CRMG Scrutiny Committee 3 September 2024
Cabinet Meeting 18 September 2024
Council Meeting 1 October 2024

TREASURY MANAGEMENT ANNUAL REPORT 2023/24

Report of the Assistant Director for Finance (Interim Section 151 Officer)

1 INTRODUCTION AND PURPOSE OF REPORT

1.1 The council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and the actual prudential and treasury indicators for 2023/24. This report meets the requirements of both the CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2 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, 23 February 2023);
- a mid-year treasury update report (Council, 11 January 2024);
- an annual report following the year describing the activity compared to the strategy (this report).

1.3 The Treasury Management Annual Report is a backward report looking at the 2023/24 financial year. Treasury Management policies and strategies and the economic landscape has moved on since the close of the 2023/24 financial year. Consideration of this report is therefore recommended in conjunction with the Treasury Management Q1 report for 2023/24 elsewhere on this Agenda.

1.4 The regulatory environment places onus on Members for the review and scrutiny of treasury management policy and activities. This report is 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.

1.5 The council has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Corporate, Resource Management and Governance Scrutiny Committee before they were reported to the full Council. Member training on treasury management issues was undertaken during the year on 21 November 2023 in order to support Members' Scrutiny and Cabinet role.

1.6 During 2023/24, the council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators are found in the main body of the report. The Assistant Director for Finance (Interim Section 151 Officer) confirms that borrowing was only undertaken for

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a capital purpose and the statutory borrowing limit (the authorised limit) was not breached.

1.7 The financial year 2023/24 saw the UK economy emerge from the twin global shocks of the pandemic and Russian invasion of Ukraine into a period of declining inflation but stagnating output. Inflation has receded more quickly than expected and markets now expect a decline in interest rates. This strengthens near-term growth prospects and should enable a faster recovery in living standards from last financial year's record decline. But the medium-term economic outlook remains challenging.

2 TREASURY MANAGEMENT POLICY STATEMENT AND PRACTICES (TMPs)

2.1 The council's Treasury Management Policy Statement and the detailed Treasury Management Practices were last updated and approved by the Council Meeting on 11 January 2024.

2.2 In December 2017, CIPFA issued a revised Treasury Management Code and Cross Sectoral Guidance Notes, and a revised Prudential Code. A particular focus of these revised codes was local authority investments which are not treasury type investments, which consequently would be reported to Members annually in a separate Capital Strategy report.

2.3 In December 2021, CIPFA issued a 2021 revision to the 2017 Treasury Management Code, introducing strengthened requirements for skills and training, and for investments that are not specifically for treasury management purposes, and the Prudential Code.

2.4 Another key introduction of the revised Code was a Liability Benchmark. As a minimum, the council is required to estimate and measure the Liability Benchmark for the forthcoming financial year and the following two financial years. This covers the full existing debt maturity profile and also shows how minimum revenue provision (MRP) and other cash flows affect the council's future debt requirement. The Liability Benchmark was analysed as part of the Annual Treasury Management Strategy for 2023/24 and also for the current financial year, but it is not reported in this outturn report as it is a forward-looking indicator.

2.5 Some of the changes from the revised CIPFA Treasury Management Code in December 2021 established additional requirements for Environmental, Social and Governance (ESG) policies and practices to be incorporated into TMP1, setting out the council's investment considerations in this regard. Members were advised in the Treasury Management Strategy Report for 2023/24 that work was still ongoing in this area, and that incorporating ESG into the council's investment policy needed further consideration. Officers are working through the requirements to incorporate ESG factors into the council's Treasury Management Strategy Statements. At the time of writing this is still under consideration.

2.6 The full Treasury Management Practices (TMPs) and Policy Statement will not be reported due to their length and complexity but will be available to view on request once the review is complete.

3 CAPITAL EXPENDITURE AND FINANCING 2023/24

3.1 The council undertakes capital expenditure on long-term assets. These activities may be financed by either:

- The application of specific capital or revenue resources (capital receipts, capital grants, capital reserves or revenue contributions); and
- Prudential borrowing (in year capital financing requirement).

3.2 The table below set out the original estimate and actual capital expenditure for 2023/24 and illustrates how this was financed compared to the previous financial year.

