	Governance and Audit Committee
	Tuesday, 11th June 2024

Subject: Annual Treasury Management Report 2023/24

Report by:	Director of Corporate Services (S151 Officer)
Contact Officer:	Peter Davy Financial Services Manager peter.davy@west-lindsey.gov.uk
Purpose / Summary:	To report on Annual Treasury Management activities and prudential indicators for 2023/24 in accordance with the Local Government Act 2003

RECOMMENDATION(S):

1. That the Committee review, comment and scrutinise the contents of the report.

IMPLICATIONS

Legal: None from this report

Financial : FIN/36/25/PD

Treasury Investment activities have generated £1.144m of investment interest at an average rate of 5.1%.

Non-Treasury investments (Commercial Property Portfolio) have generated a gross yield of 7.12%

Financing activities has resulted in a total of £24.0m of external borrowing at a cost in year of £0.584m.

Staffing : None from this report

Equality and Diversity including Human Rights : None from this report

Data Protection Implications : None from this report

Climate Related Risks and Opportunities: None from this report

Section 17 Crime and Disorder Considerations: None from this report

Health Implications: None from this report

Title and Location of any Background Papers used in the preparation of this report :

The Treasury Management Strategy 2023/24

Risk Assessment :
The Treasury Management Strategy sets out an assessment of treasury risks.

Call in and Urgency:

Is the decision one which Rule 14.7 of the Scrutiny Procedure Rules apply?

i.e. is the report exempt from being called in due to urgency (in consultation with C&I chairman)	**Yes**		**No**	X

Key Decision:

A matter which affects two or more wards, or has significant financial implications	**Yes**		**No**	X

1. Executive Summary

The Council are required to receive as a minimum the following reports;

- an annual treasury strategy in advance of the year (March 2023)
- a mid-year, (minimum), treasury update report (January 2024)
- an annual review following the end of the year describing the activity compared to the strategy, (this report)

In addition, this Corporate Policy and Resources Committee has received quarterly treasury management update reports.

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.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by either the Governance and Audit Committee who provide scrutiny of the Treasury Management Strategy and the Corporate Policy and Resources Committee who monitor in year performance and mid-year updates. Member training on treasury management issues was undertaken during the year in order to support members' scrutiny role.

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:

Prudential and treasury indicators	2022/23 Actual £000	2023/24 Original £000	2023/24 Actual £000
Capital expenditure	4,851	20,888	5,303

Prudential and treasury indicators	2022/23 Actual £000	2023/24 Original £000	2023/24 Actual £000
Capital Financing Requirement:	39,438	*38,321*	37,022
Of which – Investment Properties	*20,211*	19,837	19,536
Gross borrowing (External)	**21,500**	**26,500**	**24,000**
Finance Lease	0	0	0
Investments			
• Longer than 1 year	3,000	3,000	2,000
• Under 1 year	15,515	10,000	18,210
• **Total**	**18,515**	**13,000**	**20,210**
Net borrowing	**2,985**	**13,500**	**3,790**

Other prudential and treasury indicators are to be found in the main body of this report. The Director of Corporate Services (S151 Officer) also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit, (the authorised limit), was not breached.

The financial year 2023/24 was a challenging investment environment due to consistent interest rate rises by the Bank of England. This meant that locking in longer term investments was hard to do because of concern over the possible increase or decease of the return over time. With this in mind shorter term investments were made so as not to lose potential returns if rates went up. Conversely debt then became more expensive and so it was a fine balancing act.

This report summarises the following:-

- Capital activity during the year;
- 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;
- Summary of interest rate movements in the year;
- Detailed debt activity; and
- Detailed investment activity.

2. Capital Expenditure and Financing

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or

- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was funded.

