

Treasury Management – 2023/24 End of Year review

1.0 Introduction & Background

- 1.1 This appendix provides a review of treasury management activity for the second half of 2023/24 as required by the Treasury Management Code. It reports the performance against the Treasury Management strategy and key Prudential and Treasury Indicators for the second half of the year. This has formerly been presented as a separate report, last presented to members as the Treasury Management Mid-Year Review to Strategy, Finance & City Regeneration Committee on 7 December 2023.
- 1.2 The 2023/24 Treasury Management Strategy Statement (TMSS), which includes the Annual Investment Strategy (AIS), was approved by Policy & Resources Committee on 9 February 2023 and by Full Council on 23 February 2023 as part of the 2023/24 Budget Report. The Treasury Management Strategy sets out the role of Treasury Management, the strategy for Treasury Management activity in 2023/24, and the key parameters and indicators for investing council cash balances and undertaking borrowing for the year.
- 1.3 The council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Effective cash flow planning enables surplus monies to be invested in counterparties (financial institutions) or financial instruments commensurate with the council's risk appetite, providing adequate cash availability (liquidity) is maintained
- 1.4 The second main function of the treasury management service is the funding of the council's capital plans. These capital plans provide a guide to the borrowing need of the council, essentially the longer-term cash flow planning, to ensure that the council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn on may be restructured to meet the council's risk or cost objectives.
- 1.5 The Chartered Institute of Public Finance & Accountancy (CIPFA) defines treasury management as:

“The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions, the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks.”

2 Economic Background

- 2.1 The expectation for interest rates when the 2023/24 Treasury Management Strategy was set, based on external advice, was that Base Rate would peak in June 2023 at 4.50%, where it would remain for the rest of the financial year. However, inflation has remained stubbornly high, and the official rate was raised 3 times during 2023/24, peaking at 5.25% in August 2023 where it remained for the rest of the financial year.
- 2.2 A full summary of the economic background for 2023/24 has been provided by the council's treasury management advisors, Link Asset Services, at **Annex 2**.

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3 Treasury Management Activity

3.1 Within the year, the council complied with its legislative and regulatory requirements with regards to treasury management. A summary of the action taken in the 6 months to March 2024 is provided in Appendix 3 to this report. The main points are:

- The council entered into no new borrowing in the last 6 months of 2023/24;
- The highest risk indicator during the period was 0.016% which is below the maximum benchmark of 0.050%;
- The return on investments has exceeded the budgeted rates but has lagged slightly behind the target benchmark rates in the 6 months as a result of the sharp reduction in new fixed term investments undertaken due to reducing cash balances;
- The two borrowing limits approved by full Council have not been exceeded;
- The Annual Investment Strategy parameters have been met throughout the 6-month period.

3.2 The following table summarises the treasury activity in the half year to March 2024 compared to the corresponding period in the previous year:

October to March	2021/22	2022/23	2023/24
Long-term borrowing raised (General Fund)	(£25.0m)	(£0.0m)	(£0.0m)
Long-term borrowing raised (HRA)	(£30.0m)	(£0.0m)	(£0.0m)
Long-term borrowing repaid (General Fund)	£1.0m	£5.3m	£4.2m
Long-term borrowing repaid (HRA)	£0.6m	£5.4m	£4.2m
Short-term borrowing (raised)/repaid	£4.5m	(£0.5m)	(£25.0m)
Investments made	£438.9m	£314.9m	£334.6m
Investments maturing	(£424.1m)	(£397.4m)	(£407.0m)

3.3 The Financing Costs budget variance in 2023/24 was a £2.223m underspend. This is primarily due to improved investment income as a result of a combination of improved investment rates and balances compared to the assumptions within the budget (as demonstrated in 4.8 below).

3.4 The table below summarises how the day-to-day cash flows in the second half-year have been funded compared to the same period in the previous two years. The final column shows the full year cashflows for 2023/24. There has been a significant reduction in investment balances over the last two years. The reduction in 2023/24 is mainly as a result of a significant increase in under-borrowing: using the council's own internal reserves and balances to temporarily finance the borrowing need in the capital programme. More detail on this is contained in section 5 below.

