Report title	**Annual Treasury Management Report 2023/24**
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Department	Finance
Exempt?	No

Purpose of report:

For information

Synopsis of report:

This is the annual report on Council's treasury management activity and performance for the 2023/24 financial year covering financing and liquidity, cash management and risk management associated with these activities.

1 Background Information

1.1 The Council's treasury management activity is underpinned by CIPFA's (Chartered Institute of Public Finance and Accountancy*)* Code of Practice on Treasury Management ("the Code"), and the CIPFA Prudential Code for Capital Finance in Local Authorities ("the Prudential Code"). These regulations require local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement for the financing and investment activities.

1.2 The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2023/24 (this report). From 2023/24, the Code also recommends that members are informed of treasury management activities quarterly.

1.3 The Council's Treasury Management Strategy for 2023/24 was approved at Full Council on 09 February 2023. This report provides the details for the Council's performance against the criteria set in the 2023/24 strategy.

1.4 Treasury management is defined 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."

1.5 No treasury management activity is without risk; The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities focuses on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

1.6 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 the members.

1.7 This report was presented to the Corporate Management Committee on 20 June 2024.

2 Prudential and Treasury Indicators and Compliance

2.1 Officers hereby confirm that during the year, the Council has maintained compliance with the Code and regulatory requirements as well as its Treasury Management Statement and Treasury Management Practices.

2.2 During the year the Council operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy for 2023/24 and a prudent approach was taken in relation to all investment activity with priority being given to security and liquidity over yield.

2.3 A full set of prudential and treasury indicators for 2023/24 are set out in Appendix A

3 Risk management

3.1 The Council aims to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. The Treasury Management Strategy Statement for 2023/24, which includes the Annual Investment Strategy, sets out the Council's investment priorities as being:

Credit risk
Counterparty credit quality is assessed and monitored with reference to credit ratings; credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP; any potential support mechanisms and share price.

Liquidity risk
In keeping with the DLUHC Guidance on Investments, the Council maintains a sufficient level of liquidity through the use of Money Market Funds and call accounts.

Yield
The Council seeks to optimise returns commensurate with its objectives of security and liquidity.

4 Economic background

4.1 The economic overview as provided by the Council's Treasury Advisors, The Link Group that reflects the market position in April 2024 is detailed in Appendix E.

5 Borrowing Activity in 2023/24

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

5.1 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.

5.2 During 2023/24, the Council maintained an under-borrowed position. This meant that the capital borrowing need, the CFR, 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.

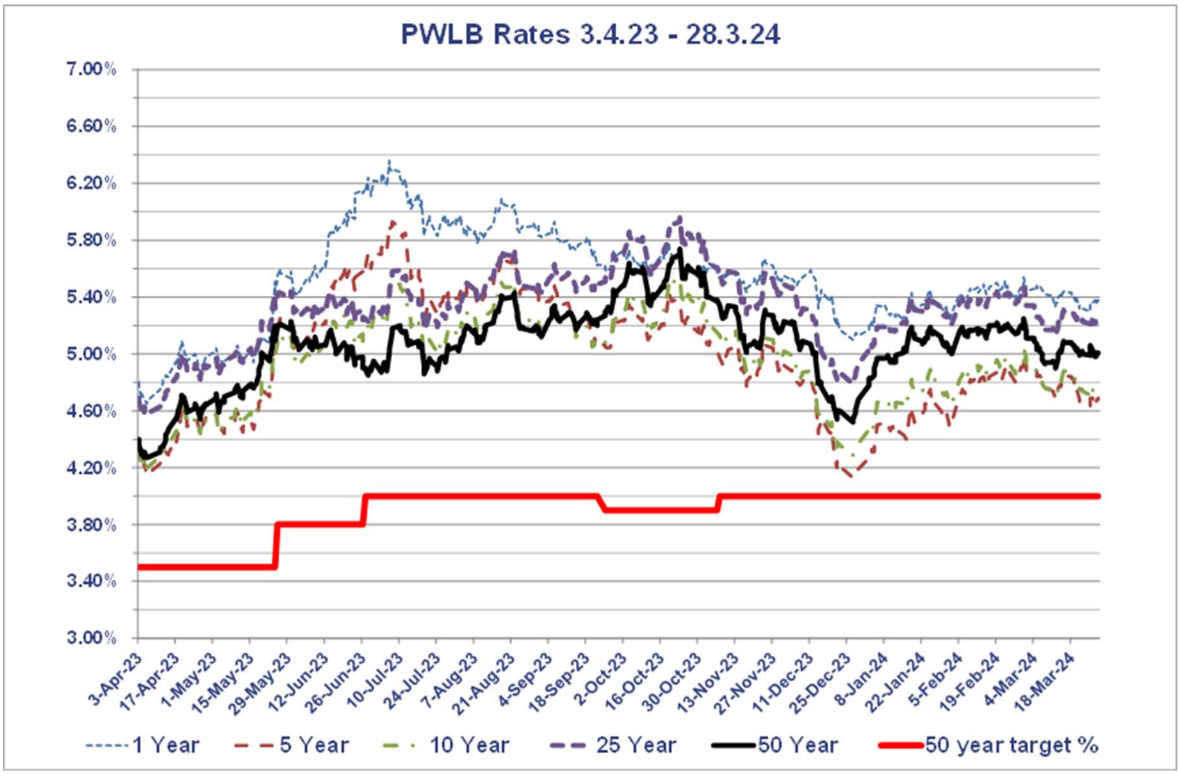
5.3 Table 1 sets out the borrowing activity for the year.

