Inverclyde council

AGENDA ITEM NO: 4

Report To:	**Policy & Resources Committee**	**Date:**	**13 August 2024**
Report By:	**Chief Financial Officer**	**Report No:**	**FIN/42/24/AP/KJ**
Contact Officer:	**Alan Puckrin**	**Contact No:**	**01475 712223**
Subject:	**Treasury Management – Annual Report 2023/24**		

1.0 PURPOSE AND SUMMARY

1.1 ☒For Decision ☐For Information/Noting

1.2 The purpose of this report is:

a. To advise the Committee of the operation of the treasury function and its activities for 2023/24 as required under the terms of Treasury Management Practice 6 ("TMP6") on "Reporting Requirements and Management Information Arrangements".

b. To request that the Committee remits the report to the Full Council for their approval.

1.3 As at 31 March 2024 the Council had gross external debt (including PPP) of £234,304,481 and investments of £6,502,107. This compares to gross external debt (including PPP) of £239,408,384 and investments of £26,127,010 at 31 March 2023.

1.4 2023/24 was experienced higher than forecast interest rate levels and this resulted in early repayment of some Market Loans and an associated reduction in cash balances. This added to the PPP Service Concession reprofiling and a one-off loan charge write off period adjustment resulted in greater variation against targets set in the Strategy in March 2023.

1.5 The Council operated within the required treasury limits and Prudential Indicators for the year set out in the Council's Treasury Policy Statement, annual Treasury Strategy Statement, and the Treasury Management Practices.

2.0 RECOMMENDATIONS

2.1 It is recommended that the Committee notes the contents of the annual report on Treasury Management for 2023/24 and the impact of higher than forecast interest rates in 2023/24.

2.2 It is recommended that the Committee remits the report to the Full Council for approval.

Alan Puckrin
Chief Financial Officer

3.0 BACKGROUND AND CONTEXT

3.1 The 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.

3.2 Treasury Management in this context is defined as: "The management of the local authority's 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."

3.3 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). Paragraphs 3.16 to 3.18 of the report include information on Loan Fund Advances required by regulations that came into effect on 1 April 2016.

3.4 The treasury management issues arising during the year were:

a. The Council's debt (including PPP) reduced during the year by £5.104m whilst Council investments reduced by £19.625m.
b. The Council repaid 3 LOBO loans totalling £29.9m between August and October, all without paying any premiums on the loans:
    i. In August, a £10m loan was repaid after the lender proposed an increase in the rate from 4.88% to 6.35%.
    ii. In October, a £4.9m loan was repaid after the same lender proposed an increase in the rate from 4.99% to 5.89%.
    iii. In October, a £15m loan at 4.99% was repaid after a lender asked in September if the Council would be interested in repaying the loan.
c. The Council repaid £5m of temporary borrowing from another Local Authority in October and £7.5m of PWLB borrowing that matured in January.
d. To fund the above and cash requirements, the Council undertook a total of £39.5m in PWLB borrowing in the year for periods of between 1 year and just over 2 years. PWLB rates are expected to fall during those periods and so the Council expects to be able to refinance the borrowing at lower rates when the loans mature.
e. The Council remained within its Prudential Indicator and Treasury Management limits during 2023/24.
f. As at 31 March 2024 the Council had under borrowed against its capital financing requirement by £65.951m. This under borrowing is £21.582m higher than at the end of 2022/23 due to the effect of applying the PPP Service Concession Arrangement and of a one-off loan charge write-off period adjustment, both as approved by the Full Council.
g. In February 2023, the Treasury Consultants forecast that the Bank Rate would increase from 4.00% to 4.25% in March 2023 then to 4.50% in May 2023 then fall to 4.25% by December 2023 and to 4.00% by March 2024 with gradual falls to 2.50% by September 2025. Inflation concerns during the year resulted in rates rising in March 2023 to 4.25% as forecast then to 4.50% in May, 5.00% in June and 5.25% in August. The latest forecast is for rates to fall to 5.00% by September, 4.50% by December and 4.00% by March with gradual falls to 3.00% by September 2026.
h. PWLB rates for new borrowing were expected to fall by between 0.30% and 0.40% but rates increased by 0.36% to 0.62% and ended the year at between 4.61% (6-7 years) and 5.36% (1-1½ years). In addition, there was volatility during the year that resulted in spreads in rates for new loans of up to 1.87% between their lowest and highest levels e.g. 3-year loans were 4.35% on 6 April but 6.22% on 6 July and ended the year at 4.96%.
i. Rates for investments increased due to increases in the Bank Rate but have been reflecting anticipated Bank Rate cuts in the rates for Fixed Term Deposits in recent months.

