Appendix C

Annual Treasury Management Update for 2023/24

1. Executive Summary

1.1. 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).

1.2. For 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 22nd February 2023)
- a mid-year treasury update report (Cabinet -12th December 2023)
- an annual review following the end of the year describing the activity compared to the strategy.

1.3. In addition, the Cabinet has received quarterly treasury management update reports on the following dates : 19th September 2023 and 13th February 2024.

1.4. 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.

1.5. Member training on treasury management issues was undertaken during the year on the 29th January 2024 in order to support members' scrutiny 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 as follows:

Table 1

Prudential and treasury indicators	2023-24 Original £m	2023-24 Outturn £m
Capital expenditure		
• Non-HRA	101	113
• HRA	62	49
• **Total**	**163**	**162**
Capital Financing Requirement:		
• Non-HRA	656	642
• HRA	285	274
• **Total**	**941**	**916**
Gross borrowing		
External debt		
General Fund	352	332
HRA	228	253
Total Gross Borrowing	**580**	**585**
Investments (Non-Treasury & Treasury)		
• Longer than 1 year	46	39
• Under 1 year	93	57
• Total	**139**	**96**
Net borrowing	441	489

- Other prudential and treasury indicators are to be found in the main body of this report.

2. Introduction and summary

2.1. This report summarises the following:-

- Overall treasury position
- Borrowing activity and breakdown
- Investment activity

- The Economy and interest rates
- The actual prudential and treasury indicators

3. Overall Treasury position

3.1. The Council's treasury management 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 the member reporting detailed in the summary, and through officer activity as detailed in the Council's Treasury Management Practices. At the end of 2023-24 the Council's treasury position, (excluding borrowing by PFI and finance leases) was as follows:-

Table 2

DEBT PORTFOLIO	31.3.24 Principal £m	Rate/ Return	Average Life yrs.
Fixed rate funding:			
-PWLB	511	3.6%	25
-Market & Other (including temporary loans)	36	4.6%	17
Variable rate funding:			
-Market	38	4.1%	0.6
Total debt	**585**	**3.5%**	
CFR	**916**		
Over / (under) borrowing	**(331)**		
Total investments	**96**	**4.2%**	
Net debt	**489**		

4. Borrowing activity and breakdown

4.1. The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2023-24 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

4.2. Part of the Council's treasury activity is to address the funding requirements for this borrowing need. The Treasury Service manages the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies, (such as the Government, through the Public Works Loan Board [PWLB], or the money markets), or utilising cash resources within the Council.

4.3. Reducing the CFR – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets 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 to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet the Council's commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

4.4. The total CFR can also be reduced by:

- the application of additional capital financing resources, (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

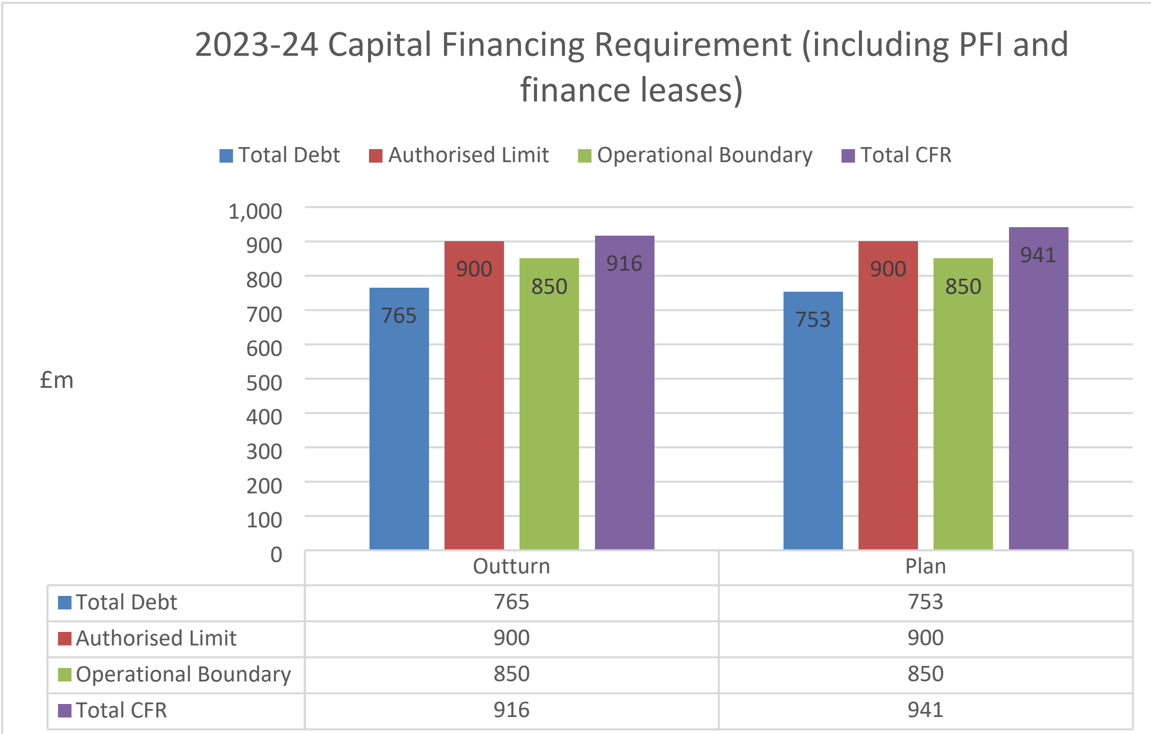
4.5. The Council's 2023-24 MRP Policy, (as required by DLUHC Guidance), was approved as part of the Treasury Management Strategy Report for 2023-24 on the 22nd February 2023.