	2022/23 Actual £m	2023/24 Budget £m	2023/24 Actual £m
General Fund			
GF Capital Expenditure	127.450	152.214	128.113
Resourced by:			
Capital grants	55.382	63.807	51.945
Capital receipts	4.008	1.208	1.546
Capital contributions	4.166	1.192	5.598
Revenue contributions	7.950	1.229	1.147
In year Capital Financing Requirement	**55.944**	**84.778**	**67.877**
HRA			
HRA Capital Expenditure	17.417	36.265	20.407
Resourced by:			
Capital grants	0.519	9.984	3.576
Capital receipts	0.341	1.342	2.083
Capital contributions	0.072	0	0.308
Revenue contributions	13.320	12.940	13.018
In year Capital Financing Requirement	**3.165**	**11.999**	**1.422**

3.3 The decrease in General Fund prudential borrowing from £84.778m in the budget capital programme for 2023/24 to £67.877m at outturn is largely due to a number of re-phased schemes to later years; most notably £14.440m for Schools Estate Capital Schemes.

3.4 There was also a significant decrease in the prudential borrowing in the HRA capital programme, largely in relation to New Build schemes, reducing overall from £11.999m in the budget to £1.422m at outturn.

3.5 The capital financing requirement has increased from £862.582m at the start of the year to £901.509m by 31/03/2024 (illustrated in 4.5 below).

4 BORROWING NEED, PRUDENTIAL AND TREASURY INDICATORS

4.1 The council's underlying need to borrow for capital expenditure is measured through the Capital Financing Requirement (CFR). This figure is a gauge of the council's requirement to take on long term borrowing. The CFR is amortised and charged to revenue over a number of years. The in-year CFR represents 2023/24 capital expenditure (see tables above) which has not yet been paid for by revenue or covered by specific capital cash backed resources, such as specific grants.

4.2 Part of the council's treasury activities is to manage the council's long-term borrowing requirements. The treasury service organises the council's cash position to ensure sufficient cash is available to meet the capital plans and long-term cash flow requirements and balance this with short term day to day cash requirements. Long-term borrowing may be sourced through borrowing from external bodies such as the Government, through the Public Works Loan Board (PWLB) or the money markets, or alternatively utilising temporary cash resources from within the council.

4.3 The General Fund underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets financed through borrowing are broadly charged to revenue over the life of the asset. The council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the General Fund borrowing need. There is no statutory requirement for the council to reduce the HRA CFR.

4.4 The council's 2023/24 MRP Policy ((as required by the former Department of Levelling Up, Housing and Communities (DLUHC) Guidance now known as the Ministry of Housing, Communities & Local Government (MHCLG)) was approved as part of the Treasury Management Strategy Report for 2023/24 on 23 February 2023.

4.5 The council's CFR for the year is shown below and represents a key prudential indicator (this includes leasing schemes on the balance sheet, which increase the council's borrowing need).

Capital Financing Requirement (CFR):	**31.03.23 Actual £m**	**31.03.24 Budget £m**	**31.03.24 Actual £m**
General Fund (GF)			
Opening balance	670.831	710.797	707.572
Add in year CFR (as above)	55.945	84.778	67.877
Less MRP/voluntary MRP	(19.204)	(24.119)	(29.963)
Closing balance	**707.572**	**771.456**	**745.486**
Housing Revenue Account (HRA)			
Opening balance	153.516	155.943	155.010
Add in year CFR (as above)	3.165	11.999	1.421
Less MRP/voluntary MRP	(1.671)		(0.408)
Closing balance	**155.010**	**167.942**	**156.023**
Total CFR	**862.582**	**939.398**	**901.509**

Note: the CFR opening balances (GF and HRA) for the 2023/24 budget differ to the actual closing balances as at 31 March 2023. This is because budget was calculated on estimates in February 2023, prior to the end of the 2022/23 financial year.

4.6 Actual borrowing activity is monitored through the prudential indicators for borrowing and the CFR and by the authorised limit and operational boundary; these are described below.

4.7 **Gross Borrowing and the CFR**: in order to ensure that actual borrowing levels are prudent over the medium term, the council's external borrowing must only be for capital purposes. This essentially means that the council is not borrowing to support revenue expenditure. Gross external borrowing should not therefore, except in the short term, exceed the total of the CFR for 2023/24 plus the estimates of any additional capital financing requirement for the next two financial years. This indicator allows the council some flexibility to borrow in advance of its immediate capital needs in 2023/24. The table below highlights the council's gross borrowing against the CFR. The council has complied with this prudential indicator.

Gross Borrowing and the CFR	**31.03.23 Actual £m**	**31.03.24 Original £m**	**31.03.24 Actual £m**
Gross borrowing	703.353	798.830	730.289
Other long-term liabilities	13.700	13.700	13.700
Total Gross External Debt	**717.054**	**812.530**	**743.989**
CFR	862.582	939.398	901.509

Note: The actual gross external debt as at 31 March 2024 above differs from the total debt figures in the table in 5.2 below as this includes the finance lease for Stockport Exchange Central Multi-Storey Car Park under 'other long-term liabilities'.

