Corporate, Resource Management
& Governance Scrutiny Committee

Meeting: 21 November 2023

TREASURY MANAGEMENT STRATEGY AND ANNUAL INVESTMENT STRATEGY MID-YEAR REVIEW REPORT 2023/24

Report of the Deputy Chief Executive (Section 151 Officer)

1. INTRODUCTION AND PURPOSE OF REPORT

1.1 This report provides Cabinet with a mid-year review of the Council's Treasury Management Strategy Statement and Annual Investment Strategy for 2023/24, approved by Council on 23 February 2023, and has been prepared in accordance with the CIPFA Code of Practice for Treasury Management in the Public Services (revised 2021).

1.2 The Report provides an economic update for the first six months of 2023/24 and details how this impacts upon the interest rate predictions and outlook provided in the initial strategy. An overview is provided of more recent forecasts and developments in the financial markets and how these are affecting the Council's investment portfolio and borrowing strategies for the current financial year. A review is provided of the Council's capital expenditure prudential indicators and compliance with Treasury and Prudential Limits for 2023/24.

1.3 There are no key changes required to the Treasury Management and Capital strategies for 2023/24, which continue to be relevant and effective.

1.4 The report is very detailed and provides a full picture of all the variables and circumstances impacting upon the Council's treasury management operation.

2. BACKGROUND

2.1 Capital Strategy

In December 2021, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. These require all local authorities to prepare a Capital Strategy which is to provide the following:

- A high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- An overview of how the associated risk is managed;
- The implications for future financial sustainability.

The Capital Strategy is reported in a separate report at the same time as the Treasury Management Strategy in the budget setting cycle in February each year.

AGENDA ITEM

2.2 **Treasury Management**

2.2.1 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low-risk counterparties, providing adequate liquidity initially before considering optimising investment return.

2.2.2 The second foremost function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, using cash flow surpluses or on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

2.2.3 Accordingly, treasury management is defined as:
'The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.'

3 CIPFA REQUIREMENTS

3.1 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2021).

3.2 The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by the full Council of an Annual Treasury Management Strategy Statement; including the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year. Quarterly reports are also required for the periods ending April to June and October to December and are assigned to Cabinet/CRMG as deemed appropriate to meet the Treasury Management governance and scrutiny aspects of the Council.)
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Corporate, Resource and Governance Scrutiny Committee (CRMG).

4. MID-YEAR TREASURY MANAGEMENT STRATEGY REVIEW FOR 2023/24

The mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first half of the 2023/24 financial year.
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy.
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators.
- A review of the Council's investment portfolio for 2023/24.
- A review of the Council's borrowing strategy for 2023/24.
- A review of any debt rescheduling undertaken during 2023/24.
- A review of compliance with Treasury and Prudential Limits for 2023/24.
- Information for Members on other prevalent issues.

5. TREASURY MANAGEMENT ADVISORS

6.1 The Council engages the services of Link Asset Services for its Treasury Management Advice contract.

5.2 Link Asset Services works with the Council in delivering a comprehensive range of Treasury Management Advisory Services. The core service includes specific advice in respect of an integrated approach to Treasury Management.

6. SCRUTINY MEMBER TRAINING

6.1 The CIPFA Treasury Management in Public Services Code of Practice places emphasis on the effective management and control of risk as the prime objective of the Council's treasury management activities. The Code also cites the importance of reporting on treasury management strategy and performance and scrutiny of treasury management strategy and policy to a specific named body; the Council has accordingly delegated the role of ensuring effective scrutiny of its Treasury Management Strategy to the Corporate, Resource and Governance Scrutiny Committee.

6.2 In line with the Code, Cabinet and CRMG have received training each year since 2009/10. Further training is being arranged for 20 November 2023 to be timely for Members consideration of the consultation on next year's treasury strategy.

6.3 The session will provide a brief refresher of Members' and Officers' roles and responsibilities within the Treasury Management environment, and how to maintain effective scrutiny of the Treasury Management function. It will update Members on the current global economic position, particularly in the US, Europe and UK and provide up to date interest rate forecasts; possible scenarios for the economy in 2023/24 given current economic indicators and developments in the financial markets. Concentration will particularly be made on new and prevalent issues that will have a major impact on the Council's treasury strategy next year.

7. ECONOMIC UPDATE

7.1 The economic update provided in the following paragraphs relates specifically to the first half of the financial year. At the time of writing, recent global events in the Middle East and the ensuing conflict risks hitting the global economy and driving up energy prices. It is still too early to predict the economic consequences and the potential costs, whether in terms of direct or indirect impact on energy prices, or the level of confidence that economies will continue to display. The effects of the war may result in firms and households becoming less confident and more uncertain about the future and dampen growth further. After recent events, oil rose from below $85 per barrel to more than $93, before falling back a little to $89. European gas prices are up by just over a quarter over the same period, at more than €50 per megawatt hour. These events however occurred after the period to which this report relates. The interest rate forecasts included later in the report are the most up to date to provide Members with a clear picture for the Council's treasury strategy for the second half of the financial year.

7.2 The first half of the 2023/24 financial year saw:

- Interest rates rise by a further 100bps, taking Bank Rate from 4.25% to 5.25% and, possibly, the peak in the tightening cycle.
- Short, medium and long-dated gilts remain elevated as inflation continually surprised to the upside.
- A 0.5% m/m (month over month) decline in real GDP in July, mainly due to more strikes.
- CPI inflation falling from 8.7% in April to 6.7% in August, its lowest rate since February 2022, but still the highest in the G7.
- Core CPI inflation declining to 6.2% in August from 7.1% in April and May, a then 31 years high.
- A cooling in labour market conditions, but no evidence yet that it has led to an easing in wage growth (as the 3myy growth of average earnings rose to 7.8% in August, excluding bonuses).

7.3 The 0.5% m/m fall in GDP in July suggests that underlying growth has lost momentum since earlier in the year. Some of the weakness in July was due to there being almost twice as many working days lost to strikes in July (281,000) than in June (160,000). But with output falling in 10 out of the 17 sectors, there is an air of underlying weakness.

7.4 The fall in the composite PMI[1] from 48.6 in August to 46.8 in September left it at its lowest level since COVID-19 lockdowns reduced activity in January 2021. At face value, it is consistent with the 0.2% (quarter over quarter) q/q rise in real GDP in the period April to June, being followed by a contraction of up to 1% in the second half of 2023.

7.5 The 0.4% m/m rebound in retail sales volumes in August is not as good as it looks as it partly reflected a pickup in sales after the unusually wet weather in July. Sales volumes in August were 0.2% below their level in May, suggesting much of the resilience in retail activity in the first half of the year has faded.

[1] PMI refers to the **Purchasing Managers Index** (PMI) and is a measure of the prevailing direction of economic trends in manufacturing. The PMI is based on a monthly survey of supply chain managers across 19 industries, covering both upstream and downstream activity.

7.6 As the growing drag from higher interest rates intensifies over the next six months, we think the economy will continue to lose momentum and soon fall into a mild recession. Strong labour demand, fast wage growth and government handouts have all supported household incomes over the past year and with CPI inflation past its peak and expected to decline further, the economy has got through the cost-of- living crisis without recession. However even though the worst of the falls in real household disposable incomes are behind us, the phasing out of financial support packages provided by the government during the energy crisis means real incomes are unlikely to grow strongly. Higher interest rates will soon bite harder too. We expect the Bank of England to keep interest rates at the probable peak of 5.25% until the second half of 2024. Mortgage rates are likely to stay above 5.0% for around a year.

7.7 The tightness of the labour market continued to ease, with employment in the three months to July falling by 207,000. The further decline in the number of job vacancies from 1.017m in July to 0.989m in August suggests that the labour market has loosened a bit further since July. That is the first time it has fallen below 1m since July 2021. At 3.0% in July, and likely to have fallen to 2.9% in August, the job vacancy rate is getting closer to 2.5%, which would be consistent with slower wage growth. Meanwhile, the 48,000 decline in the supply of workers in the three months to July offset some of the loosening in the tightness of the labour market. That was due to a 63,000 increase in inactivity in the three months to July as more people left the labour market due to long term sickness or to enter education. The supply of labour is still 0.3% below its pre-pandemic February 2020 level.