	Oct - Mar 2021/22	Oct - Mar 2022/23	Oct - Mar 2023/24	Full Year 2023/24
Net cash flow (shortage)/surplus	(£34.0m)	(£72.1m)	(£88.0m)	(£80.4m)
Represented by:				
Increase/(reduction) in long-term borrowing	£53.4m	(£10.7m)	(£8.4m)	(£24.7m)

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Increase/(reduction) in short-term borrowing*	(£4.5m)	£0.5m	£25.0m	£20.5m
Reduction/(increase) in investments	(£14.8m)	£82.5m	£73.4m	£85.3m
Reduction/(increase) in bank balance	(£0.1m)	(£0.2m)	(£1.0m)	(£0.7m)

4 Investment Strategy

- 4.1 All parameters in the Annual Investment Strategy have been complied with in full.
- 4.2 No new counterparties have been added to the approved counterparty list during the year.
- 4.3 A summary of investments made by the in-house team and outstanding as at 31 March 2024 is set out in the table below and shows that investments continue to be held in good quality, short-term instruments in line with the approved strategy.

'AAA' rated money market funds	£7.400m	9%
'AA' rated institutions*	£30.000m	34%
'A' rated institutions	£39.410m	46%
'BBB' rated institutions	£0.000m	0%
Unrated Funds	£9.200m	11%
Total	£86.010m	100%
Period – less than one week	£16.700m	19%
Period – between one week and one month	£20.310m	24%
Period – between one month and three months	£21.000m	24%
Period – between three months and 1 year	£23.000m	27%
Period – more than 1 year**	£5.000m	6%
Total	£86.010m	100%

* For the purposes of this analysis, other Local Authorities are assumed to have the same credit rating as the UK government (AA).

** All investments that are over one year either have a legal offset against debt with the same counterparty, or are with other Local Authorities.

Risk

- 4.4 As part of the investment strategy for 2023/24 the council agreed a maximum risk benchmark of 0.05% i.e. there is a 99.95% probability that the council will get its investments back. The benchmark is a simple target that measures risk based on the financial standing of counterparties and length of each investment based on historic default rates. The actual risk indicator has varied between 0.008% and 0.016% between October 2023 and March 2024, reflecting the high proportion of investments held in high security and/or very liquid investments. It should be remembered however that the benchmark is an 'average risk of default' measure and does not constitute an expectation of loss for any particular investment.

Investment Risk benchmark	0.050%
Maximum investment risk experienced Oct - Mar	0.016%

- 4.5 The treasury management service is subject to a detailed audit on a regular basis. This includes the testing of the control environment and the management of risk. A 'substantial' level of assurance was provided during the most recent audit (October 2022). No recommendations were made in the course of the audit.

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Investment Performance

- 4.6 The council's investment portfolio achieved an average rate of 5.12% over the last six months of the year against a benchmark rate of 5.19% for the same period.
- 4.7 The investment performance has underperformed the benchmark by 0.07%. This is as a result of the cash balances falling sharply in the last six months of the year. This meant that officers were not able to re-invest maturing investments into longer, higher yielding investment deals, instead needed to keep cash balances more liquid to support the cash outflow over this period.
- 4.8 The following table summarises the performance achieved on investments compared to the budgeted position and approved benchmark for the whole year.

	Average Balance	Average rate
Budget 2023/24	£140.7m	4.35%
Actual 2023/24	£168.7m	4.62%
Benchmark Rate*		4.94%

* SONIA rate is used as a benchmark. SONIA is defined in **Annex 1**.

- 4.9 Investments under-performed the benchmark rate by 0.32% across the year in total. This is due in part to the conditions outlined in 4.7, but primarily due to the lag between increased Bank Rate and increasing investment rates.
- 4.10 As a result of the falling cash balances, only one new investment of £5m, for a period of 3 months and at an investment rate of 5.41%, was entered into between October and March.
- 4.11 The total (capital & revenue) yield in two Royal London short-dated bond funds was 8.21% for the year to 31 March 2024. The capital value of the council's holding has fallen, in part due to the timing of the investment against a rising interest rate environment. The value of the investment as at 31 March 2024 was £9.195m compared to an initial investment of £10.000m. The value has recovered during the year due to the stability of the base rate since August 2024. It is expected that the capital value will continue to improve and does not represent an actual loss to the council, as there is no intention to withdraw the holding from these funds until the capital value has recovered to at least the original investment value.

5 Borrowing

- 5.1 The council operates separate debt portfolios for the General Fund and the HRA following the introduction of the HRA Self-Financing regime in 2012. The table below shows the Council's total external borrowing and average rates as at 31 March 2024, split between the General Fund and the HRA.

