APPENDIX A

ANNUAL TREASURY REPORT 2023/24

1. Background

1.1 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).

1.2 Treasury management is defined as: 'The management of the local authority's 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.'

1.3 Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management strategy.

2.0 Economic Background

2.1 **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.

2.2 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)

2.3 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”.

2.4 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%.

2.5 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.

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

2.7 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.

2.8 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.

2.9 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.

2.10 **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.

2.11 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%.

2.12 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?

2.13 **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.

3.0 Local Context

3.1 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.

3.2 A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

3.3 The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

3.4 The Council's Capital Financing Requirement (CFR) at 31 March 2024 was £135.657m, while usable reserves and working capital which are the underlying resources available for investment were £55.409m**.**

3.5 The Council has an increasing CFR over the next 2 years of £54m, due to the borrowing requirement of £64.6m (GF £29.6m / HRA £35m) for financing the capital programme over the forecast period, if reserve levels permit internal borrowing will be considered. The CFR reduces when Minimum Revenue Provision (MRP) are made and the repayment of debt, over the forecast period there are loans due for repayment with a combined total value of £9.7m.

4.0 Borrowing Strategy

4.1 Borrowing Activity in 2023/24

	Balance 1/4/23 £m	New Borrowing £m	Debt Maturing £m	Balance 31/3/24 £m
CFR	139.074			135.658
Short Term Borrowing	9.334	4.140	-3.952	9.522
Long Term Borrowing	81.435	0.000	-5.494	75.941
Total Borrowing	**90.769**	**4.140**	**-9.446**	**85.463**
Other Liabilities – Finance Lease Liability	5.009	0.000	-0.145	4.864
Total External Debt	**95.778**	**4.140**	**-9.591**	**90.327**
Increase/(Decrease) in Borrowing £000				-5.451

4.2 The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective.

4.3 The Council has an increasing CFR due to the capital programme and an estimated borrowing requirement as determined by the Liability Benchmark, which also takes into account usable reserves and working capital. Having considered the appropriate duration and structure of the Council's borrowing need based on realistic projections, it was decided not to take any long term borrowing due to the high interest rates.

4.4 **LOBOs**: The Council holds £3.5m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. All of the £3.5m of LOBOS had options during the year, none of which were exercised by the lender.

4.5 **Debt Rescheduling**: The premium charge for early repayment of PWLB debt remained relatively expensive for the loans in the Council's portfolio and therefore unattractive for debt rescheduling activity. No rescheduling activity was undertaken as a consequence.

5.0 Investment Activity

5.1 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 9 March 2023. The 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.). During 2023/24 the Council's investment balances have ranged between £33.6 and £74.0 million.

	Balance 1/4/23 £m	New Investments £m	Investments Redeemed £m	Balance 31/3/24 £m
Short Term Investments	44.575	183.115	-205.780	21.910
Long Term Investments	12.500	0.000	0.000	12.500
Total Investments	**57.075**	**183.115**	**-205.780**	**34.410**
Increase/(Decrease) in Investments £000				-22.665

5.2 Security of capital remained the Council's main objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2023/24.

5.3 Counterparty credit quality is assessed and monitored by Link the Council's treasury advisors, with reference to credit ratings; credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. Link provide recommendations for suitable counterparties and maximum investment periods.

6.0 <u>Compliance with Prudential Indicators</u>

6.1 The Council has complied with its Prudential Indicators for 2023/24, which were set on 9 March 2023 as part of the Council's Treasury Management Strategy Statement.

6.2 **Interest Rate Exposure:** These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates for both borrowing and investments. The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Approved Limit for 2023/24 %	Maximum during 2023/24 £m
Fixed Rate		
Borrowing	100%	99.38%
Investments	75%	20.34%
Compliance with Limit		*Yes*
Variable Rate		
Borrowing	20%	0.62%
Investments	100%	79.66%
Compliance with Limit		*Yes*

6.3 **Maturity Structure of Fixed Rate Borrowing.** This indicator is to limit large concentrations of fixed rate debt and control the Council's exposure to refinancing risk.

	Upper Limit %	Fixed Rate Borrowing 31/03/24 £m	Fixed Rate Borrowing 31/3/24 %	Compliance?
Under 12 months	15%	3.562	4.17%	Yes
12 months to 2 years	15%	1.000	1.17%	Yes
2 years to 5 years	30%	22.031	25.78%	Yes
5 years to 10 years	100%	8.005	9.37%	Yes
10 years and above	100%	50.865	59.52%	Yes

6.4 **Principal Sums Invested for over 364 Days.** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments.

Price Risk Indicator	Limit 2023/24	Actual 31/03/24	Compliance?
Limit on principal invested beyond year end	£15m	£12.5m	Yes

6.5 **Authorised Limit and Operational Boundary for External Debt.** The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached. The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit. The s151 Officer confirms that there were no breaches to the Authorised Limit and the Operational Boundary during 2023/24.

	Approved Operational Boundary 2023/24 £m	Authorised Limit 2023/24 £m	Actual External Debt 31/03/24 £m
Borrowing – incl Finance Leases	182.526	189.526	90.327
Other Long Term Liabilities	0.400	0.600	0.000
Total	**182.926**	**190.126**	**90.327**

6.6 In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary of the treasury management activity during 2023/24. A prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

6.7 The Council also confirms that during 2023/24 it complied with its Treasury Management Policy Statement and Treasury Management Practices.