7.8 The cooling in labour market conditions still has not fed through to an easing in wage growth. While the monthly rate of earnings growth eased sharply from an upwardly revised +2.2% in June to -0.9% in July, a lot of that was due to the one-off bonus payments for NHS staff in June not being repeated in July. The headline 3myy rate (which is measured as a three-month average of the annual rate) rose from 8.4% (revised up from 8.2%) to 8.5%, which meant UK wage growth remains much faster than in the US and in the Euro-zone. Moreover, while the Bank of England's closely watched measure of regular private sector wage growth eased a touch in July, from 8.2% 3myy in June to 8.1% 3myy, it is still well above the Bank of England's prediction for it to fall to 6.9% in September.

7.9 CPI inflation declined from 6.8% in July to 6.7% in August, the lowest rate since February 2022. The biggest positive surprise was the drop in core CPI inflation, which declined from 6.9% to 6.2%. That reverses all the rise since March and means the gap between the UK and elsewhere has shrunk (US core inflation is 4.4% and in the Euro-zone it is 5.3%). Core goods inflation fell from 5.9% to 5.2% and the further easing in core goods producer price inflation, from 2.2% in July to a 29-month low of 1.5% in August, suggests it will eventually fall close to zero. But the really positive development was the fall in services inflation from 7.4% to 6.8%. That also reverses most of the rise since March and takes it below the forecast of 7.2% the Bank of England published in early August.

7.10 In its latest monetary policy meeting on 20 September, the Bank of England left interest rates unchanged at 5.25%. The weak August CPI inflation release, the recent loosening in the labour market and the downbeat activity surveys appear to have convinced the Bank of England that it has already raised rates far enough. The minutes show the decision was "finely balanced". Five MPC members (Bailey, Broadbent, Dhingra, Pill and Ramsden) voted for no change and the other four (Cunliffe, Greene, Haskel and Mann) voted for a 25bps rise.

7.11 Similarly to the US Fed, the Bank of England wants the markets to believe in the higher for longer narrative. The statement did not say that rates have peaked and once again said if there was evidence of more persistent inflation pressures ‘further tightening in policy would be required’. Governor Bailey stated, ‘we’ll be watching closely to see if further increases are needed’. The Bank also retained the hawkish guidance that rates will stay ‘sufficiently restrictive for sufficiently long’.

7.12 This narrative makes sense as the Bank of England does not want the markets to decide that a peak in rates will be soon followed by rate cuts, which would loosen financial conditions and undermine its attempts to quash inflation. The language also gives the Bank of England the flexibility to respond to new developments. A rebound in services inflation, another surge in wage growth and/or a further leap in oil prices could conceivably force it to raise rates at the next meeting on 2nd November, or even pause in November and raise rates in December.

7.13 The yield on 10-year Gilts fell from a peak of 4.74% on 17th August to 4.44% on 29th September, mainly on the back of investors revising down their interest rate expectations. But even after their recent pullback, the rise in Gilt yields has exceeded the rise in most other Developed Market government yields since the start of the year. Looking forward, once inflation falls back, Gilt yields are set to reduce further. A ‘mild’ recession over the next couple of quarters will support this outlook if it helps to loosen the labour market (higher unemployment/lower wage increases).

7.14 The pound weakened from its cycle high of $1.30 in the middle of July to $1.21 in late September. In the first half of the year, the pound bounced back strongly from the Truss debacle last autumn. That rebound was in large part driven by the substantial shift up in UK interest rate expectations. However, over the past couple of months, interest rate expectations have dropped sharply as inflation started to come down, growth faltered, and the Bank of England called an end to its rising cycle.

7.15 The FTSE 100 has gained more than 2% since the end of August, from around 7,440 on 31st August to 7,608 on 29th September. The rebound has been primarily driven by higher energy prices which boosted the valuations of energy companies. The FTSE 100’s relatively high concentration of energy companies helps to explain why UK equities outperformed both US and Euro-zone equities in September. Nonetheless, as recently as 21st April the FTSE 100 stood at 7,914.

8. INTEREST RATE FORECAST UPDATE

8.1 The Council has appointed Link Group as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. The current interest rate forecast is provided in the table below to September 2026 and is the central forecast for PWLB[2] Certainty Rates[3] (gilt yields plus 80bps - the standard rate minus 20 bps) which have been accessible to most authorities since 1 November 2012.

The latest forecast of 25 September 2023 sets out a view that short, medium and long-dated interest rates will be elevated for some little while, as the Bank of England seeks to squeeze inflation out of the economy.

	Dec 2023%	Mar 2024 %	June 2024 %	Sept 2024 %	Dec 2024 %	Mar 2025 %	June 2025 %	Sept 2025 %	Dec 2025 %	Mar 2026 %	June 2026 %	Sept 2026 %
Bank Rate	5.25%	5.25%	5.25%	5.00%	4.50%	4.00%	3.50%	3.00%	2.75%	2.75%	2.75%	2.75%
3 mth average earnings	5.30%	5.30%	5.30%	5.00%	4.50%	4.00%	3.50%	3.00%	2.80%	2.80%	2.80%	2.80%
6 mth average earnings	5.60%	5.50%	5.40%	5.10%	4.60%	4.10%	3.60%	3.10%	2.90%	2.90%	2.90%	2.90%
12 mth average earnings	5.80%	5.70%	5.50%	5.20%	4.70%	4.20%	3.70%	3.20%	3.00%	3.00%	3.00%	3.00%
5yr PWLB	5.10%	5.00%	4.90%	4.70%	4.40%	4.20%	4.00%	3.90%	3.70%	3.70%	3.60%	3.60%
10yr PWLB	5.00%	4.90%	4.80%	4.60%	4.40%	4.20%	4.00%	3.80%	3.70%	3.60%	3.60%	3.50%
25yr PWLB	5.40%	5.20%	5.10%	4.90%	4.70%	4.40%	4.30%	4.10%	4.00%	3.90%	3.80%	3.80%
50yr PWLB	5.20%	5.00%	4.90%	4.70%	4.50%	4.20%	4.10%	3.90%	3.80%	3.70%	3.60%	3.60%

8.2 The current PWLB and Bank rate forecasts above are substantially higher than the forecasts provided in the initial Treasury Management Strategy in February 2023. The following paragraphs provide an explanation of factors at play that have been influencing borrowing rates in the UK, and how this will impact on forecasts for the remaining six months of the financial year.

8.3 The central forecast for interest rates was previously updated on 26 June and reflected a view that the MPC would be keen to further demonstrate its anti-inflation credentials by delivering a succession of rate increases. Since then, rates have indeed increased to 5.25% but with data suggesting inflation is dipping, albeit slowly, and that the economy is heading for a shallow recession, further monetary policy tightening above 5.25% is not required, at least for now.

8.4 Accordingly, although we anticipate rates staying on hold for the best part of a year, we also still anticipate the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures are behind us, but timing on this will remain one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

8.5 In the upcoming months, forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but also international factors such as policy development in the US and Europe, the provision of fresh support packages to support the faltering recovery in China as well as the on-going conflict between Russia and Ukraine and more recently Israel and Gaza.

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[2] PWLB refers to the Public Works Loan Board. The **PWLB** is a statutory body operating within the United Kingdom Debt Management Office, a Cabinet Agency of HM Treasury. PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments.

[3] The **PWLB certainty rate** is 20 basis points below the standard PWLB borrowing rate (gilt plus 100 basis points) across all loan types and maturities. This is available to Councils who outline their total proposed new long-term borrowing, as well as any borrowing planned to refinance existing loans, and the value of capital expenditure that will be financed by loans.

8.6 On the positive side, consumers are still estimated to be sitting on some excess savings left over from the pandemic, which could cushion some of the impact of the above challenges and may be the reason why the economy is performing somewhat better at this stage of the economic cycle than may have been expected. However, most of those excess savings are held by more affluent people whereas lower income families already spend nearly all their income on essentials such as food, energy and rent/mortgage payments.

8.7 PWLB Rates: Gilt yield curve movements have narrowed, with the short part of the curve seeing yields fall through recent weeks whilst the longer-end continues to reflect inflation concerns. At the time of writing there is <30 basis points difference between the 5- and 50-year parts of the curve.

