



CORPORATE GOVERNANCE COMMITTEE – 20th May 2024

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

ANNUAL TREASURY MANAGEMENT REPORT 2023/2024

Purpose of Report

1. The purpose of this report is to advise the Committee of the action taken and the performance achieved in respect of the treasury management activities of the Council in 2023/2024

Policy Framework and Previous Decisions

2. Under the CIPFA Code of Practice it is necessary to report on treasury management activities undertaken in 2023/24 by the end of September 2024. This report will be referred to the Cabinet on 21st June and the Committee is asked to provide comments in advance of this meeting.

Background

3. The term treasury management is defined as: -

“The management of the organisation’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”.

4. The Director of Corporate Resources is responsible for carrying out treasury management on behalf of the County Council, under guidelines agreed annually by the County Council.

Action Taken during Quarter 4 to March 2024

Economic Background

5. The Council’s treasury management adviser, Link Asset Management (Link), provides a periodic update outlining the global economic outlook and monetary policy positions. An extract from that report is attached as Appendix A to this report. The key points are summarised in the following paragraphs.
6. Against a backdrop of stubborn inflationary pressures, the Russian invasion of Ukraine, and war in the Middle East, UK interest rates continued to be volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2023/24.

7. 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 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.
8. 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%.
9. At the end of Q4 2023/2024, the consumer price index (CPI) stood at 3.2%, continuing its downward trajectory from 4.0% in December. As reported previously, there continues to be clear signs of an easing in domestic inflationary pressures. Core CPI (CPI excluding energy and food prices) has also continued to decline, from 5.1% in December to 4.2% in March.

Debt Rescheduling

10. Gilt yields, which underpin PWLB rates, have increased slightly since the last quarterly update. However, this was not sufficient to present further debt rescheduling opportunities for the Council.

Compliance with Prudential and Treasury Indicators

11. The prudential and treasury indicators are shown in Appendix B. It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the quarter ending 31st March 2024, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2023/24.

Resource Implications

12. The interest earned on revenue balances and the interest paid on external debt impact directly onto the resources available to the Council. The budgeted income for interest generated by treasury management activities (excluding private debt and pooled property investments) for 2023/2024 was £13.6m. The actual interest received from said treasury management activities at year end totalled £21.0m. This overperformance has been driven by ongoing high levels of interest rates, although with the Bank of England base rate stabilising and expected to decrease, such a significant level of interest is highly unlikely to be sustainably achieved in the medium to long term.
13. In the short term, however, the Council's investment portfolio will benefit from a lag against the fall of the Bank of England base rate. This is due to the 6-to-12-month term deposits that the Council invests in. Interest rates are agreed at the outset of an investment, meaning that our loan portfolio secures the prevailing rates at the time of investment, irrespective of any subsequent fall in the base rate during the investment term.

Notes on Treasury Management Activities during Quarter 1 2024

14. During April, the Council took advantage of a favourable debt rescheduling opportunity for its market debt loan with Barclays (£10.0m, 3.99%). After investigation and upon further advice from Link, our treasury management consultants, a decision was made to repay the principal early. As a result of this action, the Council received a discount of £1.1m, after accounting for relevant execution fees.
15. The discount rate provided by Barclays was better than the PWLB equivalent premature repayment rate and hence the Council received a substantial discount.
16. As per the Link and Capital Economics long term forecasts, which suggest a reduction in the Bank of England base rate, repayment of this loan should also provide an opportunity for the Council to refinance in the future at a lower rate, enabling further savings.
17. The repayment of the loan also offers the Council greater flexibility on the loan portfolio with the opportunity to refinance in a different period, thus further balancing out the debt maturity profile as desired.

Treasury Management 2023/2024

18. The Treasury Management Policy Statement for 2023/24 was agreed by the full Council on 22nd February 2023, in relation to the sources and methods of borrowing and approved organisations for lending temporarily surplus funds.
19. The criteria for lending to Banks are derived from the list of approved counter parties provided by the County Council's Treasury Management advisors, Link Asset Services (Link). The list is amended to reduce the risk to the County Council by removing the lowest rated counterparties and reducing the maximum loan duration.
20. During the year all outstanding loans were repaid on time with the interest due.
21. For local authority lending, the policy is unchanged with no loans permitted in excess of 12 months duration or £10 million in value to a single authority. In 2019, Moody's, one of the world's best-known credit rating agencies, re-affirmed its view that the UK local government sector has a high credit quality. The implication being that the sector continues to be a good risk for lenders. There were no new loans made to Local Authorities during the year. However, there is an increased likelihood that LCC would want to lend to another local authority going forwards. Attached as Appendix C is a template which highlights the checks and considerations that would be taken into account before such a decision is made. Timelines are short in order to be able to agree a loan to another local authority. It's important to ensure sufficient due diligence is undertaken but this will mean that some potential opportunities could be missed. The checklist has not yet been put into action yet, but it is anticipated that the checks will be refined over time to balance time taken with focus on the most relevant areas.
22. In 2016 it was agreed that any counterparty that was downgraded whilst a loan was active, and where the unexpired period of the loan, or the amount on loan, would then breach the limit at which a new loan could be made to that counterparty, this would be included in the appropriate quarterly treasury management report to the

Corporate Governance Committee. There was one such incident during Q4 2023/2024, with three loans affected.

