East Lothian Council

REPORT TO:	**AUDIT AND GOVERNANCE COMMITTEE**
MEETING DATE:	11 June 2024
BY:	Executive Director for Council Resources
SUBJECT:	Annual Treasury Management Review 2023-24

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1 PURPOSE

1.1 To update the Committee on Treasury Management activity during financial year 2023-24.

2 RECOMMENDATIONS

2.1 Members are asked to note the report.

3 BACKGROUND

3.1 The Council is required by regulations issued under the Local Government Scotland Act 2003 to produce an Annual Treasury Management Review, in accordance with the CIPFA Treasury Management Code of Practice and Prudential Code.

3.2 The review set out in **Appendix 1** updates members on the Treasury Management activity during 2023-24 and reported relative to the indicators set out in the Treasury Management Strategy approved in February 2023. The figures contained within the report are based on the draft unaudited accounts, and therefore remain subject to change during the course of the audit. Members will be kept informed should there be any significant change arising during this period.

4 POLICY IMPLICATIONS

4.1 There are no direct policy implications associated with this report; however, the council's treasury management activity is determined by the policy framework set out in the approved Treasury Management Strategy.

5 INTEGRATED IMPACT ASSESSMENT

5.1 The subject of this report does not affect the wellbeing of the community or have a significant impact on equality, the environment or economy.

6 RESOURCE IMPLICATIONS

6.1 Financial – There are no direct financial implications associated with this report however the Council's Treasury Management activity clearly has a significant impact on the management of the Council's financial resources.

6.2 Personnel - none

6.3 Other - none

7 BACKGROUND PAPERS

7.1 Treasury Management Strategy 2023-24 to 2027-28 – East Lothian Council 28 February 2023.

7.2 Treasury Management Mid-Year Review 2023-24 – Audit & Governance 19 December 2023.

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Annual Treasury Management Review
2023-24

Annual Treasury Management Review 2023-24

1. Introduction

This Council is required by regulations issued under the Local Government in Scotland 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). The review is based on figures contained within the draft unaudited accounts and should any significant and material changes arise during the course of the audit, updated information will be made available and communicated to members.

The minimum Treasury Management reporting requirements are that members of the Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 28 February 2023)
- a report on performance against all forward-looking indicators at least quarterly as part of the authority's integrated revenue and capital monitoring
- a mid-year (minimum) treasury update report (Audit and Governance 19 December 2023)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

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.

The 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 the Audit and Governance Committee with the annual strategy approved by Council.

2. 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.), with expenditure in excess of these resources giving 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. The results from 2022-23 are shown for illustrative purposes.

	2022-23 Actual £m	2023-24 Budget £m	2023-24 Actual £m
General Services			
Capital expenditure	87.955	98.916	51.589
Financed in year	(50.179)	(32.960)	(29.262)
Net borrowing need in year	37.776	65.956	22.327
HRA			
Capital expenditure	40.349	33.964	42.849
Financed in year	(14.983)	(7.896)	(11.788)
Net borrowing need in year	25.366	26.068	31.061
Total Net Borrowing need in year	63.142	92.024	53.388

3. The Council's Overall Borrowing Need

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and deemed 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 (2022-23) plus the estimates of any additional capital financing requirement for the current (2023-24) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure but allows the Council some flexibility to borrow in advance of its immediate capital needs if required.

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 £m	31 March 2024 Budget £m	31 March 2024 Actual £m
General Services			
CFR	295.377	372.650	313.376
External borrowing position	243.555	334.556	267.200
(Under) / over funding of CFR	(51.822)	(38.094)	(46.176)
HRA			
CFR	240.066	265.974	265.745
External borrowing position	197.948	238.785	226.589
(Under) / over funding of CFR	(42.118)	(27.189)	(39.156)
Total (Under) / over funding of CFR	(93.940)	(65.283)	(85.332)

The use of fiscal flexibility for PPP assets has created a difference between the external borrowing position and the CFR (previously these were equal). An under-borrowing has been created and will change annually. The PPP CFR reflects the new profile for repayment. The under-borrowing is created when comparing this to the balance outstanding on the PPP contract.

