North Devon Council

Report Date: Monday, 1 July 2024

Topic: Annual Treasury Management Report 2023/24

Report by: Adam Tape, Head of Governance

1. INTRODUCTION

1.1. The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is 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.

2. RECOMMENDATIONS

2.1 The Committee is asked to recommend to full Council that:

- The annual treasury management report for 2023/24 be noted;
- The actual 2023/24 prudential and treasury indicators be approved.

3. REASONS FOR RECOMMENDATIONS

3.1 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).

3.2 During 2023/24 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 22/02/2023)
- a mid year treasury update report (Council 22/11/2023)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

3.3 This Council confirms that it has complied with the requirements under the Code to give prior scrutiny to all the above treasury management reports by the Policy Development Committee before they were reported to the full Council.

4. REPORT

4.1 The Council's 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 financed.

£000	31 March 2023 Actual	2023/24 Estimate	31 March 2024 Actual
Capital expenditure	**7,578**	**17,095**	**10,146**
Financed in year	(5,124)	(11,845)	(8,703)
Unfinanced capital expenditure	**2,454**	**5,250**	**1,443**

- *Estimate from the Mid-Year Treasury Management Report*

4.2 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.

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 MRP policy, (as required by DLUHC guidance), was approved as part of the Treasury Management Strategy Report for 2023/24.

The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes leasing schemes on the balance sheet (fleet vehicles), which increases the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

CFR £000	31 March 2023 Actual	31 March 2024 Estimate	31 March 2024 Actual
Opening balance	21,699	23,866	23,866
Add unfinanced capital expenditure (as above)	2,454	5,250	1,443
Add finance leases Principal payments	556	1,767	1,627
Less MRP	(733)	(741)	(741)
Less finance lease repayments	(110)	(182)	(151)
Closing balance	23,866	29,960	26,044

A finance lease scheme was introduced during 2021/22 for our vehicle fleet. Previously these costs would have been included in the capital expenditure, but these have now been shown separately as above.

The opening balance CFR of £23.9m includes the new Leisure Centre and purchase of Green Lanes Shopping Centre. A further £1.4m of unfinanced capital expenditure was added to the CFR during 23/24 including the provision of temporary accommodation (£726k) and work to Green Lanes Shopping Centre (£345k).

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 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 (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. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

£000	31 March 2023 Actual	2023/24 Estimate	31 March 2024 Actual
Gross borrowing position	4,337	11,922	5,813
Total CFR	**23,866**	**29,960**	**26,044**
Over / (under) funding of CFR	(19,529)	(18,038)	(20,231)

- *Estimate from the Mid-Year Treasury Management Report*

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 £
Authorised limit	37.50m
Maximum gross borrowing position during the year	5.8m
Operational boundary	11.9m
Financing costs as a proportion of net revenue stream	3.35%

4.3 Treasury Position as at 31st March 2024

The Council's treasury management 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 and through officer activity detailed in the Council's Treasury Management Practices. At the end of 2023/24 the Council's treasury position (**excluding borrowing by finance leases**) was as follows:

DEBT PORTFOLIO **£000**	31 March 2023 Principal	Rate/ Return	31 March 2024 Principal	Rate/ Return
Total debt (PWLB)	3,000	2.01%	3,000	2.01%
CFR (excluding Finance Leases)	22,529		23,231	
Over / (under) borrowing	(19,529)		(20,231)	
Total investments	6,984	1.50%	4,472	4.45%
Net debt/(investments)	(3,984)		(1,472)	

The cash balances and reserves have supported a large under borrowing position which is considered further in the borrowing strategy below.

The maturity structure of the debt portfolio was as follows:

	31 March 2023 actual	2023/24 Estimate limits	31 March 2024 actual
Under 12 months	£0m	60%	
12 months and within 24 months	£0m	85%	
24 months and within 5 years	£0.50m (16.67%)	100%	£0.50m (16.67%)
5 years and within 10 years	£0m	100%	
10 years and above	£2.50m (83.33%)	95%	£2.50m (83.33%)

All investments were for maturities less than one year

INVESTMENT PORTFOLIO **£000**	31 March 2023 Actual	31 March 2024 Actual
Treasury investments		
Banks	5,690	1,790
TOTAL TREASURY INVESTMENTS	**5,690**	**1,790**

During 2023/24, the Council made no material non-treasury investments in property with the sole purpose of generating an income stream.

4.4 The Strategy for 2023/24

Investment strategy and control of interest rate risk - 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 cash flow 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.

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.

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.

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

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.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Section 151 Officer 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.

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%

PWLB rates are based on gilt (UK Government bonds) yields through H.M.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.

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 Bank of England is 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.

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)

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

4.5 Borrowing Outturn

At 31st March 2024, the CFR, excluding finance leases, was £23m. External borrowing was only £3m as our cash flow (working capital) and reserve balances enabled us to internally borrow the remaining £20m. Therefore no new external borrowing was undertaken during 2023/24. The strategy of internal borrowing allowed us to avoid taking on external borrowing during the year when borrowing rates were high.

The 2023/24 original budget prudently assumed a level of new external borrowing would be required to fund approved capital expenditure. As a result of lower spend and less external borrowing taken on, there was a saving on the interest payable budget of £300k. Part of this saving was transferred to our Treasury Management Reserve, which had a balance of £425k at 31st March 2024, to mitigate the impacts of higher interest rates when additional borrowing is undertaken in future financial years.

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.

No debt rescheduling was done during the year as it was not a viable option.

4.6 Investment Outturn

Investment Policy – the Council's investment policy is governed by DLUHC investment guidance, which was implemented in the annual investment strategy approved by the Council in February 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 (£000)	31 March 2023	31 March 2024
General Fund Balance	1,238	1,238
Earmarked reserves	10,616	9,578
Provisions	926	782
Usable capital receipts/grants	3,907	5,699
Total	**16,687**	**17,297**

Investments held by the Council - the Council maintained an average balance of circa £13m of internally managed funds. The internally managed funds earned £577,506 interest at an average rate of return of 4.45%. The comparable performance indicator is the 7 day backward looking SONIA (Sterling Overnight Index Average) uncompounded rate which was 4.96% for the year. The original budget assumption for 2023/24 was for £120,000 investment interest income.

5. RESOURCE IMPLICATIONS
   5.1. As detailed in the report

6. EQUALITIES ASSESSMENT
   6.1. There are not any equalities implications anticipated as a result of this report, as the purpose of the report is to present the Council's financial position only.

7. ENVIRONMENTAL ASSESSMENT
   7.1. There are not any environmental implications anticipated as a result of this report, as the purpose of the report is to present the Council's financial position only.

8. CORPORATE PRIORITIES
   8.1. The Treasury management function supports the delivery of the Councils capital programme and ensures cash flows meets the day to day requirements for service delivery.

9. CONSTITUTIONAL CONTEXT
   9.1. Part 3 Annexe 1, para 1(c) – delegated power
   9.2. Article 4.5.26 and Part 4 (Financial Procedure Rules) para 13.8 - referred power

10. STATEMENT OF CONFIDENTIALITY
   10.1. This report contains no confidential information or exempt information under the provisions of Schedule 12A of 1972 Act.

11. STATEMENT OF INTERNAL ADVICE
   11.1 The author (below) confirms that advice has been taken from all appropriate Councillors and Officers

Adam Tape, Head of Governance