8.8 The overall balance of risks to economic growth in the UK is to the downside.

9. THE COUNCIL'S CAPITAL POSITION (PRUDENTIAL INDICATORS)

9.1 This part of the report aims to update Members on:

- the Council's capital expenditure plans.
- how these plans are being financed.
- the impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- on compliance with the limits in place for borrowing activity.

Appendix 1 gives a full summary of the Prudential and Treasury indicators at the mid-year point.

9.2 Prudential Indicator for Capital Expenditure

9.2.1 This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed on 23 February 2023.

Capital Expenditure by Portfolio	**2023/24 Original Estimate £m**	**2023/24 Current Estimate £m**
Communities, Culture and Sport	0	0.857
Economy, Regeneration and Housing	108.512	93.216
Finance and Resources	41.411	28.963
Health and Adult Social Care	0.067	0.348
Parks, Highways and Transport Services	38.489	38.009
Total Capital Expenditure	**188.479**	**161.393**
Non HRA	**152.214**	**133.560**
HRA	**36.265**	**27.833**

9.2.2 There has been a net decrease of £27.086m in the 2023/24 Capital Programme since approved in February 2023. Officers regularly review the spending profiles of their capital schemes and schemes have been re-phased from 2023/24 to later years to reflect the latest information, most notably £17.232m in the Schools Estates Capital Programme and £8.432m for HRA New Build Schemes. The reduction in the Programme due to re-phasing has been offset by the addition of new schemes, including £4.283m for the purchase of Adswood Depot Changes in the Capital Programme during the financial year have been reflected in the revised CFR estimates below. As part of the Council's response to the in-year forecast outturn reported at

Quarter 2, Officers are reviewing the Capital Programme to identify capital scheme spending profiles which can be rephased to later year to reduce the cost of borrowing impacted by the current high interest rates. This could result in further rephasing of spending profiles over the second half of the year.

9.3 Changes to Financing of the Capital Programme

9.3.1 The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by the statutory charge to revenue for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	**2023/24 Non HRA Original Estimate £m**	**2023/24 HRA Original Estimate £m**	**2023/24 Total Original Estimate £m**	**2023/24 Non HRA Current Estimate £m**	**2023/24 HRA Current Estimate £m**	**2023/24 Total Current Estimate £m**
Total Capital Expenditure	152.214	36.265	**188.479**	133.560	27.833	**161.393**
Financed By:						
Capital Grants	63.807	9.984	**73.791**	55.527	11.040	**66.567**
Capital Receipts	1.208	1.342	**2550**	1.709	1.342	**3.051**
Capital Contributions	1.192		**1.192**	3.211		**3.211**
Revenue Contribution	1.229	12.940	**16.169**	1.428	12.136	**13.564**
Borrowing Requirement	**84.778**	**11.999**	**96.777**	**71.685**	**3.315**	**75.000**

9.3.2 The Council has set out an ambitious long-term vision for the future of Stockport via its Borough Plan and Council Plan. Much of the investment required is funded by prudential borrowing so there will be a subsequent impact on the Council's prudential indicators, in particular the Capital Financing Requirement (CFR) and Minimum Revenue Provision (MRP). The Council's prudential indicators will be reviewed and updated in line with the capital programme to reflect the investment.

9.4 Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary

9.4.1 The following tables show the CFR, which is the underlying external need to incur borrowing for a capital purpose and the expected debt position over the period. This is termed the Operational Boundary.

Prudential Indicator:

Capital Financing Requirement (CFR)	**2023/24 Original Indicator £m**	**2023/24 Current Indicator £m**
CFR General Fund (Non HRA)	771.456	749.158
CFR HRA	167.942	158.325
Total CFR	**939.398**	**907.483**

<u>Prudential Indicator</u>:

External Debt: Operational Boundary	2023/24 Original Indicator £m	2023/24 Current Indicator £m
Debt	942.300	942.300
Other Long-term Liabilities	13.700	13.700
Total	**956.000**	**956.000**

9.4.2 It should be noted that the CFR measures the Council's underlying need to borrow, i.e. the extent to which forecast capital expenditure has not been funded from resources such as capital receipts, grants etc. As indicated from the above, the CFR is much higher than the Council's actual borrowing, as previously reported it has been a treasury policy over recent years to incur capital expenditure in year, but temporarily fund this from the Council's own cash balances, i.e. balances and reserves, rather than external borrowing; often referred to as Internal Borrowing. The Capital Programme is regularly reviewed and during the first half of 2023/24 many schemes have been rephased to later years. As a result, the revised CFR has decreased during the first half of the year to £907.483m and the impact of this reduction can be seen when comparing the mid-year position to the original gross borrowing estimates and limits below. The level of internal borrowing indicates at some point in the financial year the Council may decide to convert some of this internal borrowing and externally borrow for this capital expenditure. However, at the mid-year point in the financial year, spending on the capital programme is 30.8% and, is lower than expectations.

9.4.3 The Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2023/24 and the following two financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue purposes. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

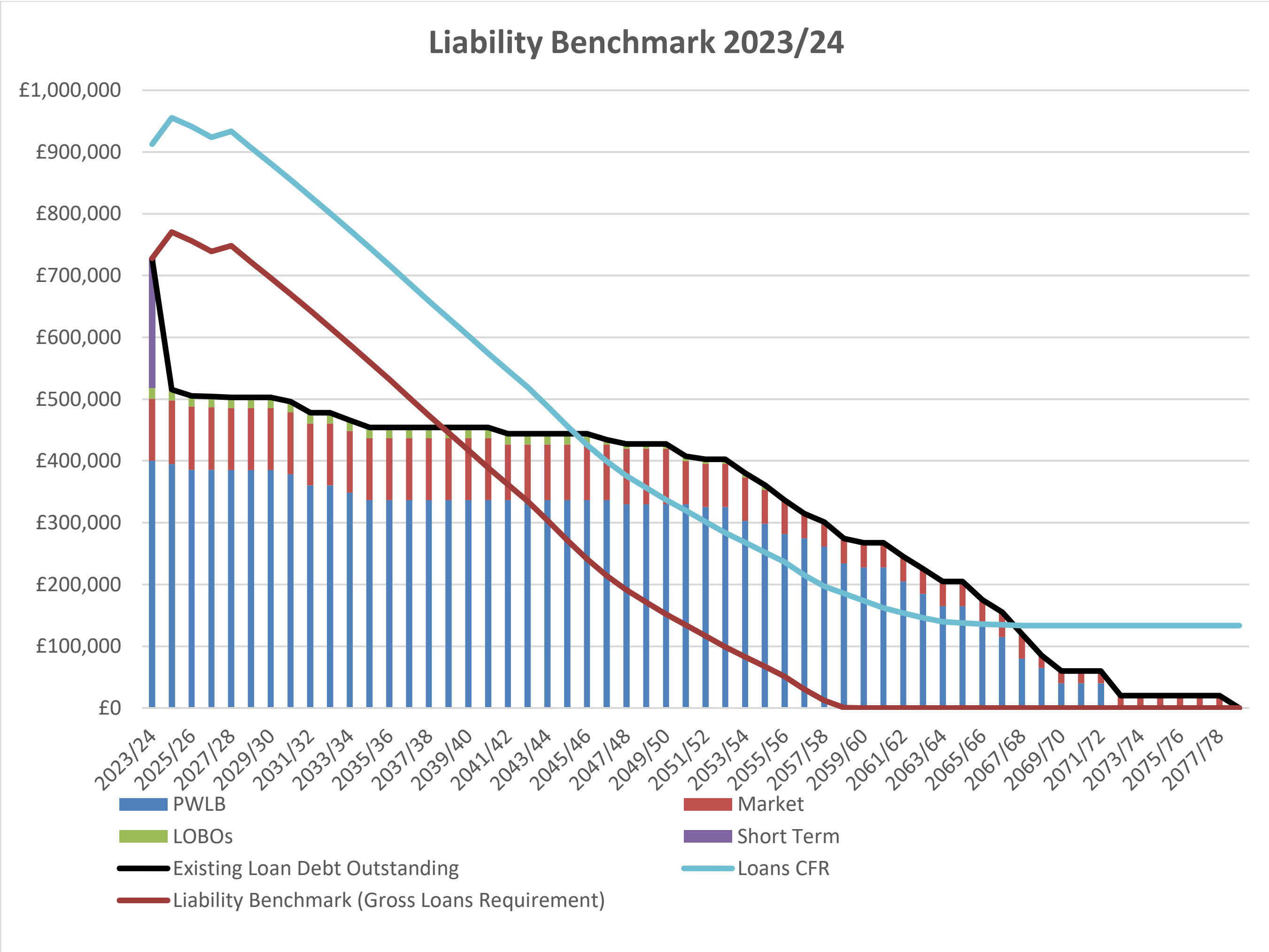
Gross Borrowing and the CFR	2023/24 Original Indicator £m	2023/24 Actual 30.09.23 £m
Gross Borrowing	798.830	696.370
Other Long-term Liabilities	13.700	13.700
Total	**812.530**	**710.070**
CFR	**936.290**	**907.483**

