

AGENDA ITEM.

**REPORT TO AUDIT &
GOVERNANCE COMMITTEE**

29th JULY 2024

**REPORT OF DEPUTY CHIEF
EXECUTIVE & DIRECTOR OF
FINANCE, PERFORMANCE &
TRANSFORMATION**

TREASURY MANAGEMENT STRATEGY – ANNUAL REPORT 2023/24

SUMMARY

This report informs Members of the performance against the treasury management and prudential indicators set in the Treasury Management Strategy approved by Council in February 2023.

REASONS FOR PRODUCING THIS REPORT

The Council operates under the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Council to approve a treasury management annual report after the end of each financial year.

This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

Introduction

The Council's Treasury Management Strategy for 2023/24 was approved at Council on the 22nd February 2023. The Council has borrowed and 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 Council's Treasury Management Strategy.

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, complying with CIPFA's requirement, was approved by full Council on 22nd February 2023.

External Context

The Council's treasury management advisors Arlingclose have provided the following commentary on the external context.

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.

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.

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.

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.

In the Bank'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.

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.

Financial markets: 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.

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.

Credit review: 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.

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.

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.

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.

Local Context

On 31st March 2024 the Council had net borrowing of £86.61m 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 Actual £m	2023/24 Movement £m	31.3.24 Actual £m
General Fund CFR	184.16	5.83	189.99
Less: Other debt liabilities	(6.79)	1.24	(5.55)
Borrowing CFR	177.37	7.07	184.44
Less: Usable reserves	(115.71)	12.22	(103.49)
Less: Working capital	3.72	1.95	5.67
Net Borrowing / (Investments)	65.38	21.23	86.61

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.

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 £m	2023/24 Movement £m	31.3.24 Balance £m	31.3.24 Rate %
Long-term borrowing	77.43	12.32	89.75	
Short-term borrowing	16.81	1.83	18.64	
Total borrowing	94.24	14.15	108.39	5.40%
Long-term investments	13.56	(0.53)	13.03	
Short-term investments	0.00	0.00	0.00	
Cash and cash equivalents	15.30	(6.55)	8.75	
Total investments	28.86	(7.09)	21.77	
Net Borrowing / (Investments)	65.38	21.23	86.61	

During the year long term loans increased by £12.3m due to the requirement to fund the capital programme. In November 2023 a £10m 7 year loan and a £5m 5 year loan were entered into via the Public Works Loan Board (PWLB).

Table 2a: Long-dated Loans borrowed

Long-dated Loans borrowed	Amount £m	Rate %	Period (Years)
PWLB EIP Loan - Nov 2023	10.0	4.96	7
PWLB Maturity Loan - Nov 2023	5.0	4.87	5
Total borrowing	15.0		

Short term loans increased by £1.83m during the year. After other short term loans matured during the year there was a requirement for cash flow purposes to enter into further loans during the last months of the financial year.

Overall total borrowing increased from £94.24m as at 31st March 2023 to £108.39m as at 31st March 2024.

Total investments decreased during the year reducing £7.09m from £28.86m at the end of 2022-23 to £21.77m at the end of 2023-24. This was due to the authority internally borrowing to fund the capital programme, repayment of government grants and planned use of reserves.

Borrowing Update

CIPFA's 2021 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.

The Authority has not invested in assets primarily for financial return or that are not primarily related to the functions of the Authority. It has no plans to do so in future.

The Authority currently holds £17.790m in commercial investments (2022-23 £16.558m) that were purchased prior to the change in the CIPFA Prudential Code. The Authority as part of the updated code in the future will need review the options for exiting these investments if there is an economical case to do so.

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.

Interest rates have seen substantial rises over the last two years, although these rises have now begun to plateau. Gilt yields fell in late 2023, reaching April 2023 lows in December 2023 before rebounding to an extent in the first three months of 2024. Gilt yields have remained volatile, seeing upward pressure from perceived sticker inflation at times and downward pressure from falling inflation and a struggling economy at other times.

On 31st December, the PWLB certainty rates for maturity loans were 4.74% for 10-year loans, 5.18% for 20-year loans and 5.01% for 50-year loans. Their equivalents on 31st March 2023 were 4.33%, 4.70% and 4.41% respectively.

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.

At 31st March 2024 the Council held £108.39m of loans, an increase of £14.15m from the previous year. The year-end borrowing position and the year-on-year change is shown in Table 3 below.

Table 3: Borrowing Position

	31.3.23 Balance £m	2023/24 Movement £m	31.3.24 Balance £m	Average Rate %	31.3.24 WAM* years
Public Works Loan Board	41.11	14.02	55.13	4.78%	6.0
Banks (LOBO)	37.00	0.00	37.00	4.83%	35.9
Local Authorities	16.13	0.12	16.26	6.60%	0.0
Banks (fixed-term)	0.00	0.00	0.00	0.00%	0.0
Total borrowing	94.24	14.15	108.39	5.40%	15.5

*Weighted average maturity

The Council continues to holds £37m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the year.