	General Fund Borrowing £m	HRA Borrowing £m	Total Borrowing	Average Rate
PWLB	151.692	182.925	334.617	2.78%
Market Loans	16.251	18.749	35.000	4.33%
Long-term borrowing	167.943	201.674	369.617	2.92%
Average rate of long-term borrowing	3.14%	2.79%	2.92%	
Short-term borrowing	23.000	0	23.000	7.24%
Total Borrowing	190.943	201.674	392.617	3.58%

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- 5.2 As reported in the Mid-Year Review, Link Asset Services have been forecasting that investment rates have peaked and would begin to fall during 2024. Therefore, new long-term borrowing for both the General Fund and the HRA has been avoided over the last two years with borrowing need for the capital programme to be met from using existing cash balances (known as under-borrowing) and short-term borrowing from other local authorities until long-term rates start reducing.
- 5.3 The General Fund capital outturn includes projects funded by borrowing of £31.394m compared to an original estimate of £55.344m and the HRA Capital Outturn includes projects funded by borrowing of £37.594m compared to an original estimate of £58.890m.
- 5.4 The Capital Financing Requirement (CFR) for both the General Fund and HRA are shown in the table below.

General Fund Capital Financing Requirement (CFR) – Underlying Borrowing requirement	Original Estimate 2023/24 £m	Actual 2023/24 £m
Opening General Fund CFR	234.743	211.894
In year borrowing requirement	55.344	31.394
Minimum Revenue Provision	(18.850)	(9.601)
Closing General Fund CFR	271.238	233.587
GF External Long-term Borrowing as at 31 March 2024		167.943
General Fund Under-borrowing as at 31 March 2024		65.644
HRA Capital Financing Requirement (CFR) – Underlying Borrowing requirement	Original Estimate 2023/24 £m	Actual 2023/24 £m
Opening HRA CFR	208.947	204.455
In year borrowing requirement	58.890	37.594
Minimum Revenue Provision	0	0
Closing HRA CFR	267.837	242.049
HRA External Long-term Borrowing as at 31 March 2024		201.674
HRA Under-borrowing as at 31 March 2024		40.735

- 5.5 The overall under-borrowing position of the council as at 31 March 2024 is £106.019m. The table below highlights a significant increase of £83.937m compared to the previous financial year, caused by the repayment of long-term borrowing in the year combined with the increase in the council's CFR.

Under-borrowing as at 31 March 2024	2022/23 £m	2023/24 £m
Total CFR	416.348	475.636
Less: External long-term borrowing	(394.266)	(369.617)
Total Under-borrowing	22.082	106.019

- 5.6 The increase in internal borrowing has been largely supported by reducing the Council's investment balances during the year, as well as some new short-term borrowing required in March of £23.000m. The short-term borrowing was undertaken at an average rate of 7.24%. This rate reflects a particularly high demand for short-term borrowing between Local Authorities in March; Local

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Authorities tend to have very similar cash flow patterns, additionally many Local Authorities are utilising very similar strategies of avoiding long-term borrowing. All short-term borrowing was repaid during April 2024.

- 5.7 The table below shows that the Council has complied with the Operational Boundary and Authorised Borrowing Limits set within the Treasury Management strategy.

Borrowing Limits	Operational Boundary £m	Authorised Borrowing Limit £m
Limit set for 2023/24	607.000	657.000
Less: PFI & Leases	38.000	38.000
Limit for Underlying Borrowing	569.000	619.000
Actual External Borrowing at 31 March 2024	392.617	392.617
Headroom*	176.383	226.383

**Authorised Borrowing headroom cannot be less than zero*

- 5.8 The maturity profile of the Authority's borrowing has complied with the limits set within the strategy. There has been an increase in the borrowing due within 12 months due to the inclusion of the short-term debt undertaken in March 2024.

Maturity Structure of borrowing	Lower Limit set	Upper Limit set	Actual as at 31 March 2024
Under 12 Months	0%	40%	10%
12 months to 2 years	0%	40%	3%
2 years to 5 years	0%	50%	3%
5 years to 10 years	0%	75%	6%
Over 10 years	40%	100%	78%

6 Treasury Advisors

- 6.1 Officers recognise that responsibility for decisions remains with the organisation at all times and ensure that undue reliance is not placed upon external service providers and advisers. However, it is recognised that there is value in employing external providers of treasury management services in order to access specialist skills and resources.

7 Member Training

- 7.1 It is a requirement of CIPFA's Treasury Management code to ensure that the members responsible for decision making and scrutiny of the authority's TMSS are adequately trained to undertake their roles in this area.
- 7.2 Treasury Management training was last provided in January 2024. This was offered to all members and is currently available on the Members section of the Learning Zone.

Annex 1 – Glossary of Terms

Authorised Borrowing Limit: The limit for which the council's external borrowing cannot breach. This limit is set by Council as part of the budget each year. This needs to be approved by Council to amend in the year if required.

Capital Financing Requirement (CFR): The council's cumulative need to borrow to support its capital programme. This increases each year by capital expenditure where existing funding streams (such as reserves, capital receipts, grants or revenue contributions) have not been applied (which is also known as funding through borrowing). The Council must make an annual minimum revenue provision (MRP) which reduces the CFR.