9.4.4 The Deputy Chief Executive (Section 151 Officer), reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

9.4.5 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised Limit and Overall Borrowing	2023/24 Original Indicator £m	2023/24 Current Indicator £m
Borrowing	962.300	962.300
Other Long-term Liabilities	13.700	13.700
Total	**976.000**	**976.000**

9.4.6 The graph below is the Liability Benchmark, which is a new prudential indicator introduced for 2023/24. The Liability Benchmark is a tool to help identify treasury risks. For example, in the earlier years, external loans are less than the liability benchmark so indicate a borrowing requirement. Each year the Council will need to fund its existing debt liabilities, planned prudential borrowing and other cash flows and is therefore exposed to interest rate, liquidity and refinancing risks. Conversely, in later years, the external loans exceed the Liability Benchmark highlighting an overborrowed position, which poses credit, reinvestment and cost of carry risks. The Liability Benchmark is shown at 30 September 2023.



10. TREASURY MANAGEMENT STRATEGY STATEMENT (TMSS) & ANNUAL INVESTMENT STRATEGY (AIS) UPDATE 2023/24

10.1 The Treasury Management Strategy Statement (TMSS) for 2023/24 was approved by this Council on 23 February 2023.

10.2 The underlying TMSS approved previously is still relevant and effective; the only revision required at the mid-year point of the financial year centres around adjusted interest rate forecasts (explained in Section 8) engendered by the current economic situation (given in Section 13) of the report, which will give rise to significant implications for the Council's investment returns and borrowing strategies.

11. TREASURY ACTIVITY 2023/24

11.1 The overall treasury position as at 30 September 2023 is given in the table below.

Treasury Position	Financial Year 2023/24 (2 Pools)				Financial Year 2022/23 (2 Pools)			
	General Fund		HRA		General Fund		HRA	
	£m	%	£m	%	£m	%	£m	%
	as at 30.09.23		as at 30.09.23		as at 31.03.23		as at 31.03.23	
Fixed Rate Funding:								
PWLB	327.024	3.11%	73.126	4.75%	330.975	3.14%	75.494	4.76%
Market (LOBO)	10.942	4.26%	6,558	4.26%	10.942	4.26%	6.558	4.26%
Market (converted LOBOs)	37.517	3.89%	22.483	3.89%	37.517	3.89%	22.483	3.89%
Market (other long-term loans)	40.000	2.33%	0	0%	40.000	2.33%	0	0%
Market (short-term)	135.000	4.95%	0	0%	125.000	2.55%	0	0%
Salix loans	3.700	0%	0	0%	4.365	0%	0	0%
Sub-total	**554.183**		**102.167**		**548.799**		**104.435**	
Variable Rate Funding:								
Market (short-term fixed period)	10.000	5.25%	0	0%	20.000	4.30%	0	0%
Market (short-term)	30.020	5.25%	0	0%	30.020	4.25%	0	0%
Sub-total	**40.020**				**50.020**		**0**	
Total Debt	**594.203**	**3.67%**	**102.167**	**4.53%**	**598.819**	**3.10%**	**104.535**	**4.54%**
Total Investments	**38.775**	**5.66%**	**0**	**0%**	**66.150**	**4.35%**	**0**	**0%**
Net Debt	**555.428**		**102.167**		**532.669**		**104.535**	

Note:

- This table excludes other long-term liabilities included in the tables in 9.4.3.
- Total borrowing has changed between periods from £703.354m to £696.370m, whilst the net treasury position has increased from £637.204m to £657.595m. This is represented by repayment of a maturing PWLB loan of £6.319m, repayment of £0.665m in Salix loans and a reduction in investments of £27.375m
- Temporary investments have reduced between periods and used to finance cashflow shortages where possible and avoid costly short-term borrowing.

12. TREASURY MANAGEMENT STRATEGY STATEMENT (TMSS)

BORROWING STRATEGY

12.1 It is a statutory duty for the Council to determine and keep under review the 'Affordable Borrowing Limits'. Council's approved Prudential Indicators (affordability limits) are outlined in the approved TMSS.

12.2 During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement (TMSS) and in compliance with the Council's Treasury Management Practices.

12.3 The Council's original Borrowing Requirement was £96.777m (excluding MRP). The revised estimate of the 2023/24 borrowing required to support prudential borrowing within the capital programme is circa £75m due to the overall financial position and the underlying need to borrow for capital purposes (the Capital Financing Requirement, CFR). There has been some significant re-phasing of capital schemes during the first six months of the year. Despite this, the borrowing that the Council will actually need will also consider the level of investments held and will be greatly influenced by the amount of capital spending during 2023/24.

12.4 The Council's forecast closing capital financing requirement (CFR) for 2023/24 was £939.398m and this has decreased to £907.483m at this mid-year stage. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The table in 9.4.3 shows the Council's internally borrowed position. This is a prudent and cost-effective approach in the current economic climate but requires on-going monitoring if upside risk to gilt yields prevails.

12.5 The table for PWLB certainty rates below shows for a selection of maturity periods, the range (high and low points) in rates, the average rates, and individual rates over the first six months of the financial year.

	1 Year	5 Years	10 Years	25 Years	50 Years
High	6.36%	5.93%	5.51%	5.73%	5.45%
Date	06.07.23	07.07.23	22.08.23	17.08.23	28.09.23
Low	4.65%	4.14%	4.20%	4.58%	4.27%
Date	06.04.23	06.04.23	06.04.23	06.04.23	05.04.23
Average	5.62%	5.16%	5.01%	5.29%	5.00%
Spread	1.71%	1.79%	1.31%	1.15%	1.18%

12.6 **PWLB maturity certainty rates (gilts plus 80bps) to 30 September 2023**

- Gilt yields and PWLB certainty rates were on a generally rising trend throughout the first half of 2023/24. At the beginning of April, the 5-year rate was the cheapest part of the curve and touched 4.14% whilst the 25-year rate was relatively expensive at 4.58%.

- July saw short-dated rates peak at their most expensive. The 1-year rate peaked at 6.36% and the 5-year rate 5.93%. Although in due course, short-dated rate expectations fell, the medium dates shifted higher through August and the 10-year rate pushed higher to 5.51% and the 25-year rate to 5.73%. The 50-year rate was 4.27% on 5 April but rose to 5.45% on 28 September.

- Rates are forecast to fall back over the next two to three years as inflation dampens. The CPI measure of inflation is expected to fall below 2% in the second half of 2024, and we forecast 50-year rates to stand at 3.90% by the end of September 2025. However, there is considerable gilt issuance to be digested by the market over the next couple of years, as a minimum, so there is a high degree of uncertainty as to whether rates will fall that far.

12.7 The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. As short-term interest rates were lower than long-term rates for many years, it was cost effective for the Council to either use internal resources, or to borrow short-term rather than take long-term borrowing to fully fund its Capital Financing Requirement (CFR). By doing so, the Council was been able to reduce net borrowing costs (and investment income forgone was negligible due to enduring low short-term rates) and reduce overall treasury risk. This is called maintaining an 'internally borrowed position' and using the Council's cash reserves and balances to fund borrowing as a temporary measure. This strategy was prudent for many years as investment returns were low and counterparty risk relatively high, however recent rises in Bank rate mean this position needs to be monitored and regularly reviewed.