Capital and Financing	2022/23 Actual £000's	2023/24 Original Budget £000's	2023/24 Actual £000's
Capital expenditure	**4,851**	**20,888**	**5,303**
Financed in year by:			
Capital Receipts	523	3,350	324
Capital grants/contributions	2,989	13,248	4,142
Revenue	955	3,943	776
Leases	0	0	0
S106	328	204	797
Prudential Borrowing	56	143	(736)

3. The Council's overall borrowing need

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.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises 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 temporary cash resources within the Council.

Reducing the CFR – the Council's 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 borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

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).

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 6th March 2023.

The Council has retained a Valuation Volatility Reserve with a minimum balance of 3% of purchase price of the investment property portfolio. This Reserve will be utilised to mitigate any loss on the investment upon sale of the assets if the capital receipt does not meet the debt outstanding. With the introduction of MRP for 2022/23, this reserve and minimum balance will be reviewed on an annual basis. This is considered a prudent approach for these specific assets.

The Council's CFR for the year is shown below, and represents a key prudential indicator.

Capital Financing Requirement (CFR)	**31 March 2023 Actual £000's**	**31 March 2024 Actual £000's**
Opening balance	40,293	39,438
Add adjustment for Prudential Borrowing	56	(736)
Less MRP/Finance Lease Repayments	(911)	(1,680)
Less VRP	0	0
Closing balance	**39,438**	**37,022**
Movement on CFR	*(855)*	*(2,416)*

Borrowing activity is constrained by prudential indicators for gross borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council ensures 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) plus the estimates of any additional capital financing requirement for the current (2024/25) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. 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.

	31 March 2023 Actual £000's	2023/24 Budget £000's	31 March 2024 Actual £000's
Gross Borrowing Position	21,500	26,500	24,000
CFR	39,438	38,321	37,022
(Under)/Over Funding of CFR	(17,938)	(11,821)	(13,022)

The Authorised Limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, 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.

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 are acceptable subject to the authorised limit not being breached.

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.

	2023/24 £000's
Authorised limit	43,000
Operational boundary	37,022
Financing costs as a proportion of net revenue stream	11.15%

4. Treasury Position as at 31 March 2024

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. At the end of 2023/24 the Council's treasury, (excluding borrowing and finance leases), position was as follows:

TABLE 1	31 March 20223 Principal £000's	Rate/ Return	Average Life yrs.	31 March 2024 Principal £000's	Average Rate/ Return	Average Life yrs.
Fixed rate funding:						
-PWLB	16,500	2.14%	26	14,000	2.25%	27
-Other LA	5,000	3.50%	1	10,000	5.78%	0.3
Total debt	**21,500**		**21**	**24,000**		***27.3***
CFR	**39,438**		**-**	**37,022**		
Over / (under) borrowing	**(17,938)**	**-**	**-**	**(13,022)**		
Investments:						
	18,515		-	20,210		
Total investments	**18,515**		**-**	**20,210**		
Net debt	**2,985**	**-**	**-**	**3,790**		

Under borrowing reflects Internal Borrowing from the Council's cash balances.

The maturity structure of the debt portfolio was as follows:

	31 March 2023 Actual £000's	31 March 2024 Actual £000's	% Portfolio
Less than 5 years	10,500	13,000	54%
5 years and within 10 years	0	0	0
10 years and within 20 years	0	0	0
20 years and within 30 years	2,500	2,500	10%
30 years and within 40 years	0	0	0
40 years and within 60 years	8,500	8,500	36%

£14.0m of loans have been undertaken with the Public Works Loans Board at fixed rates on a maturity basis as detailed above.

Borrowing in advance of need

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.

The Council's capital investments and their subsequent financing costs as a % of the Net Revenue Stream is detailed below along with the impact on Council Tax (all other things being equal). The indicators reflect the Borrowing Strategy, that the Council will only borrow where schemes are able to provide sustained support for the costs of borrowing and reflect new income generated is in excess of the cost of borrowing.