j. The Council's investments earned a rate of return of 4.785% during the year which is lower than the benchmark return of 5.111% and is due to the Council having a lower level of investments since the first LOBO repayment in August 2023 and keeping its funds in call accounts for liquidity reasons rather than placing funds in Fixed Term Deposits that normally pay higher rates.

k. All investments were in accordance with the Council's investment policy and no institutions with which investments were made had any difficulty in repaying those investments and interest in full during the year.

3.5 The main economic uncertainty in the UK and around the world during the year came from inflation concerns, the continuing impact of the conflict in Ukraine, the conflict in the Middle East, and the likely level of interest rates and impact of those rates on the economy.

The economic situation continues to be closely monitored with inflation and interest rates projected to be well above levels previously experienced in the short/medium term.

3.6 The Council's Year End debt position was as follows:

	At 31 March 2023	At 31 March 2024
	£	£
Total Excluding PPP	184,132,384	181,234,481
PPP Debt	55,276,000	53,070,000
Total Including PPP	239,408,384	234,304,481

Further detail is given in the following table:

	At 31 March 2023		At 31 March 2024		Movement 2023/24
	Principal	Rate	Principal	Rate	Principal
	£000		£000		£000
Fixed Rate Funding:					
- PWLB	79,414		111,378		31,964
- LOBO *	0		16,000		16,000
- Market	40,000		40,000		0
- Temporary	5,000		0		(5,000)
	124,414	3.67%	167,378	4.22%	42,964
Variable Rate Funding:					
- PWLB	0		0		0
- LOBO *	59,400		13,500		(45,900)
- Market	0		0		0
- Temporary #	318		356		38
	59,718	4.90%	13,856	4.93%	(45,862)
Total Debt (Excl PPP)	184,132	4.07%	181,234	4.27%	(2,898)
PPP Debt	55,276		53,070		(2,206)
Total Debt (Incl PPP)	239,408		234,304		(5,104)

* - LOBO Loans are shown as variable when they have less than 1 year to go until their next call date.

- Temporary Loans include funds held by the Council on behalf of the Common Good and Trust Funds and that are to be treated as borrowing for Treasury Management purposes under Scottish Government requirements.

3.7 The Council's cash balances investment position was as follows:

	At 31 March 2023		At 31 March 2024		Movement 2023/24
	Principal	Return	Principal	Return	Principal
	£000		£000		£000
Investments:					
- Fixed Term Deposits	22,000	3.21%	0	0.00%	(22,000)
- Notice Accounts	50	3.74%	53	3.99%	3
- Deposit Accounts	4,077	4.15%	6,449	5.15%	2,372
Totals	26,127	3.36%	6,502	5.14%	(19,625)

Investments as at 31 March 2024: £6,502,107
Maximum level of investments in 2023/24: £44,239,096 on 15 August 2023
Minimum level of investments in 2023/24: £2,265,574 on 26 January 2024
Daily average for the year 2023/24: £23,091,570

The Council's forecast and actual Investment Balances for 2023/24 for "investments" as defined in the Investment Regulations (including loans/holdings not managed under the treasury function) are shown in Appendix 1.

3.8 2023/24 Outturn Compared to Estimates in 2023/24 Strategy

The 2023/24 outturn compared to the estimates in the 2023/24 strategy:

	2023/24 Estimate	2023/24 Outturn
Borrowing Requirement	£000	£000
New borrowing	0	0
Alternative financing requirements	0	0
Replacement borrowing (See Note 1 below)	5,000	39,500
TOTAL	5,000	39,500
Prudential/Treasury Management Indicators	£000	£000
Gross external debt including PPP (As at 31 March 2024)	224,860	234,304
Capital financing requirement (CFR) (As at 31 March 2024)	286,890	300,755
(Under)/over borrowing against CFR	(62,030)	(65,951)
	£000	£000
Gross capital expenditure	21,569	26,924
Ratio of financing costs (including PPP) to net revenue stream (See Note 2 below)	9.54%	0.39%
Ratio of net debt (debt and PPP less investments) to net revenue stream	88.5%	98.1%