	31 March 2023 Actual £m	31 March 2024 Budget £m	31 March 2024 Actual £m
PPP			
CFR	32.214	30.686	45.919
Outstanding Debt	32.214	30.686	30.688
(Under) / over funding of CFR	-	-	(15.231)

4. Treasury Position as of 31 March 2024

At the beginning and the end of 2023-24 the Council's treasury, (excluding borrowing by PPP and finance leases), position was as follows:

£m	31 March 2023 Principal	Average Rate/ Return	Average Life yrs	31 March 2024 Principal	Average Rate/ Return	Average Life yrs
CFR	535			579		
Over / (under) borrowing	(93)			(85)		
Total debt	442	3.28%	29	494	3.36%	25
Total investments	(24)	4.12%	7	(23)	2.58%	6
Net debt	418			471		

- **The authorised limit** - the Council has kept within its authorised external borrowing limit as shown in the table below.

- **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. This indicator is set at the start of the financial year and is as per the Treasury Strategy.

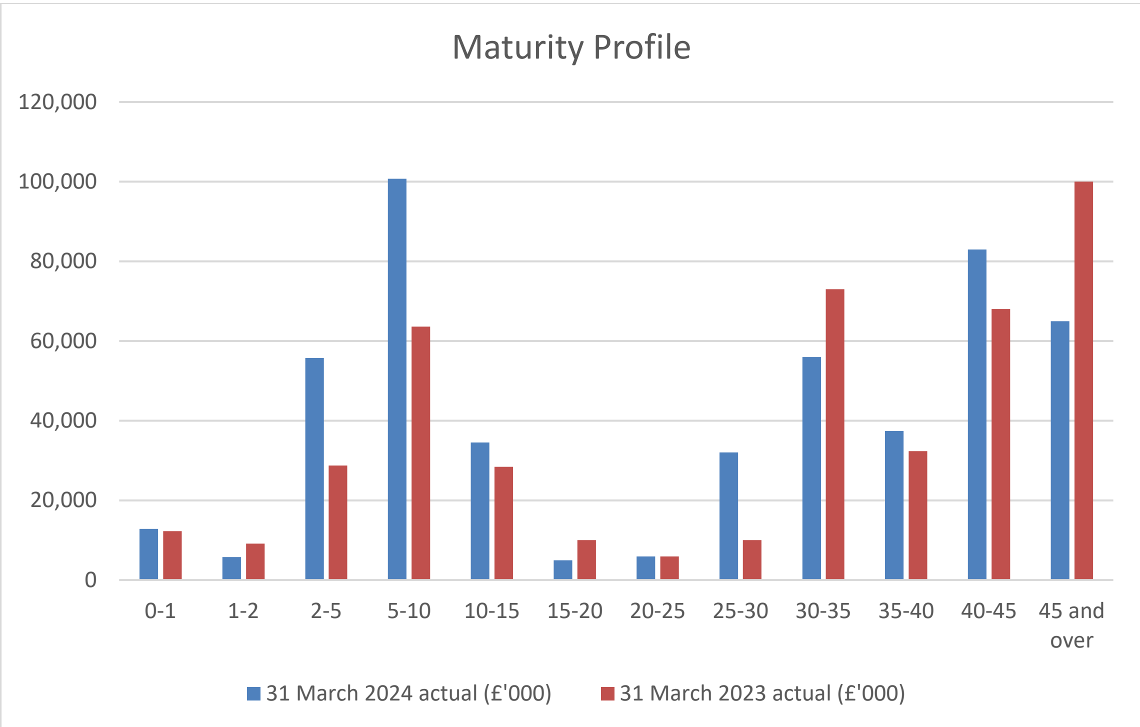
	2022-23 Actual £m	2023-24 Budget £m	2023-24 Actual £m
Authorised limit	601	680	621
External Debt	442	573	494
Operational Boundary	535	638	579

As of 31 March 2024, the average interest rate for all external debt was 3.36% (3.28% as of 31 March 2023). The average life across all loans is 25 years (29 years as of 31 March 2023).

The maturity structure and profile of the debt portfolio is set out in the tables below:

	31-Mar-23 Actual £m	(Paid) or New Loan* 2023-24 £m	31-Mar-24 Actual £m	Net movement** 2023-24 £m
Under 12 months	12.28	(18.64)	12.81	0.53
12 months and within 24 months	9.16	3.65	5.73	(3.43)
24 months and within 5 years	28.77	40.95	55.70	26.93
5 years and within 10 years	63.60	23.26	100.75	37.15
10 years and within 15 years	28.39	3.07	34.50	6.11
15 years and within 20 years	10.00		5.00	(5.00)
20 years and within 25 years	5.90		5.90	0.00
25 years and within 30 years	10.00		32.00	22.00
30 years and within 35 years	73.00		56.00	(17.00)
35 years and within 40 years	32.40		37.40	5.00
40 years and within 45 years	68.00		83.00	15.00
45 years and over	100.00		65.00	(35.00)
Total	441.50	52.29	493.79	52.29

* More detail on this is set out in Section 6 below
** Net movement shows the change between the maturity bands for existing loans



5. The strategy for 2023-24

5.1 Investment strategy and control of interest rate risk

The Council's approved investment strategy prioritises security, liquidity and then return. The Council adopts a prudent approach to managing risk and followed the approved 2023-24 Strategy where investments were only considered where the type of investment and exposure to risk was low or very low. Limits were set for fixed and variable interest rate exposure which were not exceeded during the year.