4.8 **The authorised limit**: the authorised limit is the 'affordable borrowing limit' required by Section 3 of the Local Government Act 2003; 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.

4.9 **The operational boundary**: 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 is acceptable subject to the authorised limit not being breached. The table below demonstrates that during 2023/24 the council has maintained gross borrowing within its operational boundary.

4.10 **Actual financing costs as a proportion of net revenue stream**: this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2022/23 £m	**2023/24 £m**
Authorised Limit	910.500	976.000
Maximum gross borrowing position during the year	717.054	730.289
Operational Boundary	890.500	956.000
Average gross borrowing position during the year	669.431	697.218
Financing costs as a proportion of net revenue stream: General Fund	7.90%	8.97%
Financing costs as a proportion of net revenue stream: HRA	10.58%	10.04%

4.11 The 2023/24 budget financing costs as a proportion of net revenue stream were:

- General Fund 9.60%
- HRA 10.76%

5 <u>TREASURY POSITION AS AT 31 MARCH 2024</u>

5.1 The council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the summary, and through officer activity detailed in the council's Treasury Management Practices.

5.2 At the beginning and the end of 2023/24 the council's treasury position was as follows:

Treasury Position	Financial Year 2022/23 (2 Pools)				**Financial Year 2023/24 (2 Pools)**			
	General Fund		HRA		**General Fund**		**HRA**	
	£m	%	£m	%	**£m**	**%**	**£m**	**%**
	as at 31.03.23		as at 31.03.23		**as at 31.03.24**		**as at 31.03.24**	
Fixed Rate Funding:								
PWLB	330.975	3.14%	75.494	4.76%	**448.636**	**3.69%**	**71.097**	**4.75%**
Market (LOBO)	10.942	4.26%	6.558	4.26%	**4.690**	**4.95%**	**2.810**	**4.95%**
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)	125.000	2.55%	0	0%	**90.000**	**5.73%**	**0**	**0%**
Market (short-term fixed, variable rate)	20.000	4.30%	0	0%	**0**	**0%**	**0**	**0%**
Market (short-term variable)	30.000	4.25%	0	0%	**10.000**	**5.25%**	**0**	**0%**
Salix loans	4.365	0%	0	0%	**3.036**	**0%**	**0**	**0%**
Sub-total	598.799		104.435		**633.879**		**96.390**	
Variable Rate Funding:								
Market (short-term)	0.020	4.25%	0	0%	**0.020**	**5.25%**	**0**	**0%**
Sub-total	0.020		0		**0.020**		**0**	
Total Debt	598.819	3.10%	104.535	4.54%	**633.899**	**3.92%**	**96.390**	**4.55%**
Total Investments	66.150	4.35%	0	0%	**26.475**	**5.28%**	**0**	**0%**
Net Debt	532.669		104.535		**607.424**		**96.390**	

5.3 Long term borrowing has risen between years due to new 1-year PWLB borrowing of £125m taken in Q4 of 2023/24 detailed in paragraph 9.9 below. £11.736m of maturing PWLB loans were repaid in year. This resulted in General Fund average rate PWLB moving up from 3.14% to 3.69% between periods. Market LOBO loans also decreased due to the repayment of a £10m LOBO in December 2023 detailed in paragraph 9.10 below. Levels of short-term borrowing have moved down by £80m between years largely as a result of conversion to PWLB borrowing in year; the average rate of market short-term borrowing has also moved up and is reflective of a higher Bank rate and consequently short-term rates. Bank rate has been on a rising trend throughout 2023/24 starting the year at 4.25% and ending at 5.25%. Overall net borrowing has risen by £66.610m between years.