4.6. The Council's CFR for the year is shown below and represents a key prudential indicator. It includes PFI and leasing schemes on the balance sheet, which increase the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

Table 3

CAPITAL FINANCING REQUIREMENT (including PFI and finance leases)		
	Outturn 2023/24 £m	Plan 2023/24 £m
HRA CFR	274	285
GF CFR	642	656
Total CFR	**916**	**941**
External Borrowing	585	580
Other long-term liabilities	180	173
Total Debt	**765**	**753**
Authorised Limit	900	900
Operational Boundary	850	850

Graph 1.



Gross borrowing and the CFR

4.7. The councils ensures that borrowing levels are prudent over the medium term and only for a capital purpose, the Council will 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 (2023-24) and subsequent years. This indicator allowed 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 position against the CFR. The Council has complied with this prudential indicator.

Table 4

	2023/24 Outturn £m	**2023/24 Plan £m**
Gross borrowing position	585	580
CFR	916	941
(Under) / over funding of CFR	(331)	(361)

Investments activity

4.8. The Treasury Management Strategy Statement (TMSS) for 2023-24, which includes the Annual Investment Strategy, was approved by the Council on the 22nd February 2023. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being :

- Security of capital
- Liquidity
- Yield

4.9. The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and within the Council's risk appetite. In the current economic climate, it is considered appropriate to keep investments short-term to cover cash flow needs, but also to maximise returns in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

4.10. The average level of funds available for internally managed treasury investment purposes during the year to date was £110m, compared to the budget assumptions of £83m.

Investment performance for the year

<u>Market Environment</u>

4.11. Investment returns picked up throughout the course of 2023-24. This was because central banks, including the Bank of England, continued to respond to inflationary pressures that were not transitory and realised that tighter monetary policy was called for.

4.12. Starting in April at 4.25%, the Bank Rate moved up in stepped increases of either 0.25% or 0.5%, reaching 5.25% by August. By the end of the financial year, no further increases were anticipated. Indeed, the market is pricing in a first cut in the Bank Rate in either June or August 2024.

4.13. The upward sloping yield curve that prevailed throughout 2023-24 meant that local authorities continued to be faced with the challenge of proactive investment of surplus cash. This emphasised the need for a detailed working knowledge of cash flow projections so that the appropriate balance between maintaining cash for liquidity purposes, and stagger deposits on a rolling basis to lock in the increase in investment rates as duration was extended, became an on-going feature of the investment landscape.

4.14. With bond markets selling off, UK equity market valuations struggled to make progress, as did property funds, although there have been some spirited, if temporary, market rallies from time to time – including in November and December 2023. However, the more traditional investment options, such as specified investments (simple to understand, and less than a year in duration), have continued to be at the forefront of most local authority investment strategies, particularly given that Money Market Funds have also provided decent returns in close proximity to Bank Rate for liquidity purposes. In the latter part of 2023-24, the local authority to local authority market lacked any meaningful measure of depth, forcing short-term investment rates above 7% in the last week of March.

4.15. While the Council has taken a prudent approach to investing surplus monies, 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 Global 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.

