TREASURY MANAGEMENT ANNUAL REPORT 2023/24

Finance & Investment Advisory Committee – 3 September 2024

Report of: Deputy Chief Executive and Chief Officer – Finance & Trading

Status: For Decision

Also considered by:

- Cabinet – 19 September 2024

Key Decision: No

Executive Summary: This report provides the customary review of investment and borrowing activity during 2023/24 as required by the Council's Financial Procedure Rules. The report outlines the strategy adopted during the year, shows the position of the investment and debt portfolios at the beginning and end of the year and gives details of how the investment fund performed in comparison with previous years and against various benchmarks.

This report supports the Key Aim of: Efficient management of the Council's Finances

Portfolio Holder: Cllr. Kevin Maskell

Contact Officer(s): Jessica Booth, Ext. 7436

Alan Mitchell, Ext 7483

Recommendation to Finance & Investment Advisory Committee: That Cabinet be asked to approve the Treasury Management Annual Report for 2023/24.

Recommendation to Cabinet:

That the Treasury Management Annual Report for 2023/24 be approved.

Reason for recommendation: As required by both the Council's Financial Procedure Rules and the CIPFA Code, an annual report of treasury management activity is to be presented to members for approval.

Background

1 This 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).

2 During 2023/24 the minimum reporting requirements were that members should receive the following reports:

a. An annual treasury strategy in advance of the year (Council 21/02/2023)

b. A mid-year treasury update report (Cabinet 9/11/2023)

c. An annual review following the end of the year describing the activity compared to the strategy (this report).

3 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.

4 This Council confirms it has complied with the requirement under the Code to give prior scrutiny of all the above treasury management reports by the Finance & Investment Advisory Committee before they were reported to the Full Council. Member training on Treasury Management issues was delivered during the year on 03/01/2024 in order to support members' scrutiny role.

Introduction

5 This annual treasury report covers:

a. Capital activity during the year;

b. Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement)

c. The actual prudential and treasury indicators;

d. Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;

e. Summary of interest rate movements in the year;

f. Detailed debt activity and

g. Detailed investment activity.

The Council's capital expenditure and financing

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

a. 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

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

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

	31/3/23 Actual (£000)	31/3/24 Actual (£000)
Capital Expenditure	12,617	11,857
Financed in Year	(9,631)	(8,711)
Unfinanced capital expenditure	2,986	3,146

The unfinanced capital expenditure was financed by internal borrowing.

The Council's overall borrowing need

8 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 which has not yet been paid for by revenue or other resources.

9 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.

10 **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.

11 The total CFR can also be reduced by

a. The application of additional capital financing resources (such as unapplied capital receipts); or

b. Charging more than the statutory revenue charge (MRP) each year through a voluntary revenue provision (VRP).

12 The Council's 2023/24 MRP policy, was approved as part of the Treasury Management Strategy report for 2023/24 on 21/02/2023.

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

CFR (£m)	31/3/23 Actual (£000)	31/3/24 Actual (£000)
Opening Balance	48,657	51,334
Add unfinanced capital expenditure	3,002	1,528
Less MRP	(325)	(672)
Closing Balance	51,334	52,190

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

15 **Gross borrowing and the CFR** – in order to ensure that borrowing levels are prudent over the medium term and only for capital purpose, the Council should 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, plus the estimates of any additional capital requirement for the current and next 2 financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs. The table below highlights the Council's gross borrowing position against the CFR.

	31/3/23 Actual (£000)	31/3/24 Actual (£000)
CFR General Fund	51,318	52,190
Gross borrowing position	13,798	19,420
Over/(under) funding of CFR	(37,520)	(32,770)

16 The authorised limit is the "affordable borrowing limit" required by section 3 of the Local Government Act 2003. Once this limit 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 its gross borrowing within its authorised limit.

17 The operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over this boundary are acceptable subject to the authorised limit not being breached.

18 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)
Authorised limit	47,275
Maximum gross borrowing position during the year	19,420
Operational boundary	42,275
Average gross borrowing position	14,366
Financing costs as a proportion of net revenue stream	2.07%

Treasury Position as of 31 March 2024

19 The Council's treasury management debt and investment position is organised by the treasury management service 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 through member reporting as 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 position was as follows.

Debt Portfolio	31/3/23 Principal (£000)	Rate/ Return (%)	Average Life (Years)	31/3/24 Principal (£000)	Rate/ Return (%)	Average Life (Years)
PWLB	12,298	2.18	21.02	11,820	2.18	20.02
Market	1,500	4.60	0.05	7,600	6.00	0.79
Total Debt	13,798			19,420		
Over/(under) borrowing	(37,520)			(32,770)		
Total Investments	7,929			5,937		
Net Debt	5,869			13,483		

The maturity structure of the debt portfolio was as follows.