12.8 The strategy followed in the first half of 2023/24 has been to continue to borrow shorter-term cash from the market (other councils) and to draw back liquid investments to meet cashflow requirements. Years of maintaining an internal borrowing policy has given rise to the need for more significant temporary borrowing. The Council has not undertaken any long-term borrowing during 2023/24.

12.9 The Council continually assesses how much borrowing may be needed in the short to medium term, taking into account cashflows, level of investments or use of short-term borrowing, use of reserves, and spend on the Capital Programme. The availability and type of borrowing likely to be available is also a key consideration.

12.10 The Council has an extensive three-year Capital Programme for the period 2023/24 to 2025/26. The programme is regularly reviewed and at this mid-year stage, there is a total of £385.449m planned expenditure on capital schemes over the next three years and a significant proportion of this, £161.515m, is to be financed by prudential borrowing.

12.11 The Capital Programme is being kept under regular review due to the effects of inflationary pressures, shortages of materials and labour. The Council's borrowing strategy will, therefore, also be regularly reviewed and then revised, if necessary, in order to achieve optimum value and risk exposure in the long-term.

12.12 The current PWLB rates are set as margins over gilt yields as follows:

- PWLB Standard Rate is gilt plus 100 basis points (G+100bps)
- PWLB Certainty Rate (GF) is gilt plus 80 basis points (G+80bps)
- PWLB Certainty Rate (HRA) is gilt plus 40 basis points (G+40bps)
- Local Infrastructure Rate is gilt plus 60bps (G+60bps)

12.13 The Council expects to continue to borrow short-term from other Council's where appropriate and to avoid long-term borrowing for the remainder of this financial year. Both short-term and long-term interest rates are expected to be relatively high over the next couple of years. As such the Council will look to take short-term borrowing where possible and to avoid fixing higher priced long-term loans until rates start to fall back. If however a shortage of liquidity arises in the short-term markets because either they are oversubscribed and also become expensive, the Council will consider taking short-term loans (1-2 years from the PWLB).

12.14 There will be continued volatility in gilt yields and in turn borrowing rates as markets digest daily developments in the financial markets, release of economic data both domestically and internationally. Any borrowing decision will be considered in light of managing the risk against budgetary factors for capital financing costs.

12.15 The overall longer-run trend is for gilt yields and PWLB rates to fall back over the timeline of our forecasts, as inflation starts to fall through the remainder of 2023 and into 2024. Target borrowing trigger rates have therefore been set **two years forward** on the interest rate forecasts in 8.1 above, so the Council can ideally take long-term funding at cheaper levels during 2025. Target rates are as follows:

PWLB Borrowing	**Current Certainty Rate (25.09.23 PM)**	**Target Borrowing Rate (end Q3 2025)**
5 years	5.05%	3.90%
10 years	5.10%	3.80%
25 years	5.54%	4.10%
50 years	5.30%	3.90%

12.16 The long-term (beyond 10 years) forecast for Bank Rate stands at 2.75%. As all PWLB certainty rates are currently significantly above this level, borrowing strategies will need to be reviewed in that context. Overall, better value can generally be obtained at the shorter end of the curve and short-dated fixed LA to LA monies should be considered. Temporary borrowing rates will remain elevated for some time to come but may prove the best option whilst the market continues to wait for inflation, and therein gilt yields, to drop back later in 2023 and then in 2024.

12.17 The Council's borrowing strategy will be reviewed in the coming months to achieve optimum value in the long-term.

12.18 This Council has not borrowed in advance of need during the first half of the 2023/24 financial year.

13. DEBT RESCHEDULING

13.1 Debt rescheduling opportunities have been very limited in the current economic climate and following the various increases in the margins added to gilt yields which have impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

13.2 However, now that the whole of the yield curve has shifted higher there may be better opportunities in the future, although only prudent and affordable debt rescheduling will be considered.

14. ANNUAL INVESTMENT STRATEGY

INVESTMENT PORTFOLIO

14.1 The Treasury Management Strategy Statement (TMSS) for 2023/24, which includes the Annual Investment Strategy, was approved by the Council on 23 February 2023. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

14.2 The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite.

14.3 In the current economic climate, whilst short-term interest rates are high, it is considered appropriate to keep investments short term to cover cash flow needs (rather than to take pricier temporary borrowing), but also to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

14.3 Counterparty quality and suitable limits remain primary factors when making investment decisions.

14.4 The Council will only extend duration of its investments on a limited basis. Although it is tempting to seek higher returns the Council is a net temporary borrower overall and as such investments are mostly used to manage cashflow shortages. It therefore follows if the Council were to fix out more investments this in turn would mean it would have fewer liquid investments and so would need to also take on more frequent temporary borrowing at a time when rates are rising and with the added cost of brokerage. The Council will therefore look to minimise its borrowing where possible in the second half of the financial year, and to do so by using investment balances.

14.5 Where the Council does fix investments for longer periods it will do so by taking a laddered investment approach. This is a way of allocating portions of the total investment portfolio and staggering maturity dates so that each investment matures at regular intervals and takes advantage of rising rates. This is however quite difficult with so many variables at play, i.e. spend on capital programme.

14.6 **Creditworthiness**
Following the Government's fiscal event on 23 September 2022, both S&P and Fitch placed the UK sovereign debt rating on Negative Outlook, reflecting a downside bias to the current ratings in light of expectations of weaker finances and a challenging economic outlook. Nothing further has evolved in the first half of 2023/24.

14.7 **Investment Counterparty Criteria**
The current investment counterparty criteria selection approved in the TMSS in February 2023 is meeting the requirement of the treasury management

function.

14.8 **CDS Prices**
It is noted that sentiment in the current economic climate can easily shift, so it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances. (CDS prices are market indicators of credit risk).

14.9 **Investment Balances**
The average level of funds available for investment purposes during the first half of 2023/24 was £51.822m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme.

14.10 **Investment Performance**
Investment performance year to date as at 30 September 2023

Combined Investments 2023/24	**Council Performance**			
	Ave Balance Invested £m		**% Return**	**Weighted Time to Maturity (Days)**
	April 2023	£53.266	4.35%	61.32
	May 2023	£53.310	4.41%	44.08
	June 2023	£51.377	4.52%	27.93
Average Q1		**£52.658**	**4.43%**	**44.63**
	July 2023	£52.762	5.21%	70.12
	Aug 2023	£52.181	5.39%	63.43
	Sept 2023	£47.943	5.45%	49.96
Average Q2		**£50.995**	**5.35%**	**61.63**
Average year to date		**£51.822**	**4.88%**	**53.04**

14.11 **Comparable Benchmarks**

- Members will recall that LIBOR rates were discontinued at the end of 2021 and is therefore no longer used as a comparative benchmark rate for the Council's investments.

- The alternative market reference rates for the transition away from the London Interbank Offered Rate (LIBOR) is the Sterling Overnight Index Average (SONIA).

- The Council is using backward-looking SONIA rates which are calculated by compounding actual SONIA rates from the past, rather than future market expectations (alternative rate could be used is Term Sonia rates but these are forward looking). As such, these will be lower in a rising interest rate environment than the forward-looking variants but is felt more appropriate as it is comparing an actual return to what has actually happened.

- The table below shows actual backward-looking SONIA rates for periods out to 12 months. The rates decrease for the longer-duration as they are reflective of the lower market rates and Bank rate that persisted in 2022.

	Bank Rate	SONIA	7 Day	30 Day	90 Day	180 Day	365 Day
High	5.25%	5.19%	5.19%	5.20%	5.12%	4.78%	4.06%
Date	03.08.23	29.09.23	04.09.23	27.09.23	29.09.23	29.09.23	29.09.23
Low	4.25%	4.18%	4.18%	4.02%	3.81%	3.32%	2.27%
Date	03.04.23	04.04.23	11.04.23	03.04.23	03.04.23	03.04.23	03.04.23
Average	4.81%	4.74%	4.71%	4.64%	4.44%	4.10%	3.16%
Spread	1.00%	1.01%	1.01%	1.17%	1.31%	1.46%	1.79%

- As illustrated in the tables above the Council's return for the first half of 2023/24 was 4.88% on an average weighted investment duration of 53.04 days; this outperforms the back-ward looking SONIA average benchmark in all periods.