	31 March 2023 Actual	**31 March 2024 Actual**
Ratio of Financing Costs to Net Revenue Stream	5.37%	11.15%
Increase/(Reduction) in Council Tax	£0.05	£25.75

Investments

Investment Policy – the Council's investment policy is governed by DLUHC investment guidance, which has been implemented in the annual investment strategy approved by the Council on 6th March 2023. This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.).

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

Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

Balance Sheet Resources*	**31 March 2023 £000's**	**31 March 2024 £000's**
General Fund Balance	4,884	3,328
Earmarked reserves	19,140	20,047
Provisions	691	378
Usable capital receipts	1,116	1,460
Capital Grants Unapplied	3,018	3,577
Total	**28,849**	**28,790**

*Subject to external audit of the 2023/24 accounts

Investments held by the Council

- The Council maintained an average balance of £22.408m of internally managed funds.
- The internally managed funds earned an average rate of return of 5.1%.
- The comparable performance indicator is the Sterling Overnight Index Average (SONIA) which was a rate of 4.96% as at 31 March 2024.
- Total investment income was £1.144m compared to a budget of £0.577m.

Types of investments	31 March 2023 Actual £000	31 March 2024 Actual £000
Deposits with banks and building societies	1,995	500
Money Market Funds	13,520	16,710
Other Local Authorities	0	1,000
Property funds	3,000	2,000
TOTAL TREASURY INVESTMENTS	**18,515**	**20,210**

Non-Treasury Investments

YEAR OF ACQUISITION	Commercial Property Portfolio	Sector	Total Acquisition Cost £'m
2017/18	Bradford Road, Keighley	Hotel	2.490
2018/19	43 Penistone Road, Sheffield	Leisure	2.700
2018/19	Unit 7 Drake House, Sheffield	Manufacturing	3.175
2018/19	5 Sandars Road, Gainsborough	Manufacturing	6.470
2018/19	Heaton Street, Gainsborough	Retail	1.150
2019/20	Wheatley Road, Doncaster	Commercial Unit	5.681
	TOTAL PORTFOLIO		**21.666**

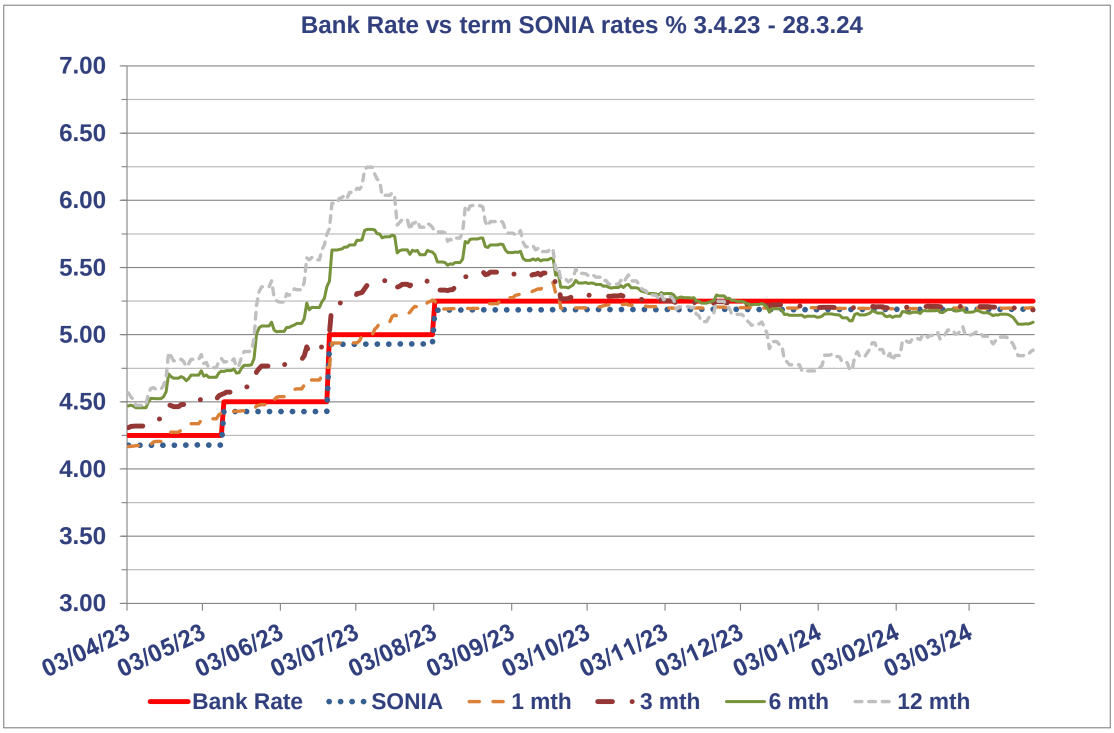
The investments are held on the balance sheet at their Fair Value *(the price expected to be received in current market conditions).* The Fair Value as at 31 March 2024 for the Commercial Property Portfolio is £21.752m.