Investment returns picked up throughout 2023-24 as the Bank of England continued to respond to inflationary pressures that were not transitory, meaning that ongoing tighter monetary policy was required.

5.2 Borrowing strategy and control of interest rate risk

During 2023-24 the Council continued to maintain an under-borrowed position. This meant that the capital borrowing need (the Capital Financing Requirement) was not fully funded by external borrowing as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This was a prudent strategy 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 policy of avoiding new borrowing where possible by close monitoring of cash balances is kept under continual review to avoid incurring higher borrowing costs in the future when the Council may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

Interest rate forecasts initially suggested further gradual rises in 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 2024 it was clear that inflation was moving down significantly from its 40-year high, 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. The CPI measure of inflation is expected to fall materially below 2% over the summer months and to stay stable at that level in 2025 and 2026. There are still ongoing significant risks in relation to this forecast.

Forecasts from our Treasury advisors at the end of March 2024 suggest interest rates will fall slightly during 2024-25 and continue to gradually reduce over the subsequent 2 years. This remains a very challenging position, and the forecast and planning of borrowing will remain under review during 2024-25 and beyond.

Link Group Interest Rate View	25.03.24												
	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	5.25	5.25	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	4.80	4.30	3.80	3.30	3.00	3.00	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.20	5.10	4.60	4.10	3.70	3.30	3.10	3.10	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.00	4.90	4.40	3.90	3.60	3.20	3.10	3.10	3.10	3.10	3.10	3.20	3.20
5 yr PWLB	4.50	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.60	3.50	3.50	3.50
10 yr PWLB	4.70	4.50	4.40	4.30	4.20	4.10	4.00	3.90	3.80	3.70	3.70	3.70	3.70
25 yr PWLB	5.20	5.10	4.90	4.80	4.60	4.40	4.30	4.20	4.20	4.10	4.10	4.10	4.10
50 yr PWLB	5.00	4.90	4.70	4.60	4.40	4.20	4.10	4.00	4.00	3.90	3.90	3.90	3.90

PWLB rates are based on gilts (UK Government bonds) yields through H.M. Treasury who determine a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, the ongoing impact of the Ukraine war, inflationary pressures (especially energy and food) and labour market factors.

The margins over gilt yields are:

- **PWLB Standard Rate -** gilt plus 100 basis points
- **PWLB Certainty Rate -** gilt plus 80 basis points
- **PWLB HRA Standard Rate -** gilt plus 100 basis points
- **PWLB HRA Certainty Rate -** gilt plus 80 basis points
- **Local Infrastructure Rate -** gilt plus 60 basis points

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 (CPI) measure) moves below the Bank of England's 2% target.

High/Low/Average PWLB Rates during 2023-24 over indicative borrowing terms:

	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%

5. Borrowing Activity during 2023-24

Borrowing – the following loans were taken during the year:-

Lender	Principal £m	Type	Interest Rate	Maturity	Date
PWLB	10	Fixed interest rate	4.19%	6 years	18/04/2023
PWLB	10	EIP	4.19%	11 years	18/04/2023
PWLB	10	EIP	4.48%	10 years	23/11/2023
PWLB	20	EIP	4.83%	11 years	11/12/2023
PWLB	20	Fixed interest rate	4.43%	6 years	11/12/2023
PWLB	5	Fixed interest rate	4.66%	6 years	27/03/2024
Total	**75**				

As PWLB rates have remained at an elevated level during 2023-24 the Council has, in conjunction with our Treasury advisors decided to undertake borrowing at shorter durations than in recent preceding years as well as repaying principle in instalments over the period of the loan. This is to lessen interest costs in future as per Section 5.2 above, as interest rates are expected to reduce in the coming years.

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.

