Name of decision-maker	DATE
Council	18 September 2024
REPORT/DECISION TITLE	**WARD(S)**
Treasury Management Strategy- 2023-24 Annual review	ALL
CHIEF OFFICER	**CABINET/LEAD MEMBER**
Asad Mushtaq, Executive Director Finance & Digital	Councillor Billy Christie, Cabinet Member Finance and Corporate Services
DECISION CLASSIFICATION	**IS THE FINAL DECISION ON THE RECOMMENDATIONS IN THIS REPORT TO BE MADE AT THIS MEETING?**
Non-exempt Report	Yes

1 Recommendations:

1.1 That Council note the update on the Merton Treasury management activity during 2023-24 and details any difference in activity from the Treasury management strategy approved in March 2023.

2 Purpose of Report and Executive Summary

2.1 The Council undertakes Treasury Management Activities in accordance with the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management, which requires that the Council receives an annual strategy report by 31 March for the year ahead and an annual review report of the previous year by 30 September. This report is the review of Treasury Management annual activities during 2023/24.

3 Links to the Merton Priorities (Borough of Sport/Civic Pride/Sustainable Futures)

3.1 This report relates to the Council's Strategic priorities as follows:

The treasury management activities span across all Merton priorities of

- *Nurturing Civic Pride*
- *Building a Sustainable Future*
- *Borough of Sport*

By ensuring there are sufficient funds are available to make the relevant investments the treasury management and investment helps the Council to achieve the Merton priorities.

4 Introduction and Background

4.1 The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2023/24. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

4.2 During 2023/24 the minimum reporting requirements were that the full Council should receive the following reports: an annual Treasury strategy in advance of the year (Council March 2023) a mid-year (minimum) treasury update report to the Council- November 2023.an annual review following the end of the year describing the activity compared to the strategy (this report) plus monthly Treasury management activity update for the S151/ Deputy S151 officer.

4.3 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING

4.4 The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need: or

- If insufficient financing is available, or a decision is taken not to apply internal resources, the capital expenditure will give rise to a borrowing need.

4.5 The actual capital expenditure forms one of the required prudential indicators. The table below shows the estimated capital expenditure and how this will be financed.

	2023/24 Actual £000s	2024/25 Estimate £000s	2025/26 Estimate £000s	2026/27 Estimate £000s	2027/28 Estimate £000s
Capital Budget	**33,629**	**48,590**	**61,380**	**37,793**	**21,069**
Slippage*	(10,628)	(14,603)	(28,006)	(5,711)	10,311
Leasing Budgets	0	(600)	0	0	0
Total Capital Expenditure	23,001	33,387	33,375	32,082	31,380
Financed by:					
Capital Receipts	1,433	489	28	14	8
Capital Grants & Contributions	14,183	23,689	23,151	18,421	11,181
Capital Reserves	0	0	0	0	0
Revenue Provisions	942	1,480	468	249	192
Other Financing Sources	0	0	0	0	0

Net financing need for the year	**6,444**	**7,728**	**9,728**	**13,399**	**19,999**

THE COUNCIL'S OVERALL BORROWING NEED

4.6 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). As at 31 March 2024 the council was 59% under borrowed. This was due to the Council paying off £51.7m PWLB loans and £15m Market Loans.

4.7 **Gross borrowing and the CFR** – in order to ensure that borrowing levels are prudent over the medium term and is only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2022/23), plus the estimates of any additional capital financing requirement for the current (2023/24) and next two financial years. This essentially means that the council is not borrowing to support revenue expenditure.

Capital Financing Requirement(CFR)	2023/24 Actual £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
Total CFR	156,934	162,964	161,970

4.8 **The authorised limit –** this is the "affordable borrowing limit". Once this has been set, the council does not have the power to borrow above this level. The table below demonstrates that during 2023/24 the Council has maintained gross borrowing within its authorised limit.

Authorised Limit	2023/24 Actual £000s	2024/25 Estimate £000s	2024/25 Estimate £000s	2026/27 Estimate £000s	2024/25 Estimate £000s
Other Long-Term Liabilities	33,487	41,137	35,592	39,150	34,823
Authorised Limit	220,420	234,101	227,563	241,974	246,079

4.9 **The operational boundary –** is the expected borrowing position of the council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

THE COUNCIL'S OVERALL TREASURY POSITION AS AT 31 MARCH 2024

4.10 At the beginning and the end of 2023/24 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

	Balance as at 31 March 2023	Balance as at 31 March 2024
CFR including PFI & lease	171,044	156,934
CFR excluding PFI & lease	145,019	134,299
External Borrowing	108,700	42,000
Over/Under Borrowing	(36,319)	(92,299)

Investment balance as at 31 March 2024

		31-Mar-23	31-Mar-24
Average interest Rate		4.17%	5.37%
Average period		207 days	247 days
Total interest		£4.8m	£14.5m
Balance as at 31 March	Fixed Deposits/ long term investment	£136.8m	£202m
Balance as at 31 March	MMFs	£50m	£17.7m

Debt balance as at 31 March 2024

	31-Mar-23	31-Mar-24
Average interest Rate	5.84%	6.08%
Average period	36 Yrs	11 Yrs
Total interest	£6.1m	£4.17m
Balance as at 31March	£108.7m	£42m

4.11 In 2023-24 interest rates continued to be high, raising to 5.25% in August 2023 and remaining at this rate since then to 31 March 2024. On the 5th January 2023 London Borough of Merton sold its subsidiary company, CHAS 2013 Ltd. The sales proceeds were placed in Money Market Funds and the DMO in the short term.
In June 2023 the council decided to place £87m into long-term government bonds using the CHAS funds previously mentioned. This makes up the £202m investment balance along with £17.7m in the Money Market fund for immediate access.