This investment portfolio is generating a gross yield of 7.12% and £1.549m in income relevant to the financial year.

The Council mitigates any loss on investment by holding a Valuation Volatility Reserve at a minimum of 3% of the purchase price of properties. The balance on this reserve as at 31 March 2024 is £0.967m.

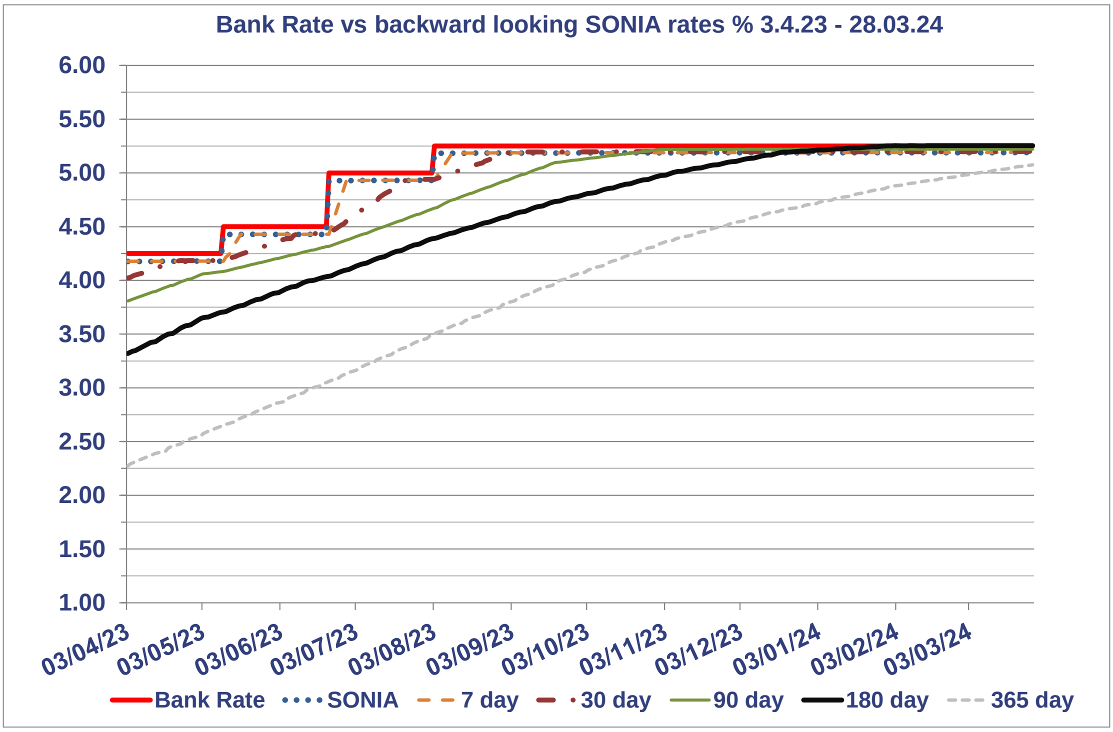
5. The Strategy for 2023/24

Investment strategy and control of interest rate risk



FINANCIAL YEAR TO QUARTER ENDED 28/03/2024						
	Bank Rate	**SONIA**	**1 mth**	**3 mth**	**6 mth**	**12 mth**
High	5.25	5.19	5.39	5.48	5.78	6.25
High Date	03/08/2023	28/03/2024	19/09/2023	30/08/2023	07/07/2023	07/07/2023
Low	4.25	4.18	4.17	4.31	4.46	4.47
Low Date	03/04/2023	04/04/2023	03/04/2023	03/04/2023	06/04/2023	06/04/2023
Average	5.03	4.96	5.02	5.13	5.23	5.25
Spread	1.00	1.01	1.22	1.17	1.33	1.77

Investment Benchmarking Data – Sterling Overnight Index Averages (Backward-looking) 2023/24



FINANCIAL YEAR TO QUARTER ENDED 28/03/2024

	Bank Rate	SONIA	7 day	30 day	90 day	180 day	365 day
High	5.25	5.19	5.19	5.20	5.22	5.25	5.08
High Date	03/08/2023	28/03/2024	28/03/2024	26/03/2024	25/03/2024	22/03/2024	28/03/2024
Low	4.25	4.18	4.18	4.02	3.81	3.32	2.27
Low Date	03/04/2023	04/04/2023	11/04/2023	03/04/2023	03/04/2023	03/04/2023	03/04/2023
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