Table 1 – Borrowing activity in 2023/24				
	Opening Balance £'000	New borrowing £'000	Borrowings repaid £'000	Closing balance £'000
HRA – PWLB	100,000	0	0	100,000
General Fund - PWLB	499,000	0	10,000	489,000
General Fund – Other	44,181	0	5,566	38,615
	643,181	**0**	**15,566**	**627,615**

5.4 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.

5.5 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 Fed, ECB and Bank of England are all being challenged by persistent inflation that is exacerbated by very tight labour markets and high wage increases relative to what central banks believe to be sustainable.

5.6 The actual PWLB rates during the year were as follows:



5.7 Gilt yields have 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%.

5.8 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.

5.9 There are strict criteria set out that forbid councils from borrowing more than, or in advance of, their needs purely in order to profit from the investment of the extra sums borrowed. The Council has undertaken no such borrowing.

6 Interest rates in 2023/24

6.1 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.

6.2 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.

6.3 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.

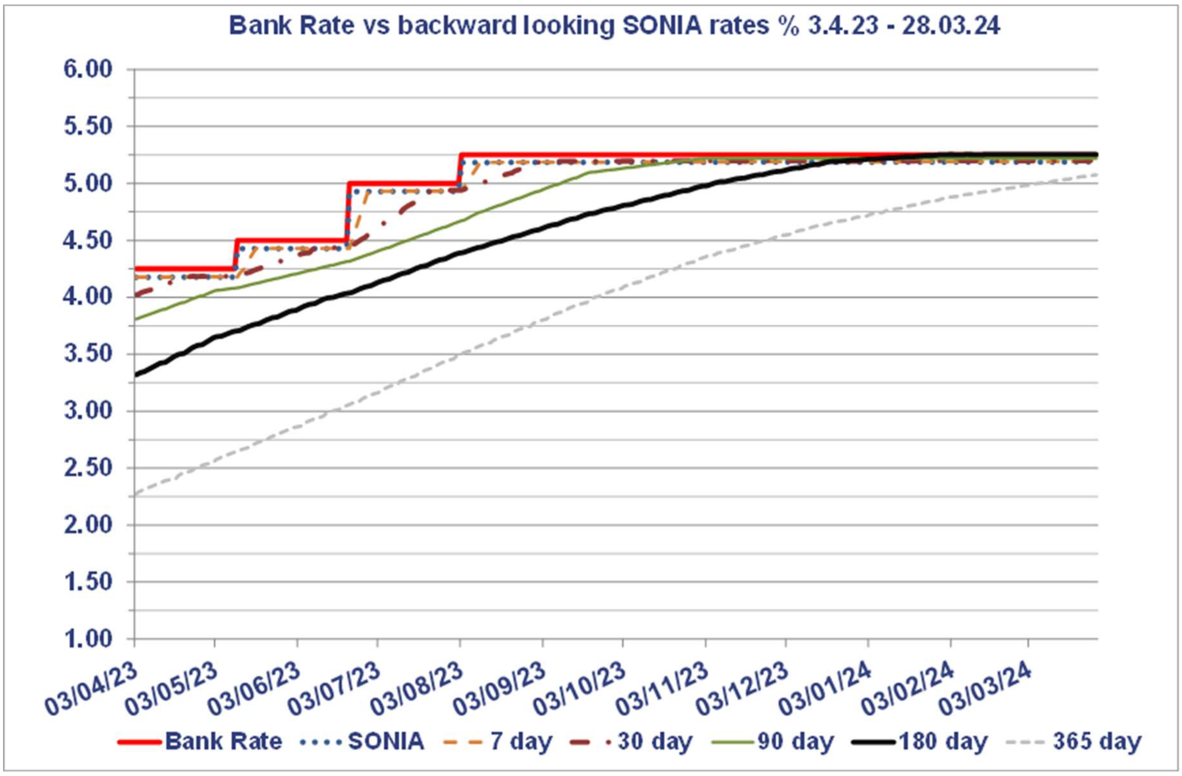
6.4 With bond markets selling off, UK equity market valuations struggled to make progress, as did property funds, although there have been some spirited, if temporary, market rallies from time to time – including in November and December 2023. However, the more traditional investment options, such as 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.