5.4 The maturity structure of the debt portfolio was as follows:

Maturity structure of fixed rate borrowing	**2022/23 Original (Max %)**	**31.03.23 Actual**	**Maturity structure of fixed rate borrowing**	**2023/24 Original (Max %)**	**31.03.24 Actual**
Less than 1 year	40%	26.2%	Less than 1 year	30%	25.6%
Between 1 and 2 years	40%	1.4%	Between 1 and 2 years	20%	6.2%
Between 2 and 5 years	40%	0.3%	Between 2 and 5 years	20%	0.2%
Between 5 and 10 years	40%	5.1%	Between 5 and 10 years	20%	6.5%
10 years and above	100%	66.9%	Between 10 and 20 years	20%	2.2%
			Between 20 and 30 years	30%	10.8%
			Between 30 and 40 years	50%	20.9%
			Between 40 and 50 years	50%	24.9%
			50 years and above	40%	2.7%
		100%			100%

5.5 The maturity structure of the investment portfolio was as follows:

Investment Portfolio	31.03.23 Actual £m	2023/24 Original (Max Limit) £m	31.03.24 Actual £m
Less than 365 days	66.150	No limit	26.475
Over 365 days	0	80,000	0
Total	**66.150**		**26.475**

5.6 The exposure to fixed and variable rates was as follows:

Interest Rate Exposure	31.03.23 Actual %	2023/24 Original (Max Limit) %	31.03.24 Actual %
Fixed Rate:			
Gross borrowing (Principal)	93%	100%	98.65%
Variable Rate:			
Gross borrowing (Principal)	7%	40%	1.35%

5.7 The table above illustrates the maximum limits that have been set (in percentage terms) for the council's total borrowing that can be at either fixed or variable interest rates; it then compares these limits to the actual borrowing at fixed and variable rates at the year end.

5.8 The percentage for fixed rate borrowing is set at 100% of the council's loans portfolio, because at certain times in the financial year it would be possible for the council not to have any temporary borrowing at variable rates.

5.9 The maximum limit for variable rate loans is set much lower as it would not be desirable for the council to have too much of its loan portfolio at variable rates, potentially exposing it to an unacceptable level of interest rate refinancing risk if rates should suddenly rise.

6 THE STRATEGY FOR 2023/24

6.1 The expectation for interest rates within the initial Treasury Management Strategy for 2023/24 anticipated that Bank Rate would rise from 4.25% and peak at 4.5% before falling back to 4% by March 2024. At the time it was expected the Monetary Policy Committee (MPC) would be keen to control inflation by delivering a succession of rate increases but further down the road the Bank of England would be keen to loosen monetary policy when the worst of the inflationary pressures are behind us.

6.2 Forecasts for PWLB rates and gilt and treasury yields at the time saw yield curve movements becoming less volatile and PWLB 5 to 50 years Certainty Rates generally in the range of 4.10% to 4.80%. Link viewed the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the elevated inflation outlook.

6.3 Based on these assumptions, the council would aim to maintain an appropriate balance between internal and external borrowing during 2023/24.

6.4 The council would make use of temporary borrowing from the money markets/other local authorities throughout 2023/24 to supplement cashflow fluctuations.

6.5 Target new long-term borrowing rates were set at two-years forward as it was anticipated that longer term rates would have fallen by March 2025.

Term	Target borrowing rate (March 2025)
5 year	3.40%
10 year	3.50%
25 year	3.70%
50 year	3.50%

6.6 In the unlikely event that PWLB borrowing is favoured in 2023/24, trigger rates are illustrated in the table below and represent the lowest forecast rate in each period for each quarter.

Term	Q1	Q2	Q3	Q4
5 year	4.20%	4.10%	4.00%	3.90%
10 year	4.40%	4.30%	4.10%	4.00%
25 year	4.60%	4.50%	4.40%	4.20%
50 year	4.30%	4.20%	4.10%	3.90%

6.7 Investment returns were likely to rise steadily in line with Bank Rate throughout 2023/24. The budgeted return of 4.40% for 2023/24 assumed 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.

6.8 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Assistant Director for Finance (Interim Section 151 Officer), therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks:

- If it had been felt that there was a significant risk of a sharp FALL in long and short-term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

- If it had been felt that there was a significant risk of a much sharper RISE in long and short-term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been reappraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

6.9 What actually transpired during 2023/24 is explained in the following paragraphs of the report.

- By the later stages of the financial year forecasts were for a faster, steeper and more prolonged pace of increase in Bank Rate.

- Gilt yields and, therefore, PWLB rates, were highly volatile and increased significantly.

- Short-term markets became difficult as a lack of liquidity to meet demand saw prices escalate throughout the second half of the financial year. Understandably market participants turned away from raising funding though expensive PWLB loans and sort to fund via short term loans until both short and long terms rates started to fall back.

7 THE ECONOMY AND INTEREST RATES

7.1 **UK.** 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.

7.2 Markets have sought an end to central banks' ongoing 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.

7.3 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.