- The Council has achieved this return largely through careful use of various notice accounts, bank deposits and money market funds. The Council expects to sustain this level of return in the second half of the financial year, however careful planning will be required to maintain a level of liquid investment balances the Council feels is sufficient to counteract any unforeseen liquidity shortages or the need to take expensive short-term, borrowing. This however should not be too high as greater returns could be achieved through fixing investments where possible for longer durations. This should be done in a laddered way so as to take advantage of rising interest rates where possible.

14.12 For 2023/24 the Council's Medium Term Financial Plan and Annual Investment Strategy budgeted for an investment return of 4.40%, assuming an average investment duration of up to three months. This represents the Council's typical investment duration which is predominantly at the short end of the curve and fairly liquid to cater for cashflow needs. This was based on the interest rate forecast in February 2023 which assumed Bank rate would peak at 4.50% by Q2 2023 Bank rate has risen more quickly and steeply than those initial assumptions and the return for 2023/24 therefore requires revising upwards at this stage in the financial year. This is purely based on current expectations for Bank rate and not an expectation that the Council will place significant investments for longer periods than 3 months later in the year.

14.13 Our estimated budgeted earnings rates for investments up to about three months' duration in each financial year are rounded to the nearest 10bps and set out below. You will note that investment earnings have been revised somewhat higher for both 2023/24 and 2024/25 as Bank Rate remains higher for longer. The return was initially amended in the Treasury Management Quarter One Review Report to 5.40% but this has now been reduced slightly as Bank Rate is now thought to have reached its peak (Q1 was forecasting 5.50% by September 2023 rather than 5.25%)

Average Earnings in each year	Target
2023/24	5.30%
2024/25	4.70%
2025/26	3.00%
2026/27	2.80%
2027/28	3.05%
Years 6 to 10	3.05%
Years 10 +	3.05%

14.14 The Deputy Chief Executive (Section 151 Officer), confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2023/24.

15. ESG INVESTMENTS

15.1 ESG Investment Policy

15.1.1 Members will be aware that the revised CIPFA Treasury Management Code in December 2021 required authorities to implement a high level ESG strategy for their Treasury Management investments. The Council has declared a climate emergency however how to translate this into the incorporation of something more formal within the treasury-related investment strategy is not straightforward and the problems with this were comprehensively detailed in the Treasury Management Strategy and Annual Investment Strategy Report for 2023/24.

15.1.2 To remind Members, Environmental, Social, and Governance (ESG) investing refers to a set of standards for an institution’s behaviour used by the Council as a socially conscious investor, to screen potential investments. For an example, Environmental criteria consider how an institution safeguards the environment, including corporate policies addressing climate change, which may be of specific interest to the Council having declared a climate emergency.

15.1.3 The Council’s Treasury Management service will seek to make investments in institutions with high Environmental, Social, and Governance (ESG)

15.2 ESG Investment Criteria

15.2.1 The Council can therefore use environmental, social, and governance (ESG) factors to evaluate the extent to which an institution, and thus, an investment in that institution, impacts in each of the three areas:

- Environmental refers to an institution’s impact on the environment, including its contributions to climate change, carbon footprint, water use, resource conservation, pollutants, and clean technology use.
- Social refers to its relationships with employees, suppliers, customers, and communities, as well as its contributions toward social good, for instance, human rights, diverse hiring practices, workplace safety, labour practices, data security, and employee and community engagement.
- Governance refers to an organisation’s structure, ethics, and management, which include board diversity and independence, executive compensation, transparency and anti-corruption policies, and shareholder rights.

15.2.2 With the growing popularity of incorporating ESG criteria into the decision-making process, the Council will seek accessible and comparable ESG ratings to help better understand an institution’s ESG performance. Only about thirty firms worldwide conduct research to provide comprehensive ESG ratings. Leaders in this space include Morgan Stanley Capital International (MSCI), Sustainalytics, and Thomson Reuters. Although each firm has its own data processing model and classification system.

15.2.3 Once the Council has chosen a metric it is likely to use this across the board, for example, consistently referencing MSCI's ratings, to directly compare institutions' ESG performance and decide which investments to include in the Council's portfolio where possible.

15.2.4 The ESG investment strategy the Treasury Team selects will be dependent on the Council's existing processes and values, as motivations surrounding ESG factors. The Council has a 'Stockport Climate Change Strategy' and has declared a climate emergency, therefore against this backdrop the Treasury Team has determined that it will favour implementing, where possible, Carbon Disclosure Ratings (CPD) to its investments, if this is feasible. However, how the Treasury Team progress towards achieving ESG in their cash and liquidity management strategies/embedding ESG and climate related issues, will not be simple.

15.2.5 Indeed increased focus on corporate sustainability raises the question of how treasury can contribute to sustainability objectives, whilst addressing the need to manage risk and liquidity first. Liquidity management should focus on risk management, as our primary responsibility to Council taxpayers is to aim to preserve capital and provide liquidity rather than delivering a higher risk to return outcome. Our emphasis on prudent risk management will therefore be expanded where possible to incorporate consideration of Environmental, Social and Governance (ESG) factors in our credit assessment through a process of ESG Integration. By incorporating ESG integration in this way, material ESG considerations will become an integral part of our security analysis alongside fundamental financial considerations.

15.2.6 At this point the Treasury Team has determined that its objective will be to report annually on our responsible investment activities and our aim will be the following:

- Material ESG considerations will become an integral part of our risk analysis alongside fundamental financial considerations.

- We will develop ESG ratings for issuers and create sector-specific weightings that reflect the materiality of ESG factors.

15.2.7 At this juncture however the Council has determined that it is too early in the process to apply ESG ratings/metrics and the following paragraphs explain the reasons why.

15.3 **Problems with the immediate implementation of ESG Metrics**

15.3.1 The objective is for the Council to incorporate Environmental, Social and Governance (ESG) considerations into its investment processes, however unlike elements such as credit risk, these are far more subjective and thus require an individual approach to identify and manage as part of an investment strategy. Broad-based 'out of the box' solutions may provide some insight, but these will need finessing to ensure that they are reflective of the Council's views. Furthermore, while the coverage of specific ESG data points is becoming more widespread, like factors such as Credit Default Swaps, coverage is by no means universal. Accordingly, any policy will also need to adopt an approach that can incorporate both 'known' and 'unknown' assessments.

15.3.2 The Financial Conduct Authority (FCA) recently announced a new consultation on a voluntary Code of Conduct for data and rating providers, aimed at increasing transparency and trust in this area. This is being coordinated by the International Regulatory Strategy Group and the International Capital Market Association. The consultation ran until October 2023, with the Code expected to be updated and finalised by the end of 2023. This follows an earlier consultation, conducted by HM Treasury on whether such providers should become encapsulated in the UK's regulatory regime on a formal basis, in the same way that banks and other financial market participants are already.

15.3.3 The voluntary Code of Conduct is there to act as an intermediary phase before the providers of ratings/metrics come under full regulatory oversight. In addition, the FCA also ran a consultation on Sustainability Disclosure Requirements and investment labelling, whose Policy Statement outcome is also expected in the coming months. Note that this focusses on funds and investment products, rather than individual counterparties.

15.3.4 Earlier on in the report it was mentioned that the three main players in the market for ESG ratings are currently Morgan Stanley Capital International (MSCI), Sustainalytics, and Thomson Reuters. This is one of the things that the FCA consultation is looking at; is there enough competition in the market to make it a transparent one or is the level of domination by some players (essentially MSCI and Sustainalytics) just so great as to distort things, thus weighing on the effectiveness and integrity of the data that investors are looking to use. As to what the FCA can do is another matter. However, the strong likelihood is that these entities will come under direct supervision by the FCA and part of this could see them having to spin off some of the advisory operations that they have from the 'rating bits'. Again, the issue here is that not only are there only one or two big players, but they also have advisory operations, so, from the outside, there could be a very significant conflict of interest going on here.