6.5 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.

6.6 The Council's Treasury Management Strategy sets out that the Council will measure its investment performance against the following SONIA (Sterling Overnight Index Average rate) rates:

- Average Bank Base rate,
- 7 day backward looking SONIA* uncompounded average
- 90 day backward looking SONIA* uncompounded average
- 365 day backward looking SONIA* uncompounded average

6.7 The SONIA (backward-looking) interest rates during the period were as follows:



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

6.8 The Council's actual interest rate performance during the year was 4.99%. The Council's overall performance compares favourably with the average SONIA rates as can be seen in the above table.

6.9 The Council's Treasury Management Strategy sets out a lower rate of interest for the Housing Revenue Account based on the risk-free nature of the account. This lower rate is achieved by deducting the credit risk margin from the actual rate achieved by the Council. The resulting interest rate applicable to the HRA during 2023/24 was 4.84%.

6.10 The Council invests in two Pooled Funds (operated by CCLA (Churches, Charities and Local Authorities) Investment Management Limited). These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Investments in these funds are long term in nature and over long term horizons they provide investors with relatively strong levels of interest (in the form of dividends). However, the capital values of these assets can be subject to large fluctuations (both up and down) over relatively short time frames.

6.11 As advised in last years quarterly Treasury Management reports, The CCLA merged CCLA Diversified Income Fund with a new fund set up for the purpose of the merger, the CCLA Better World Cautious Fund, on 16 February 2024. The new fund will continue to invest globally under the same management, albeit with enhanced ESG investment policy and using formal KPI for the expected minimum return of CPI+2% per annum over any 5-year period.

6.12 The movement of the Council's two CCLA pooled funds is as follows:

Table 2 – Pooled Funds in 2023/24				
	Original Investment £	Value 31 March 2023 £	Value 31 March 2024 £	Annual Return %
CCLA Property Fund	2,000,000	2,263,467	2,175,136	6.1
CCLA Better World Cautious Fund	2,000,000	1,894,514	1,987,676	3.3

The differences between the Original Sums invested and the Values at 31 March 2024 were £162,812 and are held on the Council's Balance Sheet in the Pooled Investments Adjustment Account – a temporary unusable reserve introduced to offset the requirements of International Financial Reporting Standard 9: Financial Instruments (IFRS 9).

6.13 Following the consultation undertaken by the DLUHC on IFRS 9, the Government has extended the mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds to 31st March 2025. Local authorities are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve (the Pooled Investments Adjustment Account) throughout the duration of the override in order for the Government to keep the override under review and to maintain a form of transparency.

7 Investment Outturn for 2023/24

7.1 The Council's investment policy is governed by DLUHC investment guidance and is reflected in the Annual Investment Strategy approved by the Council each year. 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.

