OPEN REPORT
GOVERNANCE & RESOURCES COMMITTEE

Governance & Resources Committee – 10th October 2024

TREASURY MANAGEMENT OUTTURN REPORT 2023/24

Report Of the Director of Resources

Report Author and Contact Details
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Wards Affected
All

Report Summary
This report summarises Treasury Management activities and the out-turn position against Prudential Indicators for 2023/24. The report shows that activities undertaken in 2023/24 fully complied with the Council's Treasury Management Strategy and that Prudential indicators were within targets.

Recommendations

1. That The Treasury Management Out-turn position for 2023/24 be approved.

2. That the Prudential Indicators contained in Appendix 1 be approved.

List of Appendices

Appendix 1 Prudential Indicators

Background Papers
None

Consideration of report by Council or other committee
No

Council Approval Required
No

Exempt from Press or Public
No

TREASURY MANAGEMENT ANNUAL REPORT FOR 2023/24

1. Introduction

1.1 The Authority has long adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Authority to approve treasury management mid-year and annual reports.

1.2 The Authority's Treasury Management Strategy for 2023/24 was approved at a meeting on 2 March 2023. The Authority has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Authority's treasury management strategy.

1.3 The 2021 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy for 2023/24, complying with CIPFA's requirement, was approved by full Council on 2nd March 2023.

2. External Context

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

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

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

2.4 Having begun the financial year at 4.25%, the Bank of England's Monetary Policy Committee (MPC) increased Bank Rate to 5.25% in August 2023 with a

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

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

2.6 Following this MPC meeting, Arlingclose, the authority's treasury adviser, maintained its central view that 5.25% remains the peak in Bank Rate and that interest rates will most likely start to be cut later in H2 2024. The risks in the short-term are deemed to be to the downside as a rate cut may come sooner than expected, but then more broadly balanced over the medium term. The US Federal Reserve also pushed up rates over the period, reaching a peak range of between 5.25-5.50% in August 2023, where it has stayed since. US policymakers have maintained the relatively dovish stance from the December FOMC meeting and at the meeting in March, economic projections pointed to interest rates being cut by a total of 0.75% in 2024.

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

3. Financial Markets

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

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

4. Credit Review

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

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

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

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

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

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

5. Local Context

5.1 On 31st March 2024, the Authority had net investments of £20.763m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.23 Balance £000	31.3.24 Balance £000
Borrowing CFR	5,690	5,586
External Borrowing	5,450	5,450
Internal (over) borrowing	**240**	**136**
Usable Reserves	(25,527)	(24,685)
Less: Working Capital	3,122	3,922
Net Investments	**(22,405)**	**(20,763)**

5.2 The Authority pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

5.3 The treasury management position at 31st March 2024 and the change during the year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.23 Balance £000	2023/24 Movement £000	31.3.24 Balance £000	31.3.24 Rate %
Total borrowing	**5,450**	**0**	**5,450**	**4.1**
Long-term investments	(875)	23	(852)	
Short-term investments	(2,000)	(7,000)	(9,000)	
Cash and cash equivalents	(19,530)	8,619	(10,911)	
Total investments	**(22,405)**	**1,642**	**(20,763)**	**5.55**
Net Investments	**(16,955)**	**1,642**	**(15,313)**	

5.4 Borrowing Update

At 31st March 2024, the Authority held £5.45m of loans from the Public works Loans Board, the same as the previous year, as part of its strategy for funding previous years' capital programmes.

5.5 CIPFA's Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the Authority. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield unless these loans are for refinancing purposes.

5.6 Borrowing Strategy and Activity

As outlined in the treasury strategy, the Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing lower interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective. The Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

5.7 The cost of short-term borrowing from other local authorities has generally risen with Base Rate over the year. Interest rates peaked at around 7% towards the later part of March 2024 as many authorities required cash at the same time. These rates are expected to fall back to more normal market levels in April 2024.

5.8 Treasury Investment Activity

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

5.9 The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged between £18.2 and £35.1 million due to timing differences between income and expenditure. The investment position is shown in table 3 below.

