
M	08/03/2007	08/09/2052	5,000,000.00	4.25	212,500.00
M	30/05/2007	30/11/2052	10,000,000.00	4.6	460,000.00
M	11/06/2007	11/12/2052	15,000,000.00	4.7	705,000.00
M	12/06/2007	12/12/2052	25,000,000.00	4.75	1,187,500.00
M	05/07/2007	05/01/2053	12,000,000.00	4.8	576,000.00
M	25/07/2007	25/01/2053	5,000,000.00	4.65	232,500.00
M	10/08/2007	10/02/2053	5,000,000.00	4.55	227,500.00
M	24/08/2007	24/02/2053	7,500,000.00	4.5	337,500.00
M	13/09/2007	13/03/2053	5,000,000.00	4.5	225,000.00
A	14/10/2019	10/04/2053	102,550,960.14	2.69	2,803,101.59
M	12/10/2007	12/04/2053	5,000,000.00	4.6	230,000.00
A	01/07/2021	01/07/2053	47,712,519.27	1.98	961,887.90
M	05/11/2007	05/05/2057	5,000,000.00	4.6	230,000.00
M	15/08/2008	15/02/2058	5,000,000.00	4.39	219,500.00
A	25/01/2019	25/01/2059	2,550,222.71	2.65	68,434.54
A	11/06/2019	11/06/2059	1,200,888.16	2.23	27,140.99
A	01/10/2019	01/10/2059	1,259,541.15	1.74	22,023.17
A	02/10/2019	02/10/2059	37,529,106.03	1.8	678,786.79
A	05/11/2019	05/11/2059	6,797,754.14	2.96	203,491.86
A	28/11/2019	28/11/2059	1,244,120.01	3.03	38,117.28
A	02/12/2019	02/12/2059	2,678,395.70	3.03	82,060.54
A	20/01/2020	20/01/2060	1,875,696.90	1.77	33,682.44
A	20/01/2020	20/01/2060	436,195.29	2.97	13,101.37
M	04/10/2019	04/04/2060	40,000,000.00	1.69	676,000.00
A	07/12/2021	07/12/2060	18,585,183.33	1.8	339,191.01
M	02/12/2011	02/12/2061	5,000,000.00	3.98	199,000.00
A	07/12/2021	07/12/2061	4,055,939.33	1.79	73,578.23
A	19/05/2022	19/05/2062	3,053,880.63	2.86	88,248.03
A	02/11/2022	02/11/2062	7,964,475.81	4.61	367,981.17
A	24/03/2022	24/03/2063	17,626,817.73	2.65	472,098.73
M	26/03/2020	26/03/2070	10,000,000.00	1.29	129,000.00
M	12/07/2021	12/07/2071	50,000,000.00	1.74	870,000.00
M	23/12/2021	23/12/2071	25,000,000.00	1.45	362,500.00

1,140,784,545.02

SALIX INTEREST FREE

Loan Type	Start Date	Maturity Date	Principal Outstanding (£)	Interest Rate (%)	Annual Interest (£)
Z	22/09/2015	01/10/2023	21,979.97	0.00	0.00
Z	29/03/2019	01/04/2029	83,987.16	0.00	0.00
			105,967.13		