Period	Principal amount 31/3/2023	Principal amount 31/03/2024
Under 12 months*	1,500	5,000
12 months and over and within 5 years	0	2,600
5 years and over and within 20 years	7,661	7,316
20 years and over and within 30 years	4,637	4,504

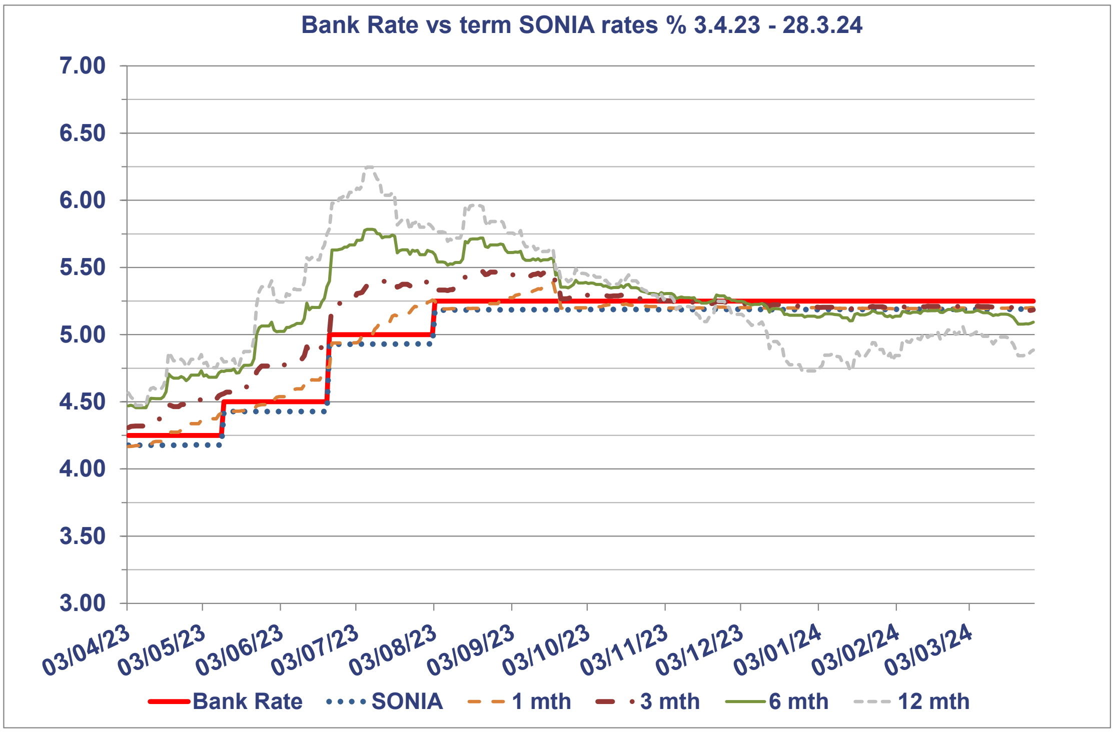
*Cash flow borrowing

20 The investment portfolio at the beginning and end of the financial year appears at Appendix A, whilst an analysis by maturity and repayment dates appears at appendix B.

Treasury Strategy 2023/24

21 Investment strategy and control of interest rate risk

Investment Benchmarking Data - Sterling Overnight Index Averages (Term) 2023/24



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

22 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.

23 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 was pricing in the first cut in Bank Rate in June or August 2024, though this was to prove to be delayed by the General Election.

24 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.

25 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 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.

26 While the Council has taken a prudent approach to investing surplus monies, it is also fully appreciative of changes to the 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 the financial institutions, with annual stress tests by regulators evidencing how institutions are far more able to cope with extreme stressed market and economic conditions.

Borrowing strategy and control of interest rate risk

27 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.

28 Against this background and the risks within the economic forecast caution was adopted with the treasury operations. The Deputy Chief Executive and Chief Officer - Finance & Trading therefore monitored interest rates in the financial markets and adopted a pragmatic strategy based on the following principles to manage interest rates. Given the high levels of interest rates long-term borrowing was postponed to enable lower rates to be achieved at a later date.