15.3.5 Adding to your list of 'players' there are also each of the credit rating agencies, as well as Bloomberg and then a number of more bespoke operators, who, rather than providing a broad assessment of ESG will focus on specific areas, such as CDP (a CDP score is a snapshot of a company's environmental disclosure and performance Carbon Disclosure Ratings) that would likely be of specific interest to the Council as it aligns to its mandate for climate change.

15.3.6 This also plays into another major area of concern about the whole field, that of transparency, relating to the methodologies that the various bodies use and how they outline their processes to investors, so that said investors can clearly understand what the 'ratings'/'data' actually represents and how it has been compiled. For example, credit ratings are very objective and while there might be some subtle differences between agency assessments, they all pretty much use the same information, assess it in similar ways and, more often than, not, come up with very similar ratings. The rating grading system is also pretty similar across the three major rating agencies, meaning that investors can easily understand how an entity is rated, whether looking at Fitch, Moody's or S&P.

15.3.7 However, ESG is very much more subjective to start with, uses a wealth of potential data options to consider, some of which may, or may not be provided by the entities, and a key issue for regulators is that the providers can (and do) change their methodologies (i.e. the focus) on a relatively regular basis, due to the subjectivity of how an E, S or G risk may impact on the valuation of a company, i.e. are they following market trends, or a more robust, repeatable process. The former is very difficult for an investor to use with any certainty, while the latter (as with credit ratings) is very much not.

15.3.8 The outcome of these consultations, through both this year and next, will potentially change some aspects of ESG 'risks' and reporting. This, therefore, necessitates some caution in the Council's approach in the near-term, especially given that following routes and solutions in their present form may mean the whole process has to be reassessed at some stage in the relatively near future. Nevertheless, while these outcomes add some uncertainty to the process, it does not mean that the Council should ignore ESG factors when formulating their investment strategy for next year and indeed its application now.

15.4 **Current Policy**

15.4.1 As a starting point, it is important that there is full appreciation of what 'ESG' means in wider investment market terms and the potential tools that are available. Primarily, its focus is on exposure and management, i.e., what environmental, social and governance 'risks' a counterparty is exposed to, and how it manages them. These two processes can either be reviewed in isolation or combined to produce some form of 'score' or 'rating'. Importantly, this is different from Socially Responsible Investing, where investors will typically apply negative screens or filters to their investment options, or Sustainable Investing, where investors are looking for investments that will provide sustainable and beneficial societal 'impacts' alongside a financial return. While these elements can be discussed and incorporated into an 'ESG' investment approach, they are potential parts, rather than encompassing the whole requirement.

15.4.2 Moreover, it is important to appreciate that an ESG policy is a corporate-level position that outlines what it means to Stockport MBC, which is then implemented within Treasury. To combine 'responsible treasury management' with effective monitoring, management and reporting of ESG risks is likely to require a combination of red lines and benchmarks. However, this is a very subjective matter, so there is no 'out of the box' solution. As such, the key is understanding where ESG 'risks' lie, how they are represented in current activity, and how they may influence what the Council wishes to do in the future, and what consequences, whether intended, but more importantly, unintended, may materialise from taking different approaches.

15.4.3 This framework requires significant care, so that any policy does not impinge on the primary goal of security. Another important issue is that different facets of an investment portfolio will be more subject to certain types of ESG risk. For example, in day-to-day cashflow operations, the focus will be Governance, as this has the potential for damaging consequences over the short term. As noted in a 2022 Fitch report, out of 950 rated banks, none had environmental factors that were 'credit-relevant', only 20 for social, but 169 for Governance. A more specific example can be seen regarding Royal Bank of Canada, which, according to the most recent Banking on Climate Chaos report, was the world's largest fossil fuel funder in 2022, yet it has an 'environmental' relevance score of just over 1 from Fitch, suggesting that this risk pillar has little relevance to either the sector or the bank specifically. This may be at odds with other facets of what the Council wishes to achieve and why a framework needs both red lines and benchmarks.

15.4.4 It is also important to stress that not every 'good' investment is necessarily a good investment, meaning that security and liquidity considerations must be considered alongside those related to ESG. As such, at present, the focus is on achieving an appropriate framework, with the potential addition of 'ratings' or 'scores' to be incorporated once there is greater clarity on the scope of regulatory changes that are expected to be introduced. Furthermore, as with credit ratings, some ESG providers do offer a limited access to their headline scores for entities. As an interim measure, the Council could look to gather accessible scores and other pertinent research on entities that they consider 'creditworthy' (note , not all entities will be covered) and then update this on a regular basis, so that an ESG score can be used alongside other considerations when we make day-to-day Treasury investment decisions. However, the level of access is limited and the process to gather information would no doubt be significantly time consuming.

15.4.5 As the regulatory backdrop unfolds, Link has stated it will make assessment of all appropriate providers in compiling its own direct-feed service to clients. This is envisaged to encompass both scores, weighted individually to each client's own views, alongside wider research and rationales to allow clients to make more holistic investment decisions across their portfolios.

15.4.6 The Treasury Team will update Members in due course on the outcome of the FCA exercise and the progress it makes towards establishing a clear risk framework in order to select counterparties for ESG investments.

15.4.7 In the meantime, as a starting point, the Council will seek to invest in the following fund, where the investment portfolio and treasury strategy allow.

15.4.8 **Standard Chartered United Nations Sustainable Development Goals Account**

- Standard Chartered have launched a Sustainable Account which enables investors to contribute to sustainable development, while maintaining daily access to their cash.

- Understanding the difficulties that investors face in balancing their liquidity management needs with a commitment to sustainability, the Sustainable Account allows investors the flexibility of an account where they can retain access to their cash for day-to-day liquidity requirements as well as use surplus cash to support the United Nations Sustainable Development Goals (SDGs).

- Cash placed into the Sustainable Account is referenced against projects aligned with the Bank's Green and Sustainable Product Framework. This framework guides what qualifies as 'green' and 'sustainable' and is mapped against the SDGs. Developed with the support of Sustainalytics ratings/metrics, (one of the main providers of environmental, social and governance (ESG) research and ratings detailed earlier in the report. The Treasury Team will be able to see the impact of the Sustainable Finance assets that their deposits are referenced against by referring to the Bank's Sustainable Finance Impact Report.

- The Green and Sustainable Product Framework addresses some of the world's biggest long-term threats, including climate change, financial exclusion and lack of access to healthcare and education. By choosing this account, the Council can play a part in financing progress towards solving some of these challenges.

- This investment will have the same credit rating as if investing directly with Standard Chartered Bank and at the time of writing meets the Council's investment criteria for a maximum 6-month investment duration.

- Deposits can be made in periods from 1 month out.

- Rates earned on the investment are comparable to market rates.

16. OTHER CONSIDERATIONS

16.1 FINANCIAL AND RISK ASSESSMENT CONSIDERATIONS

16.1.1 The financial implications are covered in the body of the report.

16.1.2 There are no further financial and risk considerations arising from the report. This report is produced as a finance report and discusses in detail risk mitigation processes which are at the heart of Treasury Management Policy. Treasury Management Risk Management is the practice of planning for unexpected expenditures. It is primarily about mitigating and avoiding the impact of the changing financial environment on the Council's cash flow objectives.

16.1.3 It is confirmed that the Deputy Section 151 Officer has signed off the financial implications detailed within the report.

16.2 LEGAL CONSIDERATIONS

16.2.1 There are no Legal and Governance implications to consider as a result of the report and recommendations.

16.2.2 The Council will ensure that all its treasury management activities comply with its statutory powers and regulatory requirements. In framing its credit and counterparty policy under Treasury Management Practice (TMP1) *Counterparty credit risk management*, it will ensure that there is evidence of counterparties' powers, authority and compliance in respect of the transactions they may effect with the Council, particularly with regard to duty of care and fees charged.

16.2.3 The Council recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to manage the risk of these impacting adversely on the Council.

16.3 HUMAN RESOURCES IMPACT

16.3.1 There is no impact to the workforce or the workforce of partner organisations as a result of the report and recommendations.

16.3.2 The Council recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills.

16.3.3 The Council will also ensure that Members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and those responsibilities.