<u>Table 3: Treasury Investment Position</u>

	31.3.23 Balance	**Net Movement**	**31.3.24 Balance**	**31.3.24 Income**	**31.3.24 Weighted**

	£'000	£'000	£'000	Return %	Average Maturity days
Banks & Building societies (unsecured)	130	(25)	105		
Central Government	4,000	(1,000)	3,000		
Local Authorities	5,000	7,500	12,500		
Money Market Funds	12,400	(8,094)	4,306		
CCLA Property Fund	875	(23)	852		
Total investments	**22,405**	**(1,642)**	**20,763**	**5.55%**	***63 days**

*Weighted average days to maturity across the portfolio. Money Market funds and the Councils operational bank accounts are held for immediate access.

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

5.11 Bank Rate has increased from 4.25% at the beginning of the year to 5.25% at the end of March 2024. Short term rates peaked at 5.7% for 3-month rates and 6.7% for 12-month rates during the period, although these rates subsequently began to decline towards the end of the period.

Table 4: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure*	Weighted Average Maturity (days)	Rate of Return %
31st March 2023	4.71	A+	58%	21	4.04
31st March 2024	5.07	A+	22%	63	5.55
Similar LAs	4.70	A+	61%	50	5.07
All LAs	**4.70**	**A+**	**61%**	**9**	**5.10**

*Bail-in is defined as: Investments that are subject to the risk of a credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.

The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent.

5.12 Externally Managed Pooled Funds – CCLA Property Fund

£1m of the Authority's investments is invested in externally managed strategic pooled funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds generated receipts of £44,128, (5.03% return) in 2023/24.

5.13 The capital value of the property fund has fallen to £852,465. At present a statutory override is in place which in effect means that the valuation loss does not impact upon the budget position of the Authority. The statutory override in in place until 31st March 2025, therefore, the Authority will continue to monitor the position and make appropriate provisions if necessary.

5.14 Interest

Table 5 below shows interest received in 2023/24 compared to the budget and the previous year.

Table 5 - Interest Received Compared to Budget

Financial Year	Original Budget £	Revised Budget £	Actual £	Revised v Actual Variance £	Average portfolio balance £m
2023/23	37,000	37,000	610,961	573,961	30.5
2023/24	237,000	237,000	1,363,308	1,126,308	27

As can be seen from the table above, interest accrued and received in 2023/24 was significantly higher than budget and the previous year. The increase in interest arose from higher rates along with more active treasury management by employees in financial services. The latter included the further diversification in investments, which involved moving away from banks and money market funds and investing for longer periods with other local authorities and central government.

6. Non-Treasury Investments

6.1 The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return.

6.2 Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).

6.3 The authority held £1.594m of such investments in directly owned property. These investments generated £0.1m of investment income for the Authority after taking account of direct costs, representing a rate of return of 6.35%. This is higher than the return earned on treasury investments but reflects the additional risks to the authority of holding such investments.

7. Compliance

7.1 The Director of Resources reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 6 below.

7.2 Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 6 below.

Table 6: Debt Limits

	2023/24 Maximum £000	**31.3.24 Actual £000**	**2023/24 Operational Boundary £000**	**2023/24 Authorised Limit £000**	**Complied?** Yes/No
Borrowing	5,450	5,450	8,000	11,000	Yes
Finance Leases	0	0	1,000	1,000	Yes
Total debt	**5,450**	**5,450**	**9,000**	**12,000**	Yes

7.3 Since the operational boundary is a management tool for in-year monitoring, it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

7.4 Table 7 below provides details of actual investment limits for 2023/24 against the limits in the Treasury Management Strategy.

Table 7: Investment Limits

	2023/24 Max	**31.03.24 Actual**	**2023/24 Limit**	**Complied**
Banks Unsecured per bank (£2m per counterparty)	£0.126	0.007	£2m	✓
Banks – Council's Own banker (Lloyds)	£1.462	0.104	£7m	✓
Local Authorities per Authority Maximum amount in the period in total	£4m per Authority £26m	£4m per Authority £12.5m	£4m	✓
Money Market Funds (per fund)	£4m per fund £12.4m	£4.306	£4m	✓

Maximum amount in the period in total				
UK Government	£9.760m	£3m	Unlim ited	✓
Pooled Funds	£0.852	0.852	£4m	✓

8. Treasury Management Indicators

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

8.2 **Security:** The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	31.3.24 Actual	**2023/24 Target**	**Complied?**
Portfolio average credit rating	A+	A	Yes

8.3 **Liquidity:** The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing / it can borrow each period without giving prior notice.