4.12 With a full year of high interest rates and the extra cash from the proceeds of CHAS being invested in a prudent mix of long-term and short-term instruments Merton enjoyed a huge increase in interest income topping £14.5m against the budget of £6.3m

4.13 As rates continue to be high the Council has been more active in making deposits given the extra cash while still making prudent decisions and always referring to our Treasury Advisors recommended counterparty list. Diversification has been achieved by placing money with the DMO and utilizing our Treasury Advisors own investment portal, Agency Treasury Services (ATS) to place funds with new counterparties.

4.14 In general the Council can use external borrowing to fund its long-term capital expenditure. Members will note Merton has not taken on any new borrowing since 2007.

4.15 In April 2023 the council decided to pay off all its long terms PWLB debts from the one off capital receipt received in Jan 2023. The Council could not pay off the LOBO loans but was able to settle the PWLB loans. Out of £51.7m PWLB loans £38m was paid off in April with the remaining PWLB loans of £13.7m maturing and paid off at the end of 2023/24.

4.16 In addition to the last two PWLB loans maturing on 31 March 2024, two LOBOs were also paid off in the year. Bayerische Landes Bank £5m loan was paid off on the 28 September 2023 when the lender exercised the option to increase the interest rate and by negotiation and mutual agreement £10m Barclays loan was paid off on the 26 March 2024. These actions brough the total debt down to £42m.

Maturity structure of the debt portfolio.	Mar-23 £'000	Mar-23 %	March 2024 £000	Mar-24 %
Under 12 months	13,700	12.6	0	
1year to 2 years	12,500	11.5	0	
2 years to 5 years	4,500	4.1	4,500	10.7
5 years to 10 years	1,000	0.9	0	
10 years to 15 years	11,500	10.6	9,000	21.4
15 years and over	65,500	60.3	28,500	67.9
Total Debt	**108,700**	**100.0**	**42,000**	**100.0**

BORROWING OUTTURN FOR 2023/24

4.17 An analysis of movements at nominal values on loans during the year is shown below:

	Balance at March 2023 £'000	Repaid in 2023/24 £'000	Balance at March 2024 £'000
PWLB	51,700	(51,700)	0
Other loans	57,000	(15,000)	42,000
Total Debt	**108,700**	**(66,700)**	**42,000**

4.18 The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

INVESTMENT OUTTURN FOR 2023/24

4.19 The Council's investment policy is governed by MHCLG/CIPFA guidance, which forms part of the annual investment strategy which was approved by the Council on the 03 March 2023.

4.20 This policy set out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc).

4.21 The Council manages its investments in-house (with advice from Link Asset Services) with the overall objective to balance risk with return and the overriding consideration being given to the security of the available funds.

4.22 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

MARKET UPDATE/FORECAST (as provided by our external advisors Link)

4.23 **UK Economy - March 2024**
Against a backdrop of stubborn inflationary pressures, the Russian invasion of Ukraine, and war in the Middle East, UK interest rates have continued to be volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2023/24. Markets have sought an end to central banks' on-going phase of keeping restrictive monetary policy in place on at least one occasion during 2023/24 but to date only the Swiss National Bank has cut rates and that was at the end of March 2024. UK, EZ and US 10-year yields have all stayed stubbornly high throughout 2023/24. The table below provides a snapshot of the conundrum facing central banks: inflation is easing, albeit gradually, but labour markets remain very tight by historical comparisons, making it an issue of fine judgment as to when rates can be cut.

4.24 The Bank of England sprung no surprises in their March meeting, leaving interest rates at 5.25% for the fifth time in a row and, despite no MPC members no longer voting to raise interest rates, it retained its relatively hawkish guidance. The interest rate was cut down to 5% at the August MPC meeting. The Bank's communications suggest the MPC is gaining confidence that inflation will fall sustainably back to the 2.0% target. However, although the MPC noted that "the restrictive stance of monetary policy is weighing on activity in the real economy, is leading to a looser labour market and is bearing down on inflationary pressures", conversely it noted that key indicators of inflation persistence remain elevated and policy will be "restrictive for sufficiently long" and "restrictive for an extended period". Of course, the UK economy has started to perform a little better in Q1 2024 but is still recovering from a shallow recession through the second half of 2023. Indeed, Q4 2023 saw negative GDP growth of -0.3% while y/y growth was also negative at -0.2%.