16.3.4 The present arrangements, including a knowledge and skills schedule, are detailed in the relevant Treasury Management Practice (TMP). This *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes* (the TM Code) revision for 2021 introduces strengthened requirements for skills and training.

16.4 EQUALITIES IMPACT

16.4.1 A full Equalities Impact Assessment is undertaken as part of the Council's Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Policy report submitted to Council ahead of the forthcoming financial year (in February each year).

16.4.2 This report is a mid-year update on the Treasury Management Strategy Statement for the current financial year.

16.5 ENVIRONMENTAL IMPACT

16.5.1 Part of the revisions to the Treasury Management Code in December 2021, (that will be incorporated into the Council's Treasury Management Policy Statement and Treasury Management Practices (TMPs)), was to provide further clarification of the way the Council is looking to incorporate environmental considerations in the Council's Investment Strategy. This requirement and approach is high level in the 2023/24 Treasury Strategy.

16.5.2 Environmental, Social and Governance (ESG) issues are increasingly significant for investors and investment managers. This is better developed in equity and bond markets than for short-term cash deposits and there is a diversity of market approaches to ESG classification and analysis.

16.5.3 This means that a consistent and developed approach to ESG for the Council in its treasury management dealings is challenging. This report has outlined in detail in Section 15 current considerations, thinking and approach as the Council develops its ESG treasury policy further.

16.5.4 ESG investment policies and treasury management practices will be consistent with the Council's own relevant policies where possible, for example, climate change policies.

17. CONCLUSIONS AND RECOMMENDATIONS

17.1 November will see the publication of the quarterly monetary policy report from the Bank of England, so we will then be somewhat wiser as to what the inflation outlook looks like according to the Bank's analysts and researchers. We have seen in recent publications the Bank is not averse to making sweeping changes to its forecasts, and with oil prices buoyant at $90 per barrel at present, and the ONS due to publish revised GDP data for the period starting Q1 2022, there is always the possibility of sizeable revisions to the assumptions underpinning the Bank's policy decisions.

17.2 Markets have concluded that rates have more than likely peaked at 5.25% although there remains an outside chance of one more increase to come before the tightening cycle is concluded. Interestingly, the markets are also pricing in a rate cut before the end of 2024. That is to be expected in so far as typically the 'terminal rate' remains in situ for some ten months or so before an easing in rates is undertaken.

17.3 While we do not now foresee Bank Rate hitting 5.50%, we do see Bank Rate staying on hold for the best part of a year at 5.25%. However, the pace of any future decreases will very much be determined by the wage and inflation data. We do not think that the MPC will increase Bank Rate above 5.25%, but it is possible.

17.4 Regarding PWLB rates, movement in the short part of the curve is expected to be driven by Bank Rate expectations to a large degree, whilst medium to longer-dated PWLB rates will remain influenced not only by the outlook for inflation, but also by the market's appetite for significant gilt issuance. The overall longer-run trend is for gilt yields and PWLB rates to fall back over the timeline of our forecasts, as inflation starts to fall through the remainder of 2023 and into 2024.

17.5 In addition, the housing market could still have more impact than is currently the case. Whilst household rents continue to increase apace, it is estimated that less than half of households with a mortgage have been subject to a new higher fixed rate. Many households locked into cheap five-year mortgages before the current up-cycle in interest rates and have, therefore, been protected from that significant element of increase in household outgoings. The latest estimates suggest that there are another 500k households whose current fixed term deal are due to expire this year, and a further 1.6m coming to an end by the close of 2024. Thus, the impact of past decisions could have a more sizeable impact on activity as more households face up to an increasingly limited number of (re)mortgage options at likely far greater cost than they have been paying under their current deals.

17.6 The General Election coming into sight on the far horizon (late next year), could see the Government's fiscal policy potentially loosen, at the same time as the Bank's monetary policy is still trying to take momentum out of the economy.

17.7 What happens outside of the UK remains critical to movement in gilt yields as well. The European Central Bank has made it clear that policy tightening is at, or close to, the terminal rate (currently 4%), whilst the US FOMC has held its Bank Rate equivalent in the range of 5.25%-5.5%.

17.8 Borrowing this year has so far been managed through the short-term markets. From a practical standpoint the Council will most probably need to continue to focus on optimising its cashflow forecasts and given the elevated level of rates right across the curve at present, seek to continue to fund either temporarily from local authorities or if that becomes problematic, with short-dated loans from the PWLB. It can be seen from the interest rate forecasts in the report that both short and longer-term rates are somewhat lower over the duration of the forecast. For this reason PWLB trigger rates for external long-term borrowing have been included two years forward in the report. Ideally the Council will look to weather high PWLB rates with short-term loans in the intervening period and then borrow when long-term rates have fallen, however this is very much dependant on liquidity remaining in the short-term markets.

17.9 Nonetheless, if it is felt certainty is paramount within the Council's debt management strategy going forward, perhaps coupled with a desire to fund on a longer-term basis due to the onerous task of continually replacing short-term loans, the Council will look to optimise any longer dated borrowing requirement. At this stage in the financial year however, this is not envisioned.

17.10 In terms of the impact of more expensive borrowing at the current time, during the second half of the financial year, the Council will ideally need to reappraise any capital expenditure plans/profiles, and internally/temporarily borrow if possible for any (re)financing need. The Council will only seek longer dated borrowing options if it is felt absolute certainty of long-term rates is needed and it has been concluded that it is affordable, sustainable and prudent to do so if funded at prevailing rates.

17.11 The Council's investments have been used to manage cashflow and to diminish borrowing need where possible as short-term interest rates have been high and rising in the first half of 2023/24.

17.12 In the second half of 2023/24 the Treasury Team will continue work on introducing ESG criteria to the Councils investment strategy.

17.13 The Council's Treasury Management Strategy remains relevant and effective at the half year point, with no significant changes required other than revisions to interest rate forecasts to reflect the current economic situation.

17.14 Cabinet is asked to recommend the following to the Council meeting:

- Note the report and the treasury activity in the first half of the financial year.
- Note the revised interest rate forecasts for PWLB rates over the short and medium term which will drive the Council's long-term borrowing strategies going forward.

BACKGROUND PAPERS

There are none

Anyone wishing to inspect the above background papers or requiring further information should contact Lorna Soufian on Tel: 0161 474 4026 or by email on lorna.soufian@stockport.gov.uk.

APPENDIX 1

Prudential and Treasury Indicators 2023/24

Capital Indicators

	Budget 2023/24 £M	2023/24 Current/Actual £M
Capital expenditure	188.479	161.393
Capital Financing Requirement (CFR)	939.398	907.483
Annual change in CFR	72.658	44.901
In-year borrowing requirement (excluding MRP)	96.777	75.000
Ratio of financing costs to net revenue stream (non HRA)	9.60%	9.08%
Ratio of financing costs to net revenue stream (HRA)	10.76%	10.82%
Incremental impact of capital investment decisions:		
Increase in council tax (band change) per annum	£45.54	£43.71
Increase in average housing rent per week	£1.38	£0.42

Treasury Indicators

	2023/24 Budget £M	2023/24 Current/ Actual £M
Authorised limit for external debt	976.000	976.000
Operational boundary for external debt	956.000	956.000
Gross external debt	812.530	710.070

Maturity Structure of fixed rate borrowing upper and lower limits

Period	Budget 2023/24 Lower	Budget 2023/24 Upper	Actual 2023/24 30.09.23
Under 12 months	0%	30%	17.8%
12 months to 2 years	0%	20%	3.6%
2 years to 5 years	0%	20%	0.3%
5 years to 10 years	0%	20%	5.2%
10 years to 20 years	0%	20%	3.8%
20 years to 30 years	5%	30%	10.2%
30 years to 40 years	20%	50%	24.7%
40 years to 50 years	20%	50%	26.0%
50 years and above	0%	40%	2.8%

Interest Rate Limits

	2023/24 Budget %	2023/24 Current/ Actual £M
Upper limit of variable interest rates based on gross debt	40%	5.6%

Principal Sums

	2023/24 Budget £M	2023/24 Current/ Actual £M
Upper limit for principal sums invested over 365 days	80	0