Investment returns picked up throughout the course of 2023/24 as 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.

Starting April at 4.25%, 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 Bank Rate in either June or August 2024.

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, 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” 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.

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 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.

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.

Borrowing strategy and control of interest rate risk

During 2023/24, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. 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.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Director of Corporate Services 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 a 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 the stickiness of inflation in the major developed economies, then the portfolio position would have been re-appraised. 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.

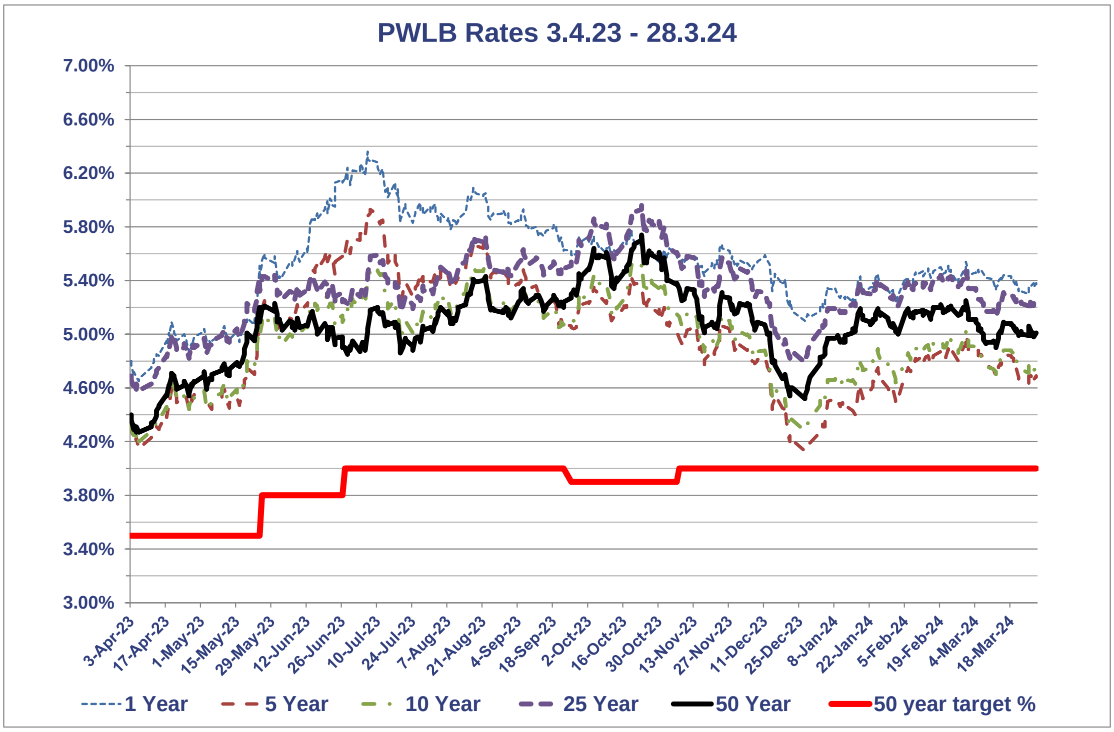
Interest rate forecasts initially suggested further gradual rises in short, medium and longer-term fixed borrowing rates during 2023/24. Bank Rate had initially been forecast to peak at 4.5% but it is now expected to have peaked at 5.25%.

