Blaby District Council

Council

Date of Meeting	16 July 2024
Title of Report	**Recommendations of the Cabinet Executive: Treasury Management Outturn 2023/24**
	This is not a Key Decision and is on the Forward Plan
Lead Member	**Cllr. Maggie Wright - Finance, People & Performance (Deputy Leader)**
Report Author	Finance Group Manager
Strategic Themes	Ambitious and well managed Council, valuing our people

1. What is this report about?

1.1 The report reviews the Council's treasury management activities undertaken during the 2023/24 financial year and gives details of the prudential and treasury indicators for the same period.

1.2 It also provides an update regarding the position regarding the Lothbury Property Trust, and actions taken following the termination of the fund.

2. Recommendation(s) to Council

2.1 That the treasury management activities for 2023/24 are approved.

2.2 That the prudential and treasury indicators for 2023/24 are approved.

2.3 That the delegated decision taken to transfer proceeds from asset sales in the Lothbury Property Trust into the UBS Triton fund is noted.

3. Reason for Decisions Recommended

3.1 The regulatory framework governing treasury management activities includes a requirement that the Council should produce an annual review of treasury activities undertaken in the preceding financial year. It must also report the performance against the approved prudential indicators for the year.

3.2 This report fulfils the requirement above and incorporates the needs of the Prudential Code to ensure adequate monitoring of capital expenditure plans and the Council's prudential indicators. The treasury strategy and prudential indicators for 2022/23 were contained in the report approved by Council on 22nd February 2023.

3.3 Following termination of the Lothbury Property Trust on 30th May 2024, it is considered that there is a greater chance of recouping the Council's initial property fund investment by re-investing the proceeds in a new property fund.

4. Matters to consider

4.1 Background

The Council is required to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2023/24 by regulations issued under the Local Government Act 2003. This report meets the requirements of both the Chartered Institute of Public Finance Accountants' (CIPFA) Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

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 (Cabinet Executive 20th February 2023, Council 22nd February 2023)
- a mid-year treasury update report (Cabinet Executive 6th November 2023, Council 28th November 2023)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

The regulations place 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.

The Council has complied with the requirement under the Code to give prior scrutiny to all the above treasury management reports by the Cabinet Executive and/or Scrutiny Commission before they were reported to the full Council. Member training on treasury management issues is undertaken on an ad hoc basis as required. It is proposed to arrange for refresher training during 2024/25.

4.2 Capital Expenditure and Financing

The Council undertakes capital expenditure on long-term assets which may either be:

- Financed immediately through the application of capital or revenue resources (e.g., capital receipts, grants, revenue contributions), which has no resultant impact on the Council's borrowing need; or
- Financed through borrowing if insufficient resources are available, or a decision is taken not to apply resources.

The actual capital expenditure forms one of the main prudential indicators. The following table summarises the capital expenditure and financing for the year. A more detailed analysis is provided at Appendix A.

	2022/23 Actual £	**2023/24 Budget £**	**2023/24 Actual £**
Capital Expenditure	2,331,693	11,857,490	6,996,593
Financed in year	(1,421,427)	(5,653,595)	(4,137,886)
Unfinanced Capital Expenditure	**910,266**	**6,205,895**	**2,858,707**

4.3 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.

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. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

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 2023/24 MRP Policy, (as required by DLUHC Guidance), was approved as part of the Treasury Management Strategy Report for 2023/24 on 22nd February 2023. The charge to revenue is based on a weighted average annuity-based calculation rather than on a straight-line basis.

Once again, the Council undertook no new borrowing during 2023/24. Although there was a borrowing need to fund the capital programme, there are still sufficient reserves and balances available to enable the Council to effectively borrow internally. Since borrowing rates continued to be exceed investment rates during 2023/24 borrowing was deferred until such time as they reach, what may be considered to be, the bottom of the yield curve. Inevitably, this situation has given rise to revenue savings.

The table below highlights the gross borrowing position against the CFR. The CFR represents a key prudential indicator. It includes finance leases that appear on the balance sheet, and which increase the Council's borrowing need. However, no borrowing is required to cover finance leases as there is a borrowing facility included in the contract.

	31st March 2023 Actual £	**31st March 2024 Budget £**	**31st March 2024 Actual £**
Opening Balance	13,965,132	14,486,025	14,486,025
Add Unfinanced Capital Expenditure	910,266	6,205,895	2,858,707
Less MRP & VRP	(389,373)	(784,445)	(784,445)
Closing Balance	**14,486,025**	**19,907,475**	**16,560,287**

Borrowing activity is constrained by prudential indicators for gross borrowing and the CFR, and by the authorised limit.