	UK	**Eurozone**	**USA**
Bank Rate	5.25%	4%	5.25%-5.5%
GDP	-0.3%q/q Q4 (-0.2% y/y)	+0.0%q/q Q4 (0.1%y/y)	2.0% Q1 Annualised
Inflation	3.4%y/y (Feb)	2.4%y/y (Mar)	3.2%y/y (Feb)
Unemployment	3.9% (Jan)	6.4% (Feb)	3.9% (Feb)

7.4 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 contentious guidance. 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'.

7.5 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 year on year (y/y) growth was also negative at 0.2%.

7.6 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 Consumer Price Index (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 hefty 4.5% in February and, ideally, needs to fall further.

7.7 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.

7.8 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.

7.9 As for equity markets, the Financial Times Stock Exchange (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.

7.10 Despite its performance, the FTSE 100 is still lagging behind the Standard & Poor's (S&P) 500, which has been at an all-time high for several weeks.

7.11 **USA.** Despite the markets willing the Federal Open Market Committee (FOMC) to cut rates soon, 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.

7.12 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%.

7.13 As for inflation, at the end of 2023/24 it was a little above 3% (at the time of writing a little below 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.

7.14 **EU.** Although the Euro-zone inflation rate has fallen to 2.4% (in April 2024 and 2.5% by June), the European Central Bank (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), rate cuts look probable.

8 BORROWING RATES IN 2023/24

8.1 PWLB certainty borrowing rates: the table for PWLB maturity rates in 8.10 below shows, for a selection of maturity periods, the range (high and low points) in rates, the average rates and individual rates at the start and the end of the financial year.

8.2 PWLB rates are based on gilt (UK Government bonds) yields through HM Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields. Inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation and the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. Indeed, in recent years many bond yields up to 10 years in the Eurozone turned negative on expectations that the EU would struggle to get growth rates and inflation up from low levels. In addition, there has, at times, been an inversion of bond yields in the US whereby 10-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession.

8.3 However, since early 2022, yields have risen dramatically in all the major developed economies, first as economies opened post Covid19; then because of the inflationary impact of the war in Ukraine in respect of the supply side of many goods. In particular, rising cost pressures from shortages of energy and some food categories have been central to inflation rising rapidly. Furthermore, at present the FOMC, ECB and Bank of England are all being challenged by persistent inflation that is exacerbated by very tight labour markets and high wage increases relative to what central banks believe to be sustainable. Gilt yields have been on a continual rise since the start of 2021, peaking in the autumn of 2023. Currently, yields are broadly range bound between 3.5% and 4.25%.

8.4 At the close of the day on 28 March 2024, all gilt yields from 1 to 50 years were between 3.81% and 4.56%, with the 1 year being the highest and 6-7 years being the lowest yield.

8.5 Regarding PWLB borrowing rates, the various margins attributed to their pricing are as follows:

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

8.6 There is likely to be a fall in gilt yields and PWLB rates across the whole curve over the next one to two years as Bank Rate falls and inflation (on the CPI measure) moves below the Bank of England's 2% target.

8.7 As a general rule, short-dated gilt yields will reflect expected movements in Bank Rate, whilst medium to long dated yields are driven primarily by the inflation outlook.

8.8 The Bank of England is also embarking on a process of Quantitative Tightening. The Bank's original £895bn stock of gilt and corporate bonds will gradually be sold back into the market over several years. The impact this policy will have on the market pricing of gilts, while issuance is markedly increasing, and high in historic terms, is an unknown at the time of writing.

8.9 As a result of the explanations above, during the financial year, the 50-year PWLB target (Certainty) rate for new long-term borrowing changed considerably. For Q1 it was based on initial estimates for PWLB rates for 2023/24 detailed in the Treasury Management Strategy report and rose considerably throughout the financial year as borrowing rates became more and more expensive.

8.10 The table below illustrates the significant spread in rates that actually occurred throughout 2023/24 for periods from 1 year to 50 years, with 50-year PWLB rates hitting 5.74 in October 2023.