Credit Ratings: The council uses the credit ratings for counterparties provided by the three main credit ratings agencies (Moody's, Fitch and Standard & Poor) to determine how much and for how long the council can lend to them. The highest credit rating as described in the strategy is AAA, and the lowest credit rating that the council is willing to lend to is BBB.

Debt Maturity Profile: The timeline over which the council has to repay its debt. A smooth profile is preferable, as small, regular repayments reduce the risk of having to replace a lot of debt at a time when it may not be the optimum market conditions.

Lender Option Borrower Option (LOBO) Loans: Loans held with market lenders (such as banks), where lenders hold the right to increase the interest rate on the loans at set intervals during the loan. The council has the right to repay the loans without penalty if the lender chooses to increase the interest rate. The council's LOBO Loan portfolio is currently £15m held with two different lenders.

Marked to Market: An accounting method of measuring the fair value of investments at a point in time by valuing the investment under prevailing market conditions.

Minimum Revenue Provision (MRP): A statutory provision that the council sets aside from revenue to reduce its CFR. This has the impact of setting aside the cash to repay any debt incurred as a result of funding the capital programme by borrowing.

Operational Boundary: A limit set by Council as part of the budget each year. Whilst the Authorised Limit cannot be breached, the operational boundary is the expected level at which external debt will reach, taking into account current levels of debt, maturing debt that may need replacing and capital plans for the forthcoming year.

PWLB Loans: Loans held with the Public Works Loans Board. This is the primary lender for Local Authorities, and the PWLB forms part of the Debt Management Office (DMO) within the HM Treasury department of Central Government.

Risk Benchmark: An indicator used to monitor the perceived level of risk within the council's investment portfolio.

Under-borrowing: (also known as internal borrowing) The difference between the council's CFR and actual level of debt, where the actual debt is lower than the CFR. This occurs when council uses cash from its own reserves to temporarily fund capital expenditure.

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SONIA: Sterling Over Night Index Average – A benchmark rate calculated and administrated by the Bank of England. This rate effective replaces LIBOR from 1 January 2022 as the key benchmark rate in the UK. The calculation of 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 institutional investors.

Annex 2 – Economic Overview

Provided by Link Asset Services – April 2024

UK Economy

Against a backdrop of stubborn inflationary pressures, the Russian invasion of Ukraine, and war in the Middle East, UK interest rates have continued to be volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2023/24.

Markets have sought an end to central banks’ on-going phase of keeping restrictive monetary policy in place on at least one occasion during 2023/24 but to date only the Swiss National Bank has cut rates and that was at the end of March 2024.

UK, EZ and US 10-year yields have all stayed stubbornly high throughout 2023/24. The table below provides a snapshot of the conundrum facing central banks: inflation is easing, albeit gradually, but labour markets remain very tight by historical comparisons, making it an issue of fine judgment as to when rates can be cut.

	UK	Eurozone	US
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 Rate	3.9% (Jan)	6.4% (Feb)	3.9% (Feb)

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. However, although the MPC noted that “the restrictive stance of monetary policy is weighing on activity in the real economy, is leading to a looser labour market and is bearing down on inflationary pressures”, conversely it noted that key indicators of inflation persistence remain elevated and policy will be “restrictive for sufficiently long” and “restrictive for an extended period”.

Of course, the UK economy has started to perform a little better in Q1 2024 but is still recovering from a shallow recession through the second half of 2023. Indeed, Q4 2023 saw negative GDP growth of -0.3% while y/y growth was also negative at -0.2%.

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

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,

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even though fixed rate mortgage rates on new loans have shifted up a little since falling close to 4.5% in early 2024.

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.

As for equity markets, the FTSE 100 has risen to nearly 8,000 and is now only 1% below the all-time high it reached in February 2023. The modest rise in UK equities in February was driven by strong performances in the cyclical industrials and consumer discretionary sectors, whilst communications and basic materials have fared poorly.

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

USA Economy.

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

In addition, the Fed will want to shrink its swollen \$16 trillion balance sheet at some point. Just because the \$ is the world's foremost reserve currency (China owns over \$1 trillion) does not mean the US can continually run a budget deficit. The mix of stubborn inflation and significant treasury issuance is keeping treasury yields high. The 10 year stands at 4.4%.

As for inflation, it is currently a little above 3%. The market is not expecting a recession, but whether rates staying high for longer is conducive to a soft landing for the economy is uncertain, hence why the consensus is for rate cuts this year and into 2025...but how many and when?

EZ Economy.

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