Notes:
1. The £39.5 million replacement borrowing was for 3 LOBO loans totalling £29.9m that were repaid between August and October 2023 and £9.6m to partly replace maturing temporary borrowing and PWLB borrowing.
2. The reduction in the ratio of financing costs to net revenue stream in 2023/24 is due to the effect of one-off savings arising from the PPP Service Concession Arrangement (for prior years and first year) and the effect of a one-off loan charge write-off period adjustment.

3.9 The table in paragraph 3.8 above shows that as at 31 March 2024 the Council had under borrowed against its capital financing requirement by £65.951m. Under borrowing means that the Council is using cash it already has (e.g. in earmarked reserves and other balances) to cash flow capital expenditure and maturing debt rather than bringing in new funds from borrowing. The level of under borrowing is kept under review in light of Council capital financing and other funding requirements.

3.10 <u>2023/24 Outturn Compared to Limits in 2023/24 Strategy</u>

The 2023/24 outturn compared to limits in the 2023/24 strategy:

	2023/24 Limits		2023/24 Outturn	
<u>Prudential/Treasury Management Indicators</u>				
Authorised limit for external debt	£000		£000	
• Borrowing	222,000		181,234	
• Other long-term liabilities	56,000		53,070	
	278,000		234,304	
Operational boundary for external debt	£000		£000	
• Borrowing	207,000		184,234	
• Other long-term liabilities	56,000		53,070	
	263,000		237,304	
Upper limit on sums invested for periods longer than 365 days (Actual is maximum in period)	£000 10,000		£000 0	
Limits on fixed and variable rate borrowing maturing in each period at 31 March 2024 (LOBOs included based on call dates and not maturity dates)	Fixed	Var.	Fixed	Var.
• Under 12 months	45%	35%	9.7%	7.6%
• 12 months and within 24 months	45%	35%	12.1%	0%
• 24 months and within 5 years	45%	35%	9.5%	0%
• 5 years and within 10 years	45%	35%	13.8%	0%
• 10 years and within 30 years	45%	35%	4.2%	0%
• 30 years and within 50 years	45%	35%	21.0%	0%
• 50 years and within 70 years	45%	35%	22.1%	0%

Council Policy Limits	2023/24 Limits	2023/24 Outturn
Maximum Percentage of Debt Repayable in Any Year (Actual is as at 31 March 2024 and relates to Financial Year 2077/78)	25%	22.1%
Maximum Proportion of Debt at Variable Rates (Actual is as at 31 March 2024)	45%	7.6%
Maximum Percentage of Debt Restructured in Year (Actual is as at 31 March 2024 and relates to 3 LOBO loans repaid early without incurring any premiums)	30%	16.2%

3.11 The Prudential Code requires that the Council states how interest rate exposure is managed and monitored.

The position in 2023/24 was that all of the Council's PWLB and Market debt was at fixed rates. The remaining debt contained some temporary borrowing at fixed rates, some small amounts at variable rates and LOBO loans where the rates were fixed unless the lenders proposed to change the rates (as happened with 2 LOBO loans that were repaid early). The Council's investments, which were all for less than 1 year, were all variable or regarded as variable under the treasury management rules.

During 2023/24, these interest rate exposures were managed and monitored by the Council through management reports on treasury management that were received and reviewed by the Chief Financial Officer.

3.12 The forecast from the Treasury Consultants in the Strategy for the Bank Rate as at 31 March and the latest forecast (produced on 29 May 2024) are:

	Forecast Per 2023/24 Strategy	Actual/ Latest Forecast	
2023/24	4.00%	5.25%	(Actual)
2024/25	2.75%	4.00%	(Forecast)
2025/26	2.50%	3.25%	(Forecast)
2026/27	---	3.00%	(Forecast)

3.13 The Council's Loans Fund Pool Rate for Interest is used to allocate interest charges to the General Fund and reflects the actual cost of the Council's Treasury activities. The rates for the last 5 years (excluding expenses) are as follows:

Year	Loans Fund Pool Rate
2019/20	3.436%
2020/21	3.362%
2021/22	3.363%
2022/23	3.776%
2023/24	4.377%

The Loans Fund pool rate includes an interest charge for using existing Council funds instead of borrowing, with that interest being paid to the Revenue budget as income. This is called Internal Resources Interest (IRI). The increase in the Bank Rate during the year has meant an increase in short-term borrowing rates on which the interest charge is based and resulted in the increase in Loans Fund pool rate between 2022/23 and 2023/24 but also increased IRI for the General Fund. In addition, the Council repaid 3 LOBO loans with the repayments funded from short-term PWLB borrowing at higher rates but to be refinanced at lower rates in the next 12-18 months.

3.14 The Council's investment policy for the year is governed by Scottish Government Investment Regulations and was implemented in the annual investment strategy approved by the Council on 21 April 2023 (after review by the Policy & Resources Committee on 21 March 2023). The policy sets out the approach for choosing investment categories and 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.

All investments in 2023/24 and 2024/25 to date were in accordance with the policy and no institutions with which investments were made had any difficulty in repaying investments and interest in full.

3.15 The result of the investment strategy undertaken by the Council in 2023/24 is as follows:

Average Investment	Rate of Return (gross of fees)	Benchmark Return (3-month SONIA compounded)
£23,091,570	4.785%	5.111%

The Council under-performed the benchmark by 0.327% which is due to keeping a greater percentage of funds on call to be able to repay LOBO loans from August 2023 onwards and seeking to use investment funds and defer borrowing.

3.16 Where capital expenditure is funded by borrowing (referred to as loans fund advances), the debt financing costs are paid from the Revenue Budget as loan charges comprised of the repayments of debt along with interest and expenses costs on the borrowing.

The Council is required to set out its policy for the repayment of loans fund advances.

a. For loans fund advances made before 1 April 2016 the policy is to maintain the practice of previous years and use the Statutory Method (option 1) with annual principal repayments being calculated using the annuity method.
b. The same method was used for loans fund advances made after 1 April 2016 for the permitted 5-year transitional period to the end of 2020/21. In applying the annuity method to new advances in any year, the interest rate used in the annuity calculation is the Council's loans fund pool rate for the year (including expenses) as rounded up to the nearest 0.01%.
c. Of the options available for new capital expenditure from 1 April 2021 onwards, it was approved by the Full Council on 22 April 2021 to maintain the use of the annuity method as set out in option b. above.

3.17 The outstanding loans fund advances (representing capital expenditure still to be repaid from the Revenue Budget) are:

	2023/24
	Actual
	£000
Balance As At 1 April	228,242
Add: Loan Charge Write-Off Period Review 23/24	3,387
Add: Advances For The Year	5,594
Less: Repayments For The Year	7,697
Balance As At 31 March	229,526

3.18 For the loans fund advances outstanding as at 31 March 2024, the liability to make future repayments (excluding debt interest and expenses) is as follows:

	£000
Year 1	7,584
Years 2-5	34,380
Years 6-10	42,507
Years 11-15	35,771
Years 16-20	32,358
Years 21-25	29,630
Years 26-30	25,699
Years 31-35	12,896
Years 36-40	4,498
Years 41-45	1,293
Years 46-50	1,183
Years 51-55	643
Years 56-60	77
Years 61-65	67
Years 66-70	81
Years 71-75	98
Years 76-80	119
Years 81-85	143
Years 86-90	174
Years 91-95	210
Years 96-100	115
TOTAL	229,526

3.19 Service Concession (PPP) Contract
At its meeting on 16 February 2023 the Policy & Resources Committee agreed to a change in the accounting treatment of the Council's Service Concession (PPP) contract from 2023/24. This generated a one-off increase in reserves of £14.889m by extending the period over which PPP debt will be charged to the Revenue budget. Decisions on the use of the increase in reserves (which will be funded from further borrowing) were taken by the Council on 2 March 2023.

3.20 Loan Charge Write-Off Periods – One-Off Adjustment
The Scottish Government proposed accounting changes from 1 April 2024 which prevent any retrospection if in future the Council extends the write off period of any loans charge debt. As a result, as part of the 2024/26 Revenue Budget as approved by Full Council on 29 February 2024, the Council approved a change to the write-off periods for new build schools and Children's Homes that resulted in a one-off saving as at 31 March 2024 along with a recurring saving from 2024/25, as included in the 31 March balances in 3.17 above.