PWLB CERTAINTY RATES IN 2023/24					
	1 Year	**5 Year**	**10 Year**	**25 Year**	**50 Year**
Low	4.65%	4.13%	4.20%	4.58%	4.27%
Date	06.04.24	27.12.23	06.04.23	06.04.23	05.04.23
High	6.36%	5.93%	5.53%	5.96%	5.74%
Date	06.07.23	07.07.23	23.10.23	23.10.23	23.10.23
Average	5.54%	4.99%	4.97%	5.34%	5.08%
Spread	1.71%	1.80%	1.33%	1.38%	1.47%

9 BORROWING STRATEGY AND CONTROL OF INTEREST RATE RISK 2023/24

9.1 Borrowing is undertaken to fund net unfinanced capital expenditure and naturally maturing debt and also to maintain cashflow liquidity requirements. Throughout 2023/24, the council maintained an under-borrowed position. Internal borrowing is a treasury management practice whereby the council delays the need to borrow externally by temporarily using cash it holds for other purposes, such as reserves. The council's internal borrowing is a cumulative measure of the potential liabilities from this form of financing at any point in time. This strategy was prudent as although near-term investment rates were equal to, and sometimes higher than, long-term borrowing costs, the latter are expected to fall back through 2024 and 2025 as inflation concerns are dampened. The council has sought to minimise the taking on of long-term borrowing at elevated levels (>4%) and has focused on a policy of internal and temporary borrowing, supplemented by short-dated borrowing (<5 years) as appropriate.

9.2 The council's opening capital financing requirement (CFR) for 2023/24 was £862.582m rising to £901.509m by 31 March 2024. 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 4.7 above shows the council's significantly internally borrowed position (the CFR compared to total gross external debt).

9.3 Whilst the council continued to run with internal borrowing positions during 2023/24, it was also aware of its reliance on internal cash reserves and the availability of short-term loans from other councils.

9.4 The Borrowing Strategy followed in 2023/24 has been to fund net unfinanced capital expenditure and naturally maturing debt by taking shorter term loans from the market (other councils) and to draw back liquid investments to meet cashflow requirements as all borrowing became much more expensive during the year. Years of maintaining an internal borrowing policy has also given rise to the need for more significant temporary borrowing.

9.5 Interest rate forecasts initially suggested further gradual rises in short, medium and longer-term fixed borrowing rates during 2023/24. Bank Rate had initially been forecast to peak at 4.5% but actually peaked at 5.25%. By January it had become clear that inflation was moving down significantly from its 40-year double digit highs, and the Bank of England signalled in March 2024 that the next move in Bank Rate would be down, so long as upcoming inflation and employment data underpinned that view. Currently the CPI measure of inflation stands at 3.4% but is expected to fall materially below 2% over the summer months and to stay there in 2025 and 2026. Nonetheless, there remains significant risks to that central forecast, mainly in the form of a very tight labour market putting upward pressure on wages and continuing geopolitical inflationary risks proceeding from the prevailing Middle East crisis and the Russian invasion of Ukraine.

9.6 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 of each type of borrowing is also a key consideration and has given rise more recently to questions over the risk and sustainability of maintaining a higher level of temporary borrowing.

9.7 The council avoided taking long term financing for much of the 2023/24 financial year. Both short term and long-term interest rates had been rising and were expected to remain relatively high over the next couple of years. As such the council sought to take only short-term borrowing where possible and to avoid fixing higher priced long-term loans until rates start to fall back. Although short term loans also became much more expensive throughout 2023/24, the council favoured keeping high cost borrowing as short lived as possible. This policy of taking more temporary borrowing and the avoidance of long-term debt is illustrated in the maturity structure of debt indicator in 5.4 above which shows the increase in loans due within 1 year.

9.8 As long-term borrowing rates rose during 2023/24 comparable borrowing rates in the market were no longer lower than the rate at which the council's remaining two Lender Option Borrower Option (LOBO) loans were running. As a result, in December 2023 the lender of a £10m LOBO loan exercised an option date which resulted in repayment of the loan. The lender proposed an increase in interest rate from 3.75% to 4.45% at the option date, 22 December 2023, and as interest rate forecasts at the time indicated that long term interest rates will start to decrease during 2024 to below this level, the council made the decision to repay the loan.

9.9 In the latter part of 2023/24, the local authority to local authority market lacked liquidity, forcing short term rates far above 7% in the last week of March due to a scarcity of lenders. Due to an inability to raise short term loans in quarter four of 2023/24 the council borrowed £125m in 1-year PWLB loans. The duration of loans was kept as short as possible due to the expectation that Bank Rate and PWLB rates will fall during 2024. The loans were taken in six separate tranches maturing between February and May 2025 and at rates ranging from 4.83% and 5.46%.

9.10 Opportunities to take long term loans from alternative market participants were absent during 2023/24, unless the council had considered bond issuance.

9.11 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.

9.12 The council did not engage in any debt rescheduling during 2023/24 as the average 1% differential between PWLB new borrowing rates and premature repayment rates, made rescheduling unviable.

9.13 The council's overall weighted average borrowing rate for 2023/24 was 3.10% rising from 2.61% for the previous financial year. This change reflects the increase in Bank Rate and level of short-term borrowing.