29 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%

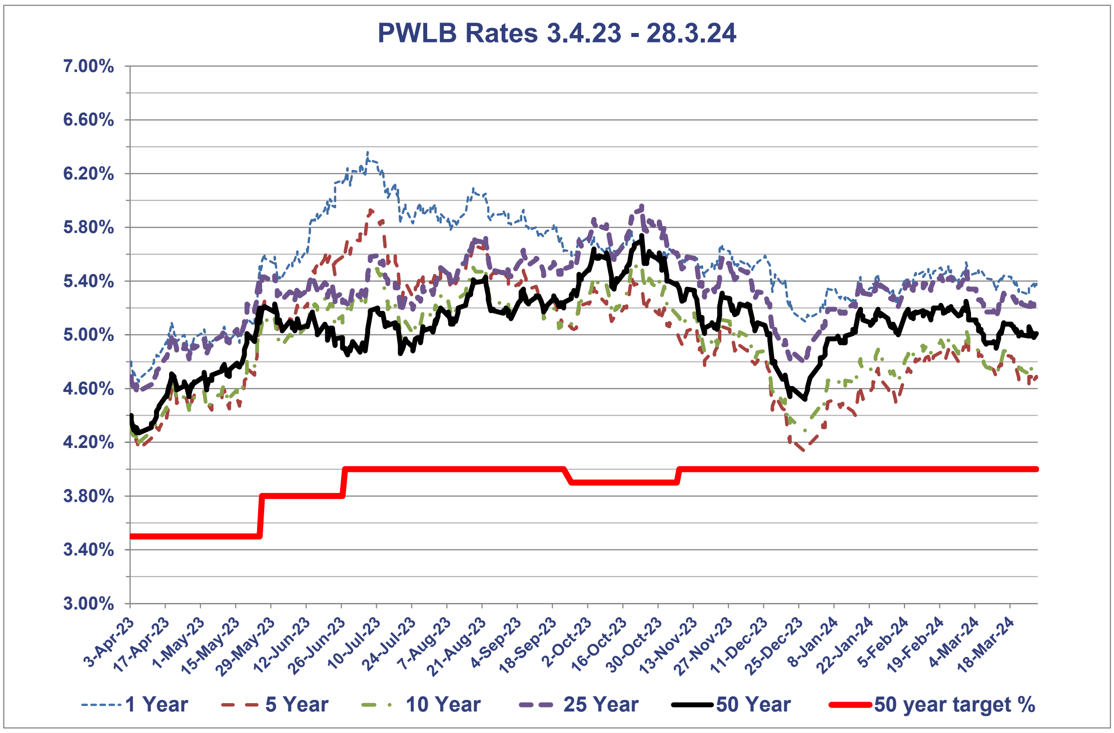
30 By January it had become clear that inflation was moving down considerably from its 40-year double-digit highs, and the Bank of England signalled in March

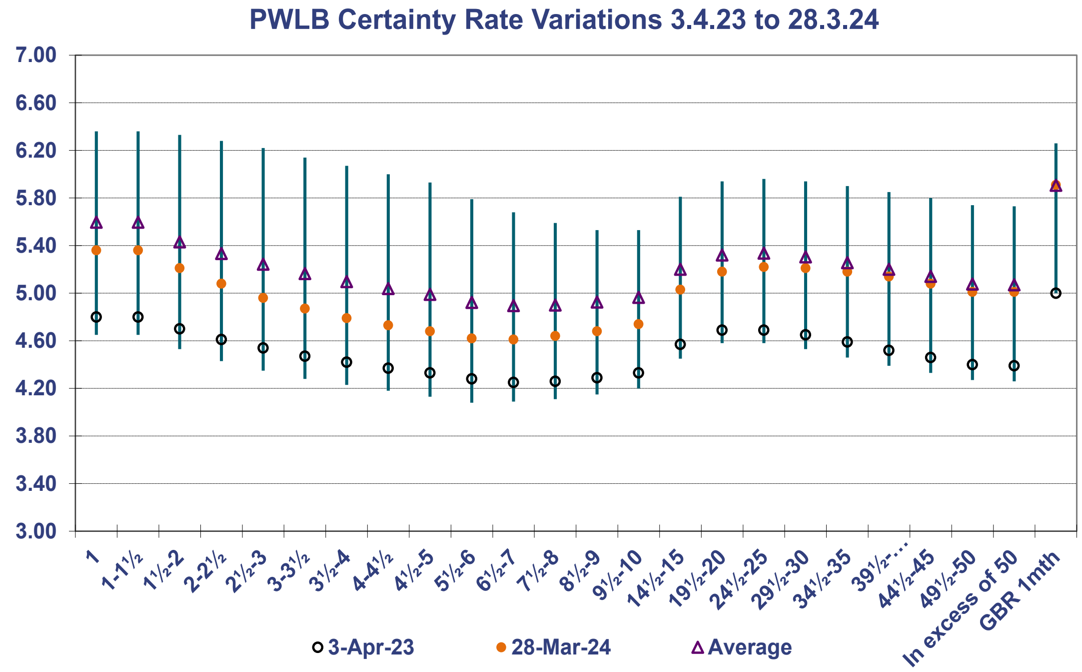
2024 that the next move in Bank Rate would be down, so long as upcoming inflation and employment data underpinned that view. At the end of the year the CPI measure of inflation stood at 3.4% but was expected to fall materially below 2% over the summer months and to stay there in 2025 and 2026. Nonetheless, 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.