4.25 But it was a strange recession. Unemployment is currently sub 4%, against a backdrop of still over 900k of job vacancies, and annual wage inflation is running at above 5%. With gas and electricity price caps falling in April 2024, the CPI measure of inflation - which peaked at 11.1% in October 2022 – is now due to slide below the 2% target rate in April and to remain below that Bank of England benchmark for the next couple of years, according to Capital Economics. The Bank of England still needs some convincing on that score, but upcoming inflation and employment releases will settle that argument shortly. It is noted that core CPI was still a heady 4.5% in February and, ideally, needs to fall further.

4.26 Shoppers largely shrugged off the unusually wet weather in February, whilst rising real household incomes should support retail activity throughout 2024. Furthermore, the impact of higher interest rates on household interest payments is getting close to its peak, even though fixed rate mortgage rates on new loans have shifted up a little since falling close to 4.5% in early 2024.

4.27 From a fiscal perspective, the further cuts to national insurance tax (from April) announced in the March Budget will boost real household disposable income by 0.5 - 1.0%. After real household disposable income rose by 1.9% in 2023, Capital

Economics forecast it will rise by 1.7% in 2024 and by 2.4% in 2025. These rises in real household disposable income, combined with the earlier fading of the drag from previous rises in interest rates, means GDP growth of 0.5% is envisaged in 2024 and 1.5% in 2025. The Bank of England is less optimistic than that, seeing growth struggling to get near 1% over the next two to three years.

4.28 As for equity markets, the FTSE 100 has risen to nearly 8,000 and is now only 1% below the all-time high it reached in February 2023. The modest rise in UK equities in February was driven by strong performances in the cyclical industrials and consumer discretionary sectors, whilst communications and basic materials have fared poorly. Despite its performance, the FTSE 100 is still lagging behind the S&P 500, which has been at an all-time high for several weeks.

USA Economy.

4.29 Despite the markets willing the FOMC to cut rates as soon as June 2024, the continued resilience of the economy, married to sticky inflation, is providing a significant headwind to a change in monetary policy. Markets currently anticipate three rate cuts this calendar year, but two or less would not be out of the question. Currently, policy remains flexible but primarily data driven.

4.30 In addition, the Fed will want to shrink its swollen $16 trillion balance sheet at some point. Just because the $ is the world's foremost reserve currency (China owns over $1 trillion) does not mean the US can continually run a budget deficit. The mix of stubborn inflation and significant treasury issuance is keeping treasury yields high. The 10 year stands at 4.4%. As for inflation, it is currently a little above 3%. The market is not expecting a recession, but whether rates staying high for longer is conducive to a soft landing for the economy is uncertain, hence why the consensus is for rate cuts this year and into 2025…but how many and when?

EZ Economy.

4.31 Although the Euro-zone inflation rate has fallen to 2.4%, the ECB will still be mindful that it has further work to do to dampen inflation expectations. However, with growth steadfastly in the slow lane (GDP flatlined in 2023), a June rate cut from the current 4% looks probable.

5 Available Options

5.1 This report is for information only. The annual investment strategy investment and the investment approach are detailed as part of the Treasury management strategy.

6 Preferred Option

6.1 N/A

7 Reasons for Recommendations

7.1 N/A

8 Consultation Results

8.1 The Annual Report forms part of a regulatory requirement to disclose treasury activity throughout the year along with the mid-year review and the Treasury

Management Strategy (TMS). All 3 reports are produced with advice and guidance taken from the CIPFA code and our treasury advisors, LINK asset management who advise and update us regularly to help produce the reports.

9 Next Steps & Timetable: Communication and Implementation of the Decision

9.1 *NA*

10 Report Appendices

10.1 The following documents are to be published with and form part of the report:

- *None*

11 Background Papers

- *None*

12 Cross-Cutting Issues and Implications and Sign-Off

Issue	Implications	Sign-off
Legal including Human Rights Act	*Paragraph 2.1 of this report covers the legal implications for this report.*	Fabiola Hickson Head of Procurement and Information Governance 12.08.24
Finance and other resources	Financial information is contained throughout this report. No additional financial implications to note.	Ellis Kelly Head of Accountancy 12.08.24
Equalities	*The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act. There is no apparent equality impact on end users.*	Nemashe Sivayogan Head of Treasury & Pensions 09.08.2024
Climate change	*'The decisions recommended in this paper have a remote or low impact on Merton's Climate Strategy & Action Plan adopted by full Council on 18th November 2020.'*	Nemashe Sivayogan Head of Treasury & Pensions 09.08.2024

Issue	Implications	Sign-off
Executive Director	*Clearance/Approval of Report*	Asad Mushtaq 14 .08.2024
Cabinet Member/s	*Clearance/Approval of Report*	Cllr Billy Christie 14.08.2024

REPORT AUTHOR: (Nemashe Sivayogan- Head of Treasury and Pensions)
Tel no. 020 85453461
Email nemshe.sivayogan@merton.gov.uk

This page is intentionally left blank