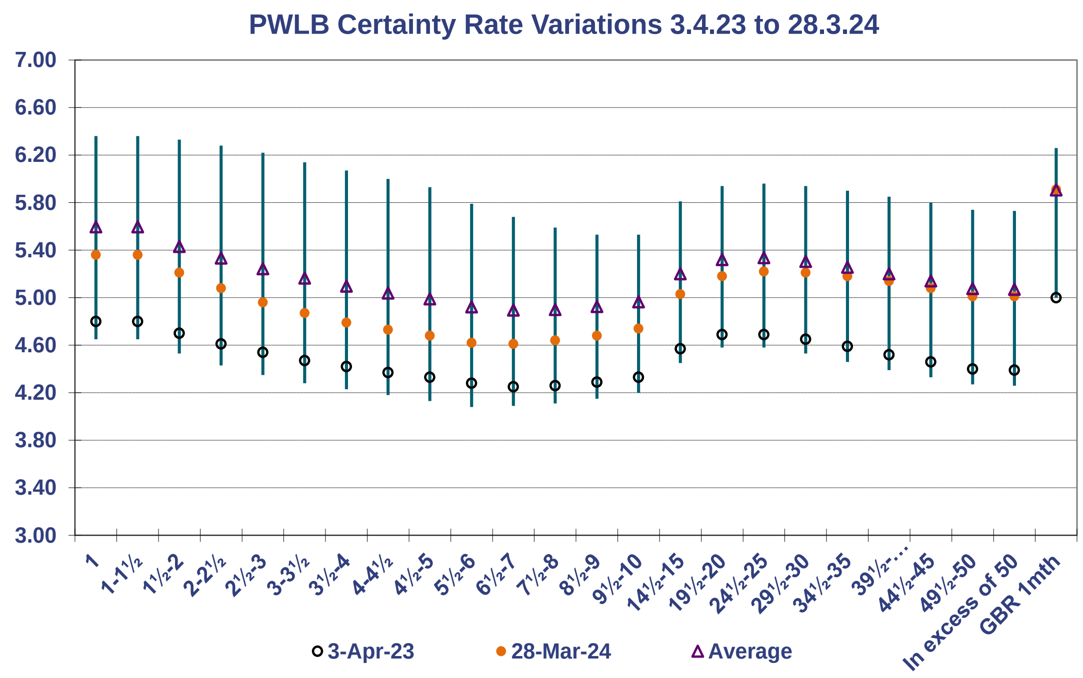
By January it had become clear that inflation was moving down significantly from its 40-year double-digit highs, and the Bank of England signalled in March 2024 that the next move in Bank Rate would be down, so long as upcoming inflation and employment data underpinned that view. Currently the CPI measure 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 geo-political inflationary risks emanating from the prevailing Middle East crisis and the Russian invasion of Ukraine.