Rescheduling
No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Repayments
The following loans were repaid in full during the year: -

Lender	Principal £m	Type	Interest Rate	Maturity	Date
PWLB	0.66	Fixed Interest rate	7.875%	17	14/09/2023
PWLB	0.13	Fixed Interest rate	7.875%	17	14/09/2023
PWLB	10.0	Fixed interest rate	3.47%	12 years	24/09/2023
Commerzbank	10.0	Lenders Option Borrowers Option	4.030%	Option exercised	24/11/2023
Total	**20.79**				

Instalments of £1.90m were also paid on 7 loans which are payable as an Annuity or EIP (equal instalments of principal) basis rather than on maturity.

6. Investment Activity for 2023-24

Investment Policy
The Council's investment policy is governed by Scottish Government investment regulations which have been implemented in the annual investment strategy approved by the Council on 28 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 as set.

Investments held by the Council

During 2023-24 and in accordance with the approved strategy 23 short term investments were made and repaid. Any other surplus cash balances were held in the Council's bank account, which is an interest-bearing account.

Date of Investment	Borrower	Amount £m	Interest rate	Date repaid
12/07/2023	Standard Chartered (Sustainable Deposit)	5.0	5.42%	12/10/2023
12/07/2023	DMADF (UK Government)	5.0	5.12%	12/09/2023
24/08/2023	Cheshire East Borough	5.0	5.32%	25/10/2023

03/10/2023	DMADF (UK Government)	10.0	5.17%	31/10/2023
03/10/2023	DMADF (UK Government)	3.0	5.17%	04/10/2023
04/10/2023	DMADF (UK Government)	5.0	5.17%	05/10/2023
05/10/2023	DMADF (UK Government)	6.0	5.17%	06/10/2023
06/10/2023	DMADF (UK Government)	8.0	5.17%	09/10/2023
09/10/2023	DMADF (UK Government)	6.0	5.17%	13/10/2023
17/10/2023	DMADF (UK Government)	10.0	5.17%	20/10/2023
26/10/2023	DMADF (UK Government)	5.0	5.18%	27/11/2023
26/10/2023	DMADF (UK Government)	4.0	5.18%	13/11/2023
02/11/2023	DMADF (UK Government)	9.0	5.17%	03/11/2023
03/11/2023	DMADF (UK Government)	5.0	5.17%	13/11/2023
03/11/2023	DMADF (UK Government)	4.0	5.17%	06/11/2023
13/12/2023	DMADF (UK Government)	10.0	5.19%	18/12/2023
13/12/2023	DMADF (UK Government)	10.0	5.19%	21/12/2023
13/12/2023	DMADF (UK Government)	5.0	5.20%	25/01/2024
15/12/2023	Cheltenham Borough	5.0	5.45%	15/01/2024
13/12/2023	Lloyds Banking Group	5.0	5.38%	10/01/2024
16/02/2024	DMADF (UK Government)	10.0	5.19%	26/02/2024
16/02/2024	Lloyds Banking Group	5.0	5.15%	25/01/2024
01/03/2024	DMADF (UK Government)	5.0	5.19%	08/03/2024

The Council also has the following loans to third parties which fall under the scope of the Council's approved Investment Strategy.

	Loan balance on 31 March 2023 £m	**Loan balance on 31 March 2024 £m**
East Lothian Housing Association	8.189	7.914

Under accounting standard IFRS9, an expected credit loss for all loans to third parties must be obtained and recognised in the Council's Income and Expenditure account within Surplus/Deficit on Provision of Services.

This was £0.065m for 2022-23 and was decreased to £0.055m for 2023-24 to reflect the risk profile of the debt in the current financial environment.

Investments held by Fund Managers

The Council uses Rathbones (previously known as Investec) as external fund managers to invest cash balances on behalf of the 4 Common Good Funds and the ELC Charitable Trusts. The performance of the managers against the benchmark return was:

£m	Investments held 31 March 2023	Investments held 31 March 2024	Return	Benchmark
Charitable Trusts	3.563	3.807	9.74%	11.47%
Common Good Funds	3.425	3.850	9.99%	11.47%
Total	6.988	7.657	£0.669m	

The Council's investment advisors have reported that the portfolio has performed strongly for 2023-24 with a net return of 10% for the Common Good and 9.7% for the Charitable Trusts as global equity markets performed strongly. This was driven by expectation of better growth as inflation started to fall and this will lead to lower interest rates later in the calendar year that should further support economic growth. There are continued geopolitical risks with a number of ongoing conflicts globally and the upcoming elections in the USA. These are mitigated by having investments in companies with strong balance sheets.