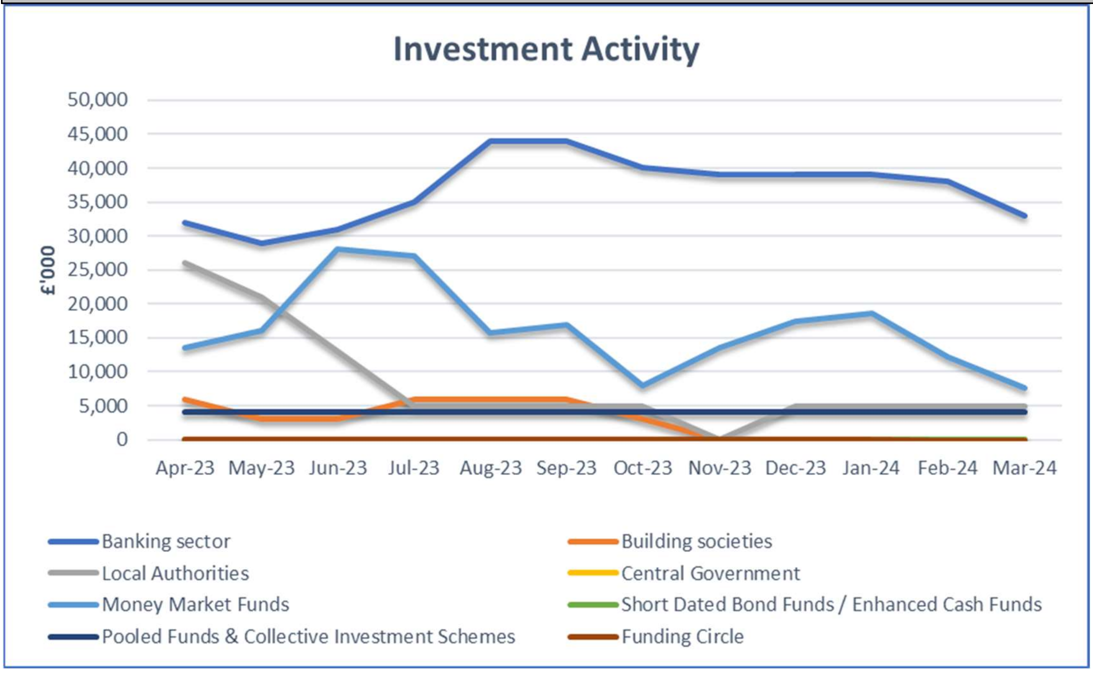
7.2 Investments of £49.6 million were held by the Council at 31 March 2024 with investment turnover principally driven by the availability of counterparties that meet the criteria set out in the Annual Investment Strategy. Table 3 summarises investment activity during the year, split between the sectors of the counterparties that the funds were invested with.

Table 3 - Investment activity in 2023/24

	Opening Balance	New Investments	Investments Recalled	Closing Balance
	£000	£000	£000	£000
Specified Investments				
Banking sector	25,000	99,000	91,000	33,000
Building societies	6,000	9,000	15,000	0
Local Authorities	26,000	13,000	34,000	5,000
Central Government	0	0	0	0
Money Market Funds	12,000	153,300	157,700	7,600
Unspecified Investments				
Short Dated Bond Funds & Cash Funds	0	0	0	0
Pooled Funds & Investment Schemes	4,000	0	0	4,000
Funding Circle	42	0	28	14
	73,042	274,300	297,728	49,614

7.3 The monthly movement in balances between these categories is set out in Table 4 below and reflects the available counterparties and investment rates at that time.

Table 4 - Movement between investments during 2023/24



7.4 A full list of investments held at 31 March 2024 is set out in Appendix C.

7.5 In addition to the normal money markets, the Council also invests in its own companies by way of loans provided to them for the purchase of assets from the Council (that the Council cannot hold itself) and via working capital loans. All such Loan Agreements have been approved by Full Council at rates set in accordance with competition rules. The table below sets out these loans and the income to the Council in 2023/24.

Loan Type	Original Investment £	Annual Interest £	Interest Rate %
Development Loans - AddlestoneOne	25,326,054	1,276,433	5.04
Development Loans – Magna Square	11,837,595	499,546	4.22
Development Loans - Other	1,000,000	48,600	4.86
Working Capital Loans	445,000	33,553	7.54
Working Capital Loans	300,000	22,080	7.36
Working Capital Loans	3,000,000	186,820	7.40
Totals	**41,908,649**	**2,067,032**	

7.6 The Council's cash balances comprise revenue and capital resources and cash flow monies (creditors etc). Interest earned on these balances is derived from in-house managed investments. The table below shows gross investment income achieved in 2023/24 alongside the interest paid on borrowings:

Table 7 – Net investment income / Debt interest 2023/24		
	Original Estimate £'000	Outturn Actual £'000
Investment income earned	4,756	3,461
Dividend income earned	120	195
Interest on loans to RBC companies	2,036	2,067
Interest paid on deposits and other balances	(11)	(17)
Gross investment income	**6,901**	**5,706**
Management expenses	(26)	(18)
Debt interest	(16,730)	(16,147)
Net Investment Income / (Debt interest)	**(9,855)**	**(10,459)**

This is broken down between services as follows:

General Fund	(7,715)	(8,908)
Housing Revenue Account	(2,140)	(1,551)
Net Investment Income / (Debt interest)	**(9,855)**	**(10,459)**

7.7 The revised estimate for investment income assumed a higher level of interest rates over the last 6 months of the year than actually materialised. Due to higher than anticipated borrowing rates, officers decided not to take out replacement borrowing for the various maturities, instead choosing to run down investment balances to generate a net betterment for the Council (see paragraphs 5.3 and 7,2). It should be noted that this is only a temporary measure until such time that the current high borrowing rates return to levels in line with medium term market predictions.

7.8 Aside from the parameters set in the Annual Investment Strategy, the main factors that determine the amount of investment income are the level of interest rates, cash flow and the level of reserves and balances. The impact of capital cash flows – receipts from sales and timing of capital projects – also has a significant impact on cash flows.

8 Non-treasury Investments

8.1 The Prudential Code, TM Code and DLUHC regulations include guidance on what is termed "non-treasury" investments. These are predominantly investments for commercial return such as:

- commercial loans to companies and other organisations (reported in paragraph 7.5), and
- holding property for a financial return (investment property).

The Council owns a significant investment property portfolio which is now managed through its developing Asset Management Strategy and provided loans to its wholly owned companies and local community groups.

8.2 To better describe the role the investment property portfolio plays in the Council's capital and revenue strategies a set of performance reporting measures were approved as part of both the Annual Asset Management Strategy and the Capital & Investment Strategy which up until now have been incorporated in the Treasury Management reports.

8.3 At the time of writing this report the Council was still awaiting final property valuations and the additional benchmarking analysis relative to the broader market, based on data via a subscription to MSCI Analytics. A decision was therefore made to submit these as a separate report to the next meeting of this committee. It is anticipated that future Investment property reports will be presented to the same committees as the Treasury Management reports,

9 Legal Implications

9.1 The powers for a local authority to borrow and invest are governed by the Local Government Act 2003 and associated Regulations. A local authority may borrow or invest for any purpose relevant to its functions, under any enactment, or for the purpose of the prudent management of its financial affairs. The Regulations also specify that authorities should have regard to the CIPFA Treasury Management Code, the Government Investments Guidance and the CIPFA Prudential Code for Capital Finance in Local Authorities when carrying out their treasury management functions.

10 Environmental/Sustainability/Biodiversity implications

10.1 Ethical or Sustainable investing is becoming a more commonplace discussion within the wider investment community. There are currently a small, but growing number of financial institutions and fund managers promoting Environmental, Social and Governance (ESG) products however the types of products we can invest in are constrained to those set out in our Investment Strategy which is driven by investment guidance, both statutory and from CIPFA, making it clear that all investing must adopt SLY principles – security, liquidity and yield: ethical issues must play a subordinate role to those priorities.

10.2 The Council does not invest directly in any companies – other than our own - and our investments are limited to investments with the banking sector (term deposits etc) and investments in property (our investment properties). The Council has £4million split between two pooled funds both managed by the CCLA and their approach to ESG can be found on their website: https://www.ccla.co.uk/sustainability/corporate-governance/approach-esg

11 Council Policy

11.1 This is set out in the Treasury Management Policy Statement, the Annual Investment Strategy, and associated Practices and Schedules.

11.2 The Council's treasury management policy statement states:

"The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks."

11.3 It is the security of investments that has always been the main emphasis of our treasury strategy. In balancing risk against return, Officers continue to place emphasis on the control of risk over yield.

12 Conclusions

12.1 The financial year continued the challenging investment environment of previous years. The management of counterparty risk remains our primary treasury management priority. The criteria in the Annual Investment Strategy are continuously reviewed to minimise risk as far as reasonably possible whilst retaining the ability to invest with secure institutions.

13 Appendices

- Appendix A - Treasury Indicators 2023/24
- Appendix B - Borrowings as of 31 March 2024
- Appendix C - Investments as of 31 March 2024
- Appendix D - Abbreviations used in the report
- Appendix E - Economic Update (as provided by the LINK Group