Treasury Investment Activity

The CIPFA Treasury Management Code now defines treasury management investments as those investments which arise from the Authority’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.

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Council’s investment balances fluctuated due to timing differences between income and expenditure.

The year-end investment position is shown in Table 4 below.

Table 4: Treasury Investment Position

	31.3.23 Balance	Net Movement	31.3.24 Balance	31.3.24 Income Return
	£m	£m	£m	%
Banks & building societies	0.24	0.16	0.40	3.25
Government (incl. LA's)	0.00	0.00	0.00	0.00
Money Market Funds	15.00	-6.70	8.30	5.26
Pooled Property funds	13.56	-0.53	13.03	4.56
Total investments	28.80	-7.07	21.73	

Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council’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.

The Authority expects to be a long-term borrower and new treasury investments are therefore primarily made to manage day-to-day cash flows using short-term low risk instruments. The existing portfolio of strategic pooled funds will be maintained to diversify risk into different asset classes and boost investment income

Bank Rate increased by 1% over the period, from 4.25% at the beginning of April 2023 to 5.25% by the end 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. Money Market Rates also rose and were between 4.4% and 5.7% by the end of March 2024.

The progression of credit risk and return metrics for the Council’s investments managed in-house are shown in the extracts from Arlingclose’s quarterly investment benchmarking in Table 5 below.

Table 5: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure	WAM* (days)	Rate of Return
31.03.2023	4.92	A+	100%	1	3.85%
30.06.2023	4.68	A+	79%	4	4.40%
30.09.2023	4.32	AA-	84%	2	4.84%
31.12.2023	5.35	A+	100%	1	5.15%
31.03.2024	4.89	A+	100%	1	5.07%
Similar LA's (31.03.24)	4.95	A+	64%	58	5.13%
All LAs (31.03.24)	4.82	A+	61%	9	5.10%

*Weighted average maturity

Externally Managed Pooled Funds: £13.03m (based on 31.3.24 valuation) of the Council's investments are held in an externally managed strategic pooled property fund 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 a dividend return of £0.683m (4.92%) (£0.587m 2022-23) which is used to support services in year.

The market background for commercial property improved marginally in 2023 and was more stable, in contrast to the very challenging backdrop of 2022. Low transactional volumes were a constraint on valuations and made prospective sellers and buyers more cautious. Although many sectors lacked momentum, there was growing confidence in the longer-term outlook as occupier demand and rental markets held up. Industrial and retail warehousing sectors remained strong, but the retail and offices sectors remained weak, the latter continuing to be hindered by low occupancy from hybrid working practices.

The change in the Authority's funds' capital values and income earned over the 12-month period is shown in Table 4.

Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's medium- to long-term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates.

Statutory Override: In April 2023 the Department for Levelling Up, Housing and Communities (DLUHC), renamed as the Ministry for Housing, Communities & Local Government (MHCLG) published the full outcome of the consultation on the extension of the statutory override on accounting for gains and losses on pooled investment funds. The override has been extended until 31st March 2025, but no other changes have been made; whether the override will be extended beyond this date is unknown but commentary to the consultation outcome suggests it will not. The Authority will discuss with Arlingclose the implications for the investment strategy and what action may need to be taken.

Non-Treasury Investments

The definition of investments in the Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. 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).

Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) also broadens the definition of investments to include all such assets held partially or wholly for financial return.

The Council also held £18.213m of such investments in;

- directly owned property £17.970m
- loans to local businesses £0.039m
- other £0.204m

These investments generated £0.902m of investment income for the Council after taking account of direct costs in 2023/24 representing a rate of return of 5.02%.

Consultations

In December DLUHC, renamed as the Ministry for Housing, Communities & Local Government (MHCLG), published two consultations: a “final” consultation on proposed changes to regulations and statutory guidance on MRP closing on 16th February and a “call for views” on capital measures to improve sector stability and efficiency closing on 31st January.

Draft regulations and draft statutory guidance are included in the MRP consultation. The proposals remain broadly the same as those in June 2022 – to limit the scope for authorities to (a) make no MRP on parts of the capital financing requirement (CFR) and (b) to use capital receipts in lieu of a revenue charge for MRP.

In its call for views on capital measures, government wishes to engage with councils to identify and develop options for the use of capital resources and borrowing to support and encourage ‘invest-to-save’ activity and to manage budget pressures without seeking exceptional financial support. Whilst Government has identified some options including allowing authorities to capitalise general cost pressures and meet these with capital receipts, there is no commitment to take any of the options forward.

Compliance

The Deputy Chief Executive and Director of Finance, Performance & Transformation reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Council’s approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated below.

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

Table 6: Debt Limits

	2023/24 Maximum	31.3.24 Actual	2023/24 Operational Boundary £m	2023/24 Authorised Limit £m	Complied
Borrowing	108.39	108.39	212.90	222.90	✓
PFI & finance leases	5.55	5.55	6.50	6.50	✓
Total debt	113.94	113.94	219.40	229.40	✓

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. Total debt was above the operational boundary for 0 days during 2023/24.