It is important to ensure that borrowing is prudent over the medium term and that it is only undertaken for capital purposes. Therefore, the Council needs to make sure that, except in the short term, its gross external borrowing does not exceed the total of the CFR in the preceding year (2023/24) plus the estimates of any additional CFR for the current year (2024/25) and next two financial years. Effectively this means that the Council is not borrowing to support revenue expenditure. This indicator also allows the Council some flexibility to borrow in advance of its immediate need where it is appropriate to do so. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31st March 2023 Actual £	**31st March 2024 Budget £**	**31st March 2024 Actual £**
CFR	14.486.025	19,907,475	16,560,287
Gross Borrowing	6,385,096	9,468,330	6,168,330
(Under)/Over Funding of CFR	**(8,100,929)**	**(10,439,145)**	**(10,391,957)**

The Authorised Limit – this is the affordable borrowing limit required by Section 3 of the Local Government Act 2003. Once it has been set, the Council does not have the power to borrow above this level. The table below demonstrates that the Council has maintained gross borrowing within the authorised limit during 2022/23.

The Operational Boundary – this is the expected borrowing position for the year. Periods where the actual position is either above or below 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 (i.e., borrowing, and other long term obligation costs net of investment income), against the net revenue stream.

	2023/24
Authorised limit	£23,000,000
Maximum gross borrowing position during the year	£6,385,096
Operational boundary	£20,700,000
Average gross borrowing position	£6,302,497
Financing costs as a proportion of net revenue stream	8.14%

4.4 Treasury Position on 31st March 2024

The Council's treasury management debt and investment position is organised by the treasury management service 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 detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the end of 2023/24 the Council's treasury position was as follows:

	Principal at 31st March 2023	**Rate/ Return**	**Average Life**	**Principal at 31st March 2024**	**Rate/ Return**	**Average Life**
PWLB Debt	£5,929,939	2.24%	16.1 years	£5,713,439	2.25%	18.8 years
Market Debt	0	n/a	n/a	0	n/a	n/a
Total debt	**£5,929,939**	**2.24%**	16.1 years	**£5,713,439**	2.25%	18.8 years
Capital Financing Requirement	£14,486,025			£16,560,287		
Over/(under) borrowing	**(£8,556,086)**			**(£10,846,848)**		
Short Term investments	(£25,456,000)	3.98%		(£22,089,000)	5.34%	
Long Term Investments	(£844,874)	4.84%		(£742,726)	5.27%	
Net debt	(£34,856,960)			(£22,831,726)		

Other long-term liabilities, such as finance leases, are excluded from the table above.

The interest rates in the table above are based on the loans and investments outstanding at the year end and are not necessarily the same as the average rate payable during the financial year.

The maturity structure of the debt portfolio was as follows:

	31st March 2023 £	**31st March 2024 £**
Less than one year	216,500	855,837
Between one and two years	855,837	857,602
Between two and five years	857,602	0
Between five and ten years	0	0
Over ten years	4,000,000	4,000,000
	5,929,939	**5,713,439**

Investment Portfolio	**31st March 2023 £**	**31st March 2023 %**	**31st March 2024 £**	**31st March 2024 %**
Banks	17,373,000	3.95%	18,129,000	5.27%
Local Authorities	2,000,000	2.90%	1,000,000	6.90%
Money Market Funds	8,083,000	4.03%	2,960,000	5.26%
Property Fund	844,874	4.84%	742,726	5.27%

The return on the Lothbury Property Fund comprises both rental income and interest income gross of fees.

4.5 The Strategy for 2023/24

<u>Investments</u>
Investment returns picked up throughout the course of 2023/24 as central banks, including the Bank of England, realised that inflationary pressures were not transitory, and that tighter monetary policy was called for.

Starting in April 2023 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, and the market was pricing in a first rate cut for 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 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.

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 near 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 to between 6% and 7% in the last week of March.

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.

Borrowing

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 the minimise taking on of long-term borrowing at elevated levels (greater than 4%) and has focused on a policy of internal borrowing. Cash flows have been at a sufficient level to mean that even temporary, short-dated borrowing has been unnecessary.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Executive Director (Section 151) 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 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 remain 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.

4.6 Borrowing Outturn

Due to continuing high interest rates, no borrowing was undertaken during the year. As a result, gross borrowing has fallen from £5,929,939 to £5,713,439 on 31st March 2024. The movement is summarised in the following table:

	£
Balance at 1st April 2023	**5,929,939**
New borrowing in year	0
Loans repaid in year	(216,500)
Balance at 31st March 2024	**5,713,439**

The total loan interest payable in 2023/24, excluding finance leases, was £131,268 (£167,745 in 2022/23), and the average interest rate payable was 2.25% (2.14% in 2022/23). The slight increase in the interest rate payable is reflective of a PWLB loan with a rate of 2.68% being repaid in February 2024.