Yield Performance

4.16. Below is SONIA (Sterling Overnight Index Averages) indicators based on a backward look showing the performance of the market when investments were made in the past.

FINANCIAL YEAR 2023-24 (SONIA - Backward Looking)		
	Bank Rate	Sonia – (Backward looking) 12 months
Current Bank Rate	5.25%	3.93%
Councils Performance		5.09%
(Under)/Outperforming SONIA		1.16%

4.17. As illustrated above, the Council outperformed the benchmark by one hundred and sixteen basis points for the year. The Council's budgeted investment return for 2023-24 assumed an average of 3.5% return based on the timing of placed and future short-term investment following budgets preparations, the Council has outperformed the budget assumption to date. The improved return is reflected in the amount of interest receivable, as shown in the table below.

5. Treasury Management Budget

5.1. Outlined below is the Treasury budget performance for the year. The net financing costs have varied significantly to budget as shown in the outturn with an improvement of £4.4m.

Table 5

Treasury revenue budget	Council Approved budget	Outturn	Variance
	£'m	£'m	£'m
Net financing costs -less interest receivable	6.9	2.5	4.4

5.2. The key explanation for variance to the budgets are:

- **Interest receivable on investments –** we achieved a better yield performance of £2.4m due to increased interest rates and more liquid cash being available for investment in comparison to the budget assumptions highlighted in paragraph 4.10 above. With interest rates forecasted to fall in 2024-25, this variance will reduce in future years.
  - Not undertaking new borrowing for the capital programme until the latter part of March 2024 for the HRA.
  - More surplus cash available for the year, with an average treasury investment for the year at £110m at higher yields than budget expectations of £83m.

6. The Economy and Interest Rates

6.1. 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 the Bank Rate through to 50-year gilt yields, for all of 2023-24.

6.2. 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.

6.3. UK, Eurozone 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.

Table 6.

	UK	Eurozone	US
Bank Rate	5.25%	4%	5.25%-5.5%
GDP	-0.3% in Q4 (-0.2% year on year)	+0.0% in Q4 (0.1%year on year)	2.0% Q1 Annualised
Inflation	2.3 %y/y (Apr)	2.4%y/y (Mar)	3.2%y/y (Feb)
Unemployment Rate	3.9% (Jan)	6.4% (Feb)	3.9% (Feb)

6.4. 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 hawkish guidance. The Bank's communications suggest the MPC is gaining confidence that inflation will fall sustainably back to the 2.0% target. The subsequent meeting on the 8th of May also saw no change in interest rates with a majority vote of 7 to 2 to maintain the rate.

6.5. 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 y/y growth was also negative at -0.2%.

6.6. Unemployment is currently sub 4%, against a backdrop of still over 900k 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. The CPI increased by 2.3% over the year in April after rising 3.2% in March.

6.7. 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.

6.8. 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.

6.9. 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.

6.10. 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.

7. Approved Limits

7.1. Officers can confirm that the none of the approved limits within the Annual Investment Strategy were breached during the financial year ended 31st March 2024.

8. Compliance with Treasury & Prudential limits

8.1. It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During this financial year 2023-24, the Council has operated within the treasury and prudential indicators set out in the Council’s Treasury Management Strategy Statement for 2023-24.

8.2. The Director of Finance reports that there were no difficulties complying with the 2023-24 indicators.

8.3. All treasury management operations have been conducted in full compliance with the Council's Treasury Management Practices.

9. Treasury Prudential Indicators

Prudential Indicator	2023-24 Indicator	2023-24 - Outturn
Authorised limit for external debt	----- £900.0m	-----
Operational boundary for external debt	----- £850.0m	-----
Capital Financing Requirement (CFR)	£941m	£916m
Ratio of financing costs to net revenue streams	1.6%	0.86%
Principal sums invested > 365 days *[Excluding third party loans]*	£20m	£nil
Maturity structure of borrowing limits: -		
Under 12 months	Max. 80% Min. 0%	10%
12 months to 2 years	Max. 50% Min. 0%	4%
2 years to 5 years	Max. 50% Min. 0%	9%
5 years to 10 years	Max. 50% Min. 0%	0%
10 years and above	Max. 100% Min. 0%	76%

10. Approved countries for investments as of 31st March 2024 (updated on the 5th April 2024)

10.1. This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Hong Kong and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link creditworthiness service.

Based on lowest available rating

AAA

- Australia
- Denmark
- Germany
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- Qatar

AA-

- Belgium
- France
- **U.K.**