31 Forecasts at the time of the 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/ Average 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%

32 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 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.

33 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 Federal Open Market Committee (FOMC), European Central Bank (ECB) and the 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.

Borrowing Outturn

34 One new loan was taken out during the year. This was a 3-year loan taken for Quercus Housing for affordable housing purposes at 4.85%. The loans outstanding were therefore as follows. This list excludes short term cash flow borrowing.

Lender	Principal	Type	Interest rate	
Crawley Borough Council	£2.6m	Fixed interest payable annually, principal at maturity.	4.85%	3 years to 12/06/2026
PWLB	£5.25m	Fixed interest rate - Annuity	2.66%	30 years to 3/11/2047
PWLB	£8m	Fixed interest rate - Annuity	1.70%	20 years to 25/11/2041

35 The Council has not borrowed more than, or in advance if its needs, purely in order to profit from the investment of the extra sums borrowed.

36 There were no repayments or rescheduling of debt during 2023/24.

Investment Outturn for 2023/24 and Performance

37 The Council's investment policy is governed by Department for Levelling Up, Housing and Communities (DLUHC) investment guidance which has been implemented in the annual investment strategy approved by the Council on 21/02/2023. 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.)

38 The investment activity during the year confirmed to the approved strategy and the Council had no liquidity difficulties. Appendix C shows the performance of the fund during 2023/24 both in table and graphical form. The table shows the average percentage return on the fund, both monthly and for the whole year, and compares them with the average 7-day and 3-month Sterling Overnight Index Average (SONIA) rates.

39 The graph shows actual monthly receipts for 2021/22, 2022/23 and 2023/24 plus budgeted monthly receipts for 2023/24. The monthly interest budget has

been profiled in line with the previous year's monthly weighted average principal.

40 Over the course of the year the interest receipts amounted to £901,922 against a budget of £288,000, equating to a return of 5.12%. Balances available for investment continued to reduce during the year owing to ongoing internal borrowing and the funding of the capital programme. However, performance was positively affected by both rising interest rates and the return on the multi asset income funds during the year. These funds have the potential for capital loss as well as capital growth. For this reason, they are viewed with a minimum 5-year investment horizon which, in theory, evens out capital loss and growth.

41 Our treasury management advisers recommend the SONIA figures as a benchmark. The 3-month rate reflects the more realistic neutral investment position for core investments with a medium-term horizon and a rate which is more stable with less fluctuation caused by market liquidity. Historically this rate has been slightly higher than the 7-day rate and therefore a more challenging comparator, but one which does not necessitate a significantly increase level of risk. The figures calculated by our advisers for these benchmarks are as follows;

a. 7-day SONIA compounded 4.9617

b. 90-day SONIA compounded 4.7358

42 The Council operates to approved prudential indicators for treasury management as contained in the Treasury Management Strategy Statement (TMSS). The TMSS for 2023/24 was part of the annual treasury strategy reported to Council on 21/02/2023. The approved limits exist to regulate short-term borrowing for operational cash flow fluctuations as well as long-term borrowing for financing capital investments. Additionally, the limits aim to mitigate against fluctuations in interest rates.

Key Implications

Financial

The management of the Council's investment portfolio and cash-flow generated balances plays an important part in the financial planning of the authority. The security of its capital and liquidity of its investments is of paramount importance.

Legal Implications and Risk Assessment Statement.

Under Section 151 if the Local Government Act 1972, the Section 151 Officer has statutory duties in relation to the financial administration and stewardship of the authority, including securing effective arrangements for treasury management.

This annual review report fulfils the requirements of the Chartered Institute of Public Finance & Accountancy's Code of Practice on Treasury Management 2017.

Treasury management has two main risks:

- Fluctuations in interest rates can result in a reduction in income from investments; and
- A counterparty to which the Council has lent money fails to repay the loan at the required time.

Consideration of risk is integral to our approach to treasury management. However, this particular report has no specific risk implications as it is not proposing any new actions, but merely reporting performance over the last year.

Equality Assessment

The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act. There is no perceived impact on end users.

Climate Change Implications

The decisions recommended through this paper have a remote or low relevance to the council's ambition to tackle the challenge of climate change. There is no perceived impact regarding either an increase or decrease in carbon emissions in the district, or supporting the resilience of the natural environment.

Conclusions

The overall return on the Council's investment was above budget in 2023/24 by £614,000 achieving an average interest rate of 5.12%.

Appendices

Appendix A – Investment Portfolio at the beginning and end of the year

Appendix B – Investment maturity and repayment dates

Appendix C – Investment performance in 2023/24

Appendix D – Economic background and interest rates.

Background Papers

Treasury Management Strategy for 2023/24 - Council 21 February 2023

Adrian Rowbotham

Deputy Chief Executive and Chief Officer – Finance & Trading