23. On 12th February 2024 Link downgraded the suggested lending duration for Close Brothers from 6 months to 0 months. Close Brothers does not have a credit default swap (CDS) price, which typically determines Link's rating. However, Link noted a sharp and sustained fall in the Bank's equity price, which would typically be correlated with a sudden rise in the CDS price. As per the Council's Annual Investment Strategy this meant that Close Brothers was no longer an acceptable counterparty. The Bank's credit rating was later downgraded by Fitch to BBB+ on 20th February. The council had £35m invested across 3 loans with the bank at the time of the breach. £30m of the outstanding amount was repaid with full interest at the expiry of the loans in early March 2024, with the remaining £5m repaid with full interest at expiry on 30th April 2024.
24. Investment returns picked up throughout the early stages of 2023/2024 before generally plateauing from September 2023 onwards.
25. Starting in April 2023 at 4.25%, the Bank Rate moved up in stepped increases of either 0.25% or 0.5%, reaching 5.25% by September 2023. Link advise that the rate has now peaked, and that rates will remain consistent in the first quarter of 2024/2025 before decreasing to a forecasted 3.75% at the end of that financial year.
26. The Council has taken a cautious approach to investing and is 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 Financial Crisis of 2008/9. 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. Nonetheless caution still needs to be exercised as evidenced by recent high-profile failures (Silicon valley bank, Credit Suisse, etc.); the council continues to monitor credit ratings and watches on a daily basis and confirm the counterparty list before any new loans are placed.

Debt Position at 31 March 2024

27. On the debt portfolio, no new loans were taken. A total of £42.6m was repaid in the year, of which £42.1m was due to the early repayment of PWLB debt on favourable terms. Three loans were repaid in full, totalling £36.6m in principal and achieving a £3.2m discount. This discount was used to offset the early repayment premiums of a further £5.5m of high interest debt. These early repayments will generate £2.0m in annual interest savings for the Council. The additional £0.5m repaid was in respect of three equal instalments of principal loans, thereby reducing the overall balance of the loan portfolio.
28. The Council's external debt position at the beginning and end of the year was as follows: -

| | 31 March 2023 | | | 31 March 2024 | | |
|-------------------------------|----------------|--------------|---------------|----------------|--------------|---------------|
| | Principal | Average Rate | Average Life | Principal | Average Rate | Average Life |
| Fixed Rate Funding | | | | | | |
| - PWLB | £158.6m | 6.81% | 28 yrs | £116.0m | 7.60% | 27 yrs |
| -Market | £ 10.0m | 3.99% | 43 yrs | £ 10.0m | 3.99% | 42 yrs |
| Variable Rate Funding: | | | | | | |
| - Market (1) | £ 93.5m | 4.41% | 2 yrs | £ 93.5m | 4.41% | 2 yrs |
| Total Debt | £262.1m | 5.85% | 17 yrs | £219.5m | 6.08% | 17 yrs |

(1) The majority of lenders have an option to increase the rates payable on these loans on certain pre-set dates, and if they exercise this option the Council can either repay or accept the higher rate. The average life is based on the next option date.

29. The Authority has not raised any new external loans since August 2010 and external debt is around £140m lower than it was at its peak in November 2006. The most recent MTFs capital programme, for 2024-2028, includes a funding requirement of £93.4m to be funded from borrowing. However, due to the strength of the County Council's balance sheet, it is expected to be possible to use internal balances to fund this on a temporary basis instead of raising new loans.

Investment Position at 31st March 2024

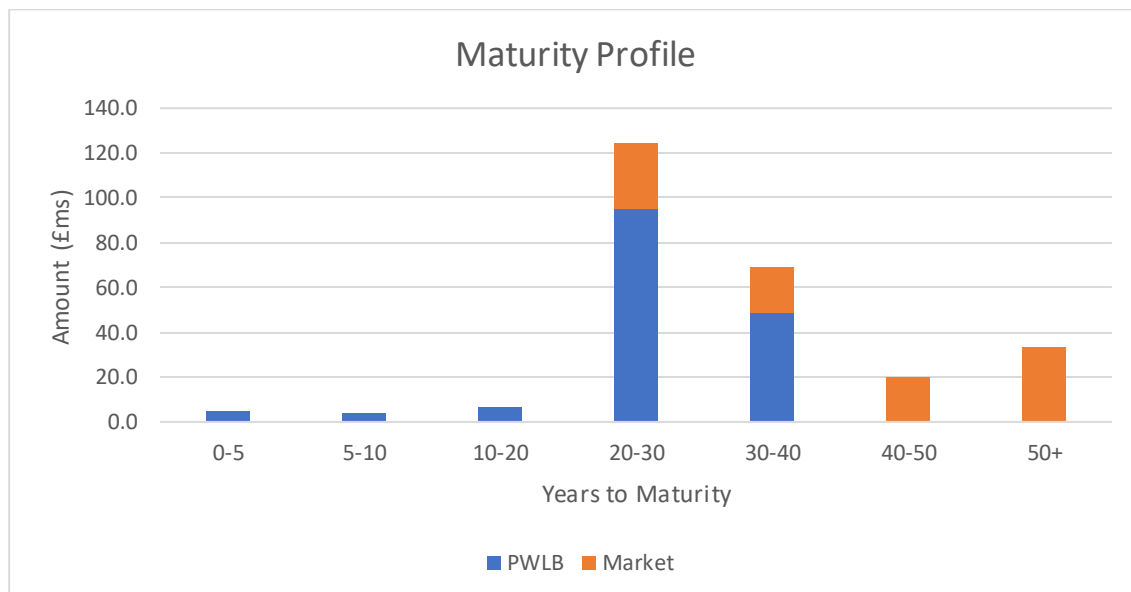
30. The position in respect of investments varies throughout the year due to the large inflows and outflows of cash that occur. Over the course of the year the loan portfolio (which includes cash managed on behalf of schools with devolved banking arrangements) varied between £412m and £490m and averaged £442m. Investments as at 31 March 2024 were £446m.

Debt Transactions

31. The Council began the financial year £54.3m over-borrowed compared with the amount required to fund the historic capital programme - this is denoted as the Capital Financing Requirement.

32. Although the term