Forecasts at the time of approval of the treasury management strategy report for 2023/24 were as follows:-

Link Group Interest Rate View	07.02.23												
	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26
BANK RATE	4.25	4.50	4.50	4.25	4.00	3.75	3.25	3.00	2.75	2.75	2.50	2.50	2.50
3 month ave earnings	4.30	4.50	4.50	4.30	4.00	3.80	3.30	3.00	2.80	2.80	2.50	2.50	2.50
6 month ave earnings	4.40	4.50	4.40	4.20	3.90	3.70	3.20	2.90	2.80	2.80	2.60	2.60	2.60
12 month ave earnings	4.50	4.50	4.40	4.20	3.80	3.60	3.10	2.70	2.70	2.70	2.70	2.70	2.70
5 yr PWLB	4.00	4.00	3.90	3.80	3.70	3.60	3.50	3.40	3.30	3.20	3.10	3.10	3.10
10 yr PWLB	4.20	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.50	3.40	3.30	3.30	3.20
25 yr PWLB	4.60	4.60	4.40	4.30	4.20	4.10	3.90	3.80	3.70	3.60	3.50	3.40	3.40
50 yr PWLB	4.30	4.30	4.20	4.10	3.90	3.80	3.60	3.60	3.40	3.30	3.20	3.20	3.10

PWLB Rates 2023/24





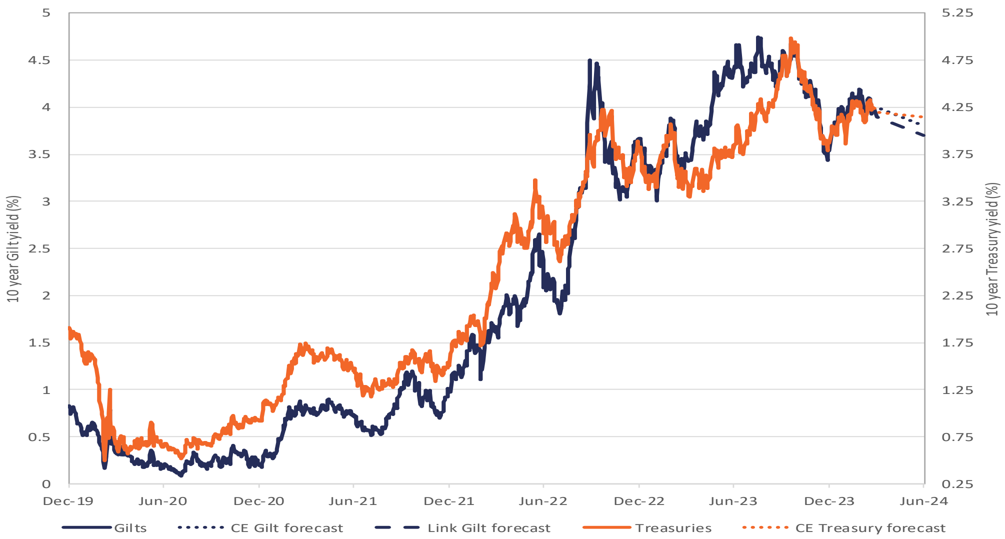
High/Low/Avergae PWLB Rates for 2023/24

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	4.65%	4.13%	4.20%	4.58%	4.27%
Date	06/04/2023	27/12/2023	06/04/2023	06/04/2023	05/04/2023
High	6.36%	5.93%	5.53%	5.96%	5.74%
Date	06/07/2023	07/07/2023	23/10/2023	23/10/2023	23/10/2023
Average	5.54%	4.99%	4.97%	5.34%	5.08%
Spread	1.71%	1.80%	1.33%	1.38%	1.47%

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.

However, since early 2022, yields have risen dramatically in all the major developed economies, first as economies opened post-Covid; 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 emanating 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 levels of persistent inflation that are exacerbated by very tight labour markets and high wage increases relative to what central banks believe to be sustainable.

Graph of UK gilt yields v. US treasury yields



Gilt yields have generally 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%.

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.

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

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

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 Consumer Price Index measure) moves below the Bank of England's 2% target.

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.

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.

6. Other Issues

Counterparty Limits

There have been no breaches of Prudential Indicators.