10 INVESTMENT RATES IN 2023/24

10.1 The council seeks to compare income returns with Sterling Overnight Index Average (SONIA) rates as an interest rate benchmark. In sterling markets, the SONIA is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors.

10.2 The table below illustrates backward-looking Sterling overnight index (SONIA) rates for 2023/24. The rates decrease for the longer duration as they are reflective of the lower market rates and Bank rate at the start of 2023/24.

		INVESTMENT RATES IN 2023/24					
	Bank Rate	**SONIA**	**7 Day**	**1 Month**	**3 Month**	**6 Month**	**1 Year**
High	5.25%	5.19%	5.19%	5.20%	5.22%	5.25%	5.08%
High Date	30.08.23	28.03.24	28.03.24	26.03.24	25.03.24	22.03.24	28.03.24
Low	4.25%	4.18%	4.18%	4.02%	3.81%	3.32%	2.27%
Low Date	03.04.23	04.04.23	11.04.23	03.04.23	03.04.23	03.04.23	03.04.23
Average	**5.03%**	**4.96%**	**4.96%**	**4.93%**	**4.84%**	**4.64%**	**3.93%**
Spread	1.00%	1.01%	1.01%	1.18%	1.41%	1.94%	2.80%

11 INVESTMENT PORTFOLIO OUTTURN FOR 2023/24

11.1 The council's cash balances comprise of revenue and capital resources and cashflow monies.

11.2 Investment Policy: The council's investment policy is governed by MHCLG guidance, which was implemented in the annual investment strategy approved by the council on 24 February 2022. This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the 3 main credit rating agencies supplemented by additional market data such as rating outlooks, credit default swaps, bank share prices etc.

11.3 Investment returns picked up throughout the course of 2023/24 as central banks, including the Bank of England, realised that inflationary pressures were not transitory, and that tighter monetary policy was called for.

11.4 Starting April 2022 at 0.75%, Bank Rate moved up in stepped increases of either 0.25% or 0.5%, reaching 4.25% by the end of the financial year, with the potential for a further one or two increases in 2023/24.

11.5 The change in investment rates meant local authorities were faced with the challenge of pro-active investment of surplus cash for the first time in over a decade, and this emphasised the need for a detailed working knowledge of cashflow projections so that the appropriate balance between maintaining cash for liquidity purposes, and 'laddering'[1] deposits on a rolling basis to lock in the increase in investment rates as duration was extended, became an ongoing feature of the investment landscape.

11.6 Through the autumn, and then in March 2023, the Bank of England maintained various monetary policy easing measures as required to ensure specific markets, the banking system and the economy had appropriate levels of liquidity at times of stress.

11.7 Nonetheless, while the council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the Financial Crisis of 2008/09. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

11.8 For its cash flow generated balances, the council utilised its business reserve instant access and notice accounts, Money Market Funds and short dated deposits, (overnight to 100 days), in order to benefit from the compounding of interest. Counterparty quality and suitable limits remain primary factors when making investment decisions.

11.9 Markets were pricing in several rate increases throughout much of the year so investment returns were generally elevated. When rates are expected to rise, an investor will generally look to keep rolling maturities on a short-term basis, the idea is that you continue to roll up ever increasing yields to generate a steadily improving return and one where 'lag' i.e., how long it takes your portfolio's return to catch up with the higher rates on offer, is limited as much as possible. The council however

[1] Laddering is an investment technique where the investors makes a number of investments with differing maturity dates. By staggering maturity dates, investors avoid getting locked into a single interest rate. A ladder helps smooth out the effect of fluctuations in interest rates, particularly useful in a rising interest rate environment.

had little opportunity to take real advantage of increased yields on offer. Overall the council is always in a borrowing position and does not have ‘core cash’ to invest over longer time horizons. Investments are generated out of cashflows and used predominantly to supplement cashflow shortages. Although chasing investment returns could be tempting the flip side of that is fixing investments, rather than using to support cashflow shortages, will only lead to an increased need for more temporary borrowing, also at high rates.

11.10 The council’s average investment balances for each quarter are detailed in the table below. Balances were maintained at a level to support cash flow fluctuations throughout 2023/24.

11.11 The investment activity during the year conformed to the approved strategy and the council had no liquidity difficulties.