Borrowing in advance of need:

The Council has not borrowed more than, or in advance of its needs, purely to profit from the investment of the extra sums borrowed.

Rescheduling:

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

4.7 Investment Outturn

The Council's investment policy is governed by guidance issued by the Department for Levelling Up, Housing and Communities (DLUHC), which has been implemented in the annual investment strategy approved by the Council on 22nd 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 experienced no liquidity difficulties during the financial year.

Interest on in house investments amounted to £1,699,508 (£778,213 in 2022/23), above the revised budget by around £0.4m, due to the Monetary Policy Committee maintaining the bank rate at 5.25%, and cash flow balances remaining high. The average rate of return for 2023/24 was 5.34% compared with the average of 3.98% achieved in 2022/23.

In addition to this the Council achieved a return of £39,112 interest and rental income on its property fund investment during 2023/24, equivalent to 5.27% for the year (4.84% in 2022/23). There is a statutory override in place until 31st March 2025, which prevents fluctuations in the fund value from having to be charged to the General Fund. The Council has also set up an earmarked reserve as a mitigation against losses in the fund value.

As Members will be aware, the Lothbury Property Trust has suffered an ongoing reduction in its fund value during the last 18 months, and the fund managers had given notice to terminate the fund on 31st March 2024. At the time of setting the 2024/25 budget, in February, Council was informed that the fund managers were in negotiations with another well-established fund, UBS Triton, to transfer a proportion of their assets to the new fund.

Following an extraordinary general meeting held in March 2024, the deadline for terminating the fund was extended to the end of May 2024. Unfortunately, due to a difference in opinion over the valuation of certain assets that were to be transferred from Lothbury to UBS, the merger option did not proceed, and the fund was wound up on 30th May.

Lothbury have already sold off approximately 40% of the fund assets, and in early June began the process of distributing the proceeds arising from those assets to all investors in proportion to their initial investment. Further distributions will be made over the next 12 months or until all sales are complete. However, although the merger has fallen through, officers have maintained communication with UBS Triton fund managers and there is still an opportunity to transfer the Council's share of proceeds from Lothbury to UBS Triton, as and when funds are distributed, at a preferential management fee rate. The Executive Director (Section 151), in consultation with the Portfolio Holder for Finance, Performance, and People, has determined under delegated authority that the transfer of funds from Lothbury to UBS Triton remains the Council's best opportunity to recover its investment loss, and the process for investing with UBS is underway.

5. What will it cost and are there opportunities for savings?

5.1 Not applicable.

6. What are the risks and how can they be reduced?

6.1

Current Risk	Actions to reduce the risks
That external borrowing might not be undertaken at the most advantageous rate	Treasury officers maintain regular contact with the Council's advisors, Link Treasury Services, who monitor movements in interest rates on our behalf. The aim is always to drawdown loans when interest rates are at their lowest point.
Credit risk – the risk that other parties might fail to pay amounts due, e.g., deposits with banks etc	The Annual Investment Strategy sets the criteria through which the Council decides with whom it may invest. The lending list is updated regularly to reflect changes in credit ratings.
Liquidity risk – the Council might not have sufficient funds to meet its commitments	Daily monitoring of cash flow balances. Access to the money markets to cover any short-term cash shortfall.
Refinancing and maturity risk – the risk that the Council might need to renew a loan or investment at disadvantageous interest rates	Monitoring of the maturity profile of debt to make sure that loans do not all mature in the same period. Monitoring the maturity profile of investments to ensure there is sufficient liquidity to meet day to day cashflow needs.
That the investment in UBS Triton will not achieve full recovery of the Council's current investment loss as expected.	UBS Triton is an established property fund with one of the highest rates of return in the market over the last 7 years. An earmarked reserve is in place to mitigate any potential fluctuations in the fund value, although it does not cover the full value of the initial investment.

7. Other options considered

7.1 None. It is a legislative requirement that the Council receives an annual report covering its treasury activities for the financial year.

8. Environmental impact

8.1 No environmental impact directly arising from this report.

9. Other significant issues

9.1 In preparing this report, the author has considered issues related to Human Rights, Legal Matters, Human Resources, Equalities, Public Health Inequalities, and Climate Local and there are no areas of concern.

10. Appendix

10.1 Appendix A – Prudential and Treasury Indicators 2023/24

11. Background paper(s)

11.1 None.

12. Report author's contact details

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