	31.3.24 Actual	**2023/24 Target**	**Complied?**
Total cash available within 3 months	£12.9	£7m	Yes
Total sum borrowed in past 3 months without prior notice	0	0	Yes

8.5 **Interest Rate Exposures**: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

Interest rate risk indicator	**31.3.24 Actual**	**2023/24 Limit**	**Complied?**
Upper limit on one-year revenue impact of a 1% rise in interest rates	38,671	400,000	Yes

Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	38,671	400,000	Yes

The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at current rates.

8.6 **Maturity Structure of Borrowing:** This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	31.3.24 Actual	**Upper Limit**	**Lower Limit**	**Complied?**
Under 12 months	0	35%	0%	Yes
12 months and within 24 months	0	50%	0%	Yes
24 months and within 5 years	0	65%	0%	Yes
5 years and within 10 years	0	80%	0%	Yes
10 years and above	100%	100%	0%	Yes

8.7 Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

8.8 **Principal Sums Invested for Periods Longer than a year:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2023/24	**2024/24**	**2024/25**
Actual principal invested beyond year end	£1m	£1m	£1m
Limit on principal invested beyond year end	£5m	£5m	£5m
Complied?	Yes	Yes	Yes

9. Financial and Resource Implications

9.1 Interest arising from Treasury investments in 2023/24 was £1,363,308. The budget for the year was set at £237,000, which means that the Authority received £1,126,308 more interest than expected in 2023/24. This additional income was reported to Council in July 2024 in the report on the Provisional Revenue Outturn for 2023/24; it has been transferred to earmarked reserves as part of the overall surplus for 2023/24.

9.2 There are no financial risks arising from the recommendations in this report.

10. Legal Advice and Implications

10.1 This report summarises Treasury Management activities and the out-turn position against Prudential Indicators for 2023/24.

10.2 The report complies with best practice and government guidance on the preparation of the treasury management outturn report, which aims in part, to mitigate financial risk to the Council.

10.3 There are 2 decisions recommended to be taken as set out at the beginning of this report. If decisions are taken in line with the recommendations, the legal risk of those decisions being challenged has been assessed as low.

11. Equalities Implications

11.1 There are no direct equalities issues arising from this report.

12. Climate Change Implications

12.1 No detailed climate change impact assessment is required when reporting outcomes, as this report does. However, it is noted that during 2023/24 the Council held several investments of significant value (see table 3). The potential climate change impacts of investments are complex, and the Council would need external expertise to understand fully the impacts of any investments.

12.2 CIPFA's Treasury Management Code of Practice (2021) acknowledges that the development of policy and practices relating to Environmental, Social and Governance (ESG) investment considerations is a developing area and it is not implied that the organisation's ESG policy will currently include ESG scoring or other real-time ESG criteria at individual investment level

12.3 The Code goes on to say that 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. This means that a consistent and developed approach to ESG for public service organisations is currently difficult.

12.4 There are, however, no universally agreed and accepted definitions or metrics for environmental, social and governance issues. Officers have explored the options available in terms of engaging a partner to assist the Council in conducting due diligence on current investments and considering and selecting funds with one or more specific themes such as climate change and transition, clean/renewable energy, sustainability, impact investing. This work would attract a fee – further details can be provided if required.

13. Risk Management

13.1 Financial and legal risks have been assessed above. Other significant risks are set out in the report.

Report Authorisation

Approvals obtained from:-

	Named Officer	**Date**
Chief Executive	Paul Wilson	30/09/2024
Director of Resources/ S.151 Officer	Karen Henriksen	01/10/2024
Monitoring Officer (or Legal Services Manager)	Kerry France	01/10/2024