11.12 Detailed below is the result of the investment strategy undertaken by the council.

Council Performance 2023/24			
Combined Investments	**Average Balance Invested**	**Return**	**Average Duration (days)**
Q1	£52.658m	4.43%	44.63
Q2	£50.995m	5.35%	61.63
Q3	£52.002m	5.59%	26.28
Q4	£30.923m	5.32%	4.14
Weighted Average 2023/24	£46.671m	5.16%	37.49

11.13 **Investments held by the council:**

During 2023/24 the council's combined investments (long and short term), maintained an average balance of £46.671m (£50.371m 2022/23) of internally managed funds, for an average period of 37.49 days (53.89 2022/23).

The internally managed funds earned an average rate of return of 5.16%.

11.14 No institutions in which investments were made had any difficulty in repaying investments and interest in full during the year.

12 PERFORMANCE MEASUREMENT

12.1 One of the key requirements in the Treasury Management Code is the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide. The council’s performance indicators are set in the Treasury Management Policy Statement and Annual Treasury Management Strategy.

12.2 This service has set the following performance indicators:

- Debt (borrowing): average rate movement year on year (illustrated in table in paragraph 5.2).

- Investments: internal returns above the average 1 and 2 month SONIA rates (comparable to average portfolio duration (37.49 days) (paragraphs 10.2 and 11.12).

13 OTHER CONSIDERATIONS

13.1 FINANCIAL AND RISK ASSESSMENT CONSIDERATIONS

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

13.1.2 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.

13.1.3 It is confirmed that the Assistant Director for Finance (Interim Section 151 Officer) has signed off the financial implications detailed within the report.

13.2 LEGAL CONSIDERATIONS

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

13.2.2 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 that may affect the council, particularly with regard to duty of care and fees charged.

13.2.3 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.

13.3 HUMAN RESOURCES IMPACT

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

13.3.2 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.

13.3.3 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.

13.3.4 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 introduced strengthened requirements for skills and training.

13.4 EQUALITIES IMPACT

13.4.1 A full Equalities Impact Assessment was undertaken with the initial Treasury Management Strategy Report for 2023/24 that went to council on 23 February 2023. This is a backward-looking performance report on that Strategy.

13.5 ENVIRONMENTAL IMPACT

13.5.1 The council's Treasury Management Policy Statement and Treasury Management Practices (TMPs) will provide further clarification of the way the council is looking to incorporate environmental considerations in the council's Investment Strategy

13.5.2 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.

13.5.3 This means that a consistent and developed approach to ESG for the council in its treasury management dealings will be challenging. The council will consider its credit and counterparty policies in light of ESG information and develop ESG investment policies and treasury management practices consistent with the council's own relevant policies where possible, for example, climate change policies. It is not expected that the council's ESG policy will include ESG scoring or other real time ESG criteria at individual investment level.

13.5.4 Link Asset Services are looking at ways in which to incorporate these factors into their creditworthiness assessment service which the council uses; measuring ESG ratings/metrics is by far the biggest issue for Treasury incorporating ESG into its investment process. They are continuing to review the market in terms of providers, their methodologies, and outputs, as well as waiting on the outcome of an FCA consultation process, which could conceivably have a material impact on the market going forward.

13.5.5 Members will be updated on the progress of this and the feasibility of including these investments as part of the council's investment portfolio in the Treasury mid-year review report for 2024/25 where hopefully some progress will have been made by Link.

14 CONCLUSIONS AND RECOMMENDATIONS

14.1 It is hoped that the report has provided Members with a clear understanding of the council's capital activity during the year and the impact of this activity on the council's underlying indebtedness (the Capital Financing Requirement), the actual Prudential and Treasury indicators; overall Treasury Position identifying how the council has borrowed in relation to this indebtedness and the impact on investment balances. The report should also have given an insight into interest rate movements throughout 2023/24 and detailed debt and investment activity.

14.2 The council's treasury management function has been successful in 2023/24; investment performance has achieved an annual return of 5.16% and debt costs have been minimised at an overall average rate of 3.71%.

14.3 During the financial year the council operated within the treasury limits and Prudential Indicators set out in the council's Treasury Management Strategy Statement and in compliance with the council's Treasury Management Practices.

14.4 The council has had as its first priority the security of invested funds and its policy to place appropriate parameters (in terms of credit quality), to organisations with whom it invests. This has safeguarded the council's investments during 2023/24.

14.5 The Cabinet is asked to recommend that the council Meeting:

- Approve the actual 2023/24 prudential and treasury indicators in this report;
- Note the Annual Treasury Management Report for 2023/24.

BACKGROUND PAPERS

There are none.

Anyone wishing to inspect the above background papers or requiring further information should contact Lorna Soufian

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