4.0 PROPOSALS

4.1 It is proposed that the Committee consider the contents of Section 3 of the report, seek any assurances from Officers, and thereafter remit the Annual Report to the Council for approval.

5.0 IMPLICATIONS

5.1 The table below shows whether risks and implications apply if the recommendations are agreed:

SUBJECT	YES	NO
Financial	X	
Legal/Risk	X	
Human Resources		X
Strategic (Partnership Plan/Council Plan)		X
Equalities, Fairer Scotland Duty & Children/Young People's Rights & Wellbeing		X
Environmental & Sustainability		X
Data Protection		X

5.2 **Finance**

Treasury activity represents a significant aspect of the Revenue Budget and over 2023/24 both borrowing costs and investment income varied considerably from that included in the approved Strategy.

One off Costs

Cost Centre	Budget Heading	Budget Years	Proposed Spend this Report	Virement From	Other Comments
N/A					

Annually Recurring Costs/ (Savings)

Cost Centre	Budget Heading	With Effect from	Annual Net Impact	Virement From (If Applicable)	Other Comments
N/A					

5.3 **Legal/Risk**

The Council has complied with all treasury management statutory requirements over 2023/24. Treasury risks are identified in the Treasury Strategy and officers are supported in this regard by the Council's treasury consultants.

5.4 **Human Resources**

None.

6.0 CONSULTATION

6.1 This report includes the latest advice from the Council's treasury consultants (Link Treasury Services Limited).

7.0 BACKGROUND PAPERS

7.1 CIPFA - Treasury Management in the Public Services – Code of Practice and Cross-Sectoral Guidance Notes – 2021 Edition
Inverclyde Council – Treasury Management Strategy Statement and Annual Investment Strategy 2023/24-2026/27.

Appendix 1

FORECAST OF INVESTMENT BALANCES
ESTIMATE FOR 2023/24 AND ACTUAL AT 31 MARCH 2024

Investment Regulation 31 requires the Council to provide forecasts for the level of investments. The estimate for 2023/24 and the actual as at 31 March 2024 are:

	Purpose of Investment	2023/24 Estimate	2023/24 Actual At 31 March 2024
		£000	£000
Cash balances managed in-house	Treasury		
- At 1 April 2023		30,000	26,127
- At 31 March 2024		15,355	6,502
- Change in year		(14,645)	(19,625)
- Average daily cash balances		22,678	23,092
Holdings of shares, bonds, units (includes local authority owned company)	Service		
- At 1 April 2023		2	2
- Purchases		0	0
- Sales		0	0
- At 31 March 2024		2	2
Loans to local authority company or other entity to deliver services	Service		
- At 1 April 2023		297	308
- Advances		0	0
- Repayments		47	47
- At 31 March 2024		250	261
Loans made to third parties	Service		
- At 1 April 2023		100	109
- Advances		0	5
- Repayments		23	21
- At 31 March 2024		77	93
Investment properties	Commercial		
- At 1 April 2023		0	0
- Purchases		0	0
- Sales		0	0
- At 31 March 2024		0	0
Total of all investments			
- At 1 April 2023		30,399	26,546
- At 31 March 2024		15,684	6,858
- Change in year		(14,715)	(19,688)

The movements in the forecast investment balances shown above are due largely to ongoing treasury management activity in accordance with the Council's treasury management strategy or, for loans made to third parties, in accordance with Council decisions made in respect of such loans.

All of the Council's cash balances are managed in-house with no funds managed by external fund managers.

The "holdings of shares, bonds, units (includes authority owned company)" are historic and relate to the Common Good.

The Loans made to third parties is comprised of:

	£000
Birkmyre Trust	27
Housing Advances	4
Small Business Loans	12
Loan to Shared Interest Society Limited	50
	93

The £50,000 loan to Shared Interest Society Limited ("Shared Interest") was approved by the Policy & Resources Committee in August 2017, Shared Interest being a company that uses funds invested by individuals and organisations to allow it to provide loans to fair trade businesses around the world.