Compliance with specific investment limits is demonstrated in Table 7 below.

Table 7: Investment Limits

	2023/24 Maximum	31.3.24 Actual	2023/24 Counterparty Limit	2023/24 Financial Limit	Complied
The UK Government	£29.80	£0m	Unlimited	N/A	✓
Local authorities & other government entities	£0m	£0m	£5m	Unlimited	✓
Secured investments	£0m	£0m	£5m	Unlimited	✓
Banks (unsecured)	£1.72m	£0.40m	£2.5m	Unlimited	✓
Building societies (unsecured)	£0m	£0m	£2.5m	£5m	✓
Registered providers (unsecured)	£0m	£0m	£2.5m	£12.5m	✓
Money market funds	£30m	£8.3m	£5m	Unlimited	✓
Strategic pooled funds	£13.5m	£13.03m	£15m	£25m	✓
Real estate investment trusts	£0m	£0m	£5m	£12.5m	✓
Other investments	£0m	£0m	£2.5m	£5m	✓

* see table 4 above for actual values with individual counterparties as at 31st March 2024.

Treasury Management Prudential Indicators

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

Maturity Structure of Borrowing: This indicator is set to control the Council'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	17%	25%	0%	✓
12 months and within 24 months	3%	40%	0%	✓
24 months and within 5 years	13%	60%	0%	✓
5 years and within 10 years	14%	80%	0%	✓
10 years and above	53%	100%	0%	✓

Principal Sums Invested for Periods Longer than 365 days: The purpose of this indicator is to control the Council'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	2024/25	2025/26
Actual principal invested beyond year end	£15m	£15m	£15m
Limit on principal invested beyond year end	£60m	£50m	£40m
Complied	✓	✓	✓

Prudential Indicators 2023/24

Introduction: The Local Government Act 2003 requires the Council to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the 2021 Prudential Code sets out the following indicators that must be set and monitored each year.

This report compares the approved indicators with the outturn position for 2023/24. Actual figures have been taken from or prepared on a basis consistent with, the Council's Statement of Accounts.

Capital Expenditure: The Council's capital expenditure and financing is summarised as follows.

Capital Expenditure and Financing	2023/24 Estimate £m	2023/24 Actual £m	Difference £m
Total Expenditure	101.3	54.6	(46.70)
Capital Receipts	1.80	1.5	(0.30)
Grants & Contributions	63.9	43.1	(20.80)
Revenue	5.1	1.7	(3.40)
Borrowing	30.5	8.3	(22.20)
Total Financing	101.3	54.6	(46.70)

Capital Financing Requirement: The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

Capital Financing Requirement	31.03.24 Estimate	31.03.24 Actual	Difference
	£m	£m	£m
General Fund	212.90	189.99	(22.91)
Total CFR	212.90	189.99	(22.91)

There was a difference of £22.91m on the CFR from the original estimate due to a variance against the in year approved spend profile within the capital programme.

Actual Debt: The Council's actual debt at 31st March 2024 was as follows:

Debt	31.03.24 Estimate	31.03.24 Actual	Difference
	£m	£m	£m
Borrowing	169.66	108.39	(61.27)
Finance leases	3.30	2.85	(0.45)
PFI liabilities	3.10	2.70	(0.40)
Total Debt	176.06	113.94	(62.12)

There was a significant reduction in the planned borrowing requirements during 2023/24 due to slippage on the capital programme and use of unapplied capital grants in year. There was also a positive cash movement on the collection fund which meant borrowing could be deferred.

Gross Debt and the Capital Financing Requirement: In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence. The table below shows the position as at 31st March 2024;

Debt and CFR	31.03.24 Estimate	31.03.24 Actual	Difference
	£m	£m	£m
Total debt	176.06	113.94	(62.12)
Capital financing requirement	212.90	189.99	(22.91)
Headroom / (Under Borrowed)	(36.84)	(76.05)	(39.21)

Total debt during the year remained below the CFR. At the 31st March the Council was under borrowed by £76.05m.

Operational Boundary for External Debt: The operational boundary is based on the Council's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Council's debt.

Operational Boundary and Total Debt	31.03.24 Boundary £m	31.03.24 Actual Debt £m	Complied
Borrowing	212.90	108.39	✓
Other long-term liabilities	6.50	5.55	✓
Total Debt	219.40	113.94	✓

Authorised Limit for External Debt: The authorised limit is the affordable borrowing limit determined in compliance with the *Local Government Act 2003*. It's the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit and Total Debt	31.03.24 Limit £m	31.03.24 Actual Debt £m	Complied
Borrowing	222.90	108.39	✓
Other long-term liabilities	6.50	5.55	✓
Total Debt	229.40	113.94	✓

Ratio of Financing Costs to Net Revenue Stream: This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income. The table below shows the position as at 31st March 2024.

Ratio of Financing Costs to Net Revenue Stream	31.03.24 Estimate %	31.03.24 Actual %	Difference %
General Fund	3.4%	1.3%	-2.1%

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