Officers continue to engage with the Investment Advisers, and consider any necessary action aligned to the Treasury Investment Strategy should there be any significant change to fund projections. The need to ensure the on-going viability of the funds is essential to ensure the long-term benefits of these investments.

The return achieved was lower the benchmark for both portfolios.

Appendix 1: Prudential and treasury indicators

1. PRUDENTIAL INDICATORS	2022/23	2023/24	2023/24
	Actual £m	Budget £m	Actual £m
Capital Expenditure			
General Services	87.955	98.916	51.589
HRA	40.349	33.964	42.849
TOTAL	128.304	132.880	94.438
Ratio of financing costs to net revenue stream			
General Services	2.72%	4.37%	4.26%
HRA	30.10%	36.24%	33.13%
Gross borrowing requirement - General Services			
brought forward 1 April	257.927	309.114	295.377
carried forward 31 March	295.377	372.650	313.376
in year borrowing requirement	37.449	63.536	17.999
Gross borrowing requirement - HRA			
brought forward 1 April	219.522	245.305	240.066
carried forward 31 March	240.066	265.974	265.745
in year borrowing requirement	20.544	20.669	25.679
Gross Debt	**£m**	**£m**	**£m**
CFR			
General Services	295.377	372.650	313.376
HRA	240.066	265.974	265.745
TOTAL	535.443	638.624	579.121
Annual Change in Capital Financing Requirement			
General Services	37.449	63.536	17.999
HRA	20.544	20.669	25.679
TOTAL	57.993	84.205	43.679
Annual Impact of Capital Investment Decisions			
General Services – Debt per Band D Equivalent	£4,943	£6,086	£5,118
HRA – Debt per dwelling	£26,254	£28,652	£28,389

2. TREASURY MANAGEMENT INDICATORS	2022/23	2023/24	2023/24
	Actual	**Budget**	**Actual**
	£m	**£m**	**£m**
Authorised Limit for External Debt -			
Borrowing	601.000	680.000	636.000
Other long-term liabilities	33.000	31.000	31.000
Total	634.000	711.000	667.000
Operational Boundary for External Debt -			
Borrowing	535.442	638.623	594.352
Other long-term liabilities	32.214	30.686	30.688
Total	567.656	669.309	625.040
Actual External Debt			
Borrowing	441.503	573.341	493.789
Other long-term Liabilities	32.214	30.687	30.688
Total	473.717	604.028	524.477

3. LOANS FUND	31 March 2023 **Actual** **£m**	31 March 2024 **Budget** **£m**	31 March 2024 **Actual** **£m**
General Services			
Opening balance	258	309	295
Add advances	38	66	22
Less repayments	(0)	(2)	(4)
Closing balance	295	373	313
HRA			
Opening balance	220	245	240
Add advances	25	26	31
Less repayments	(5)	(5)	(5)
Closing balance	240	266	266
Total			
Opening balance	477	554	535
Add advances	63	92	53
Less repayments	(5)	(7)	(9)
Closing balance	535	639	580

ABBREVIATIONS USED IN THIS REPORT

CFR: capital financing requirement - the council's annual underlying borrowing need to finance capital expenditure and a measure of the council's total outstanding indebtedness.

CIPFA: Chartered Institute of Public Finance and Accountancy – the professional accounting body that oversees and sets standards in local authority finance and treasury management.

GDP: gross domestic product – a measure of the growth and total size of the economy.

HRA: housing revenue account.

MPC: the Monetary Policy Committee is a committee of the Bank of England. which meets for one and a half days. eight times a year. to determine monetary policy by setting the official interest rate in the United Kingdom. (the Bank of England Base Rate. commonly called Bank Rate). and by making decisions on quantitative easing.

PPP: Private Public Partnership – capital expenditure financed by the private sector i.e. not by direct borrowing by a local authority.

PWLB: Public Works Loan Board – this is the part of H.M. Treasury which provides loans to local authorities to finance capital expenditure.

RPI: the Retail Price Index is a measure of inflation that measures the change in the cost of a representative sample of retail goods and services. It was the UK standard for measurement of inflation until the UK changed to using the EU standard measure of inflation.

CPI. Consumer Price Index. The main differences between RPI and CPI is in the way that housing costs are treated and that the former is an arithmetical mean whereas the latter is a geometric mean. RPI is often higher than CPI for these reasons.

TMSS: the annual treasury management strategy statement reports that all local authorities are required to submit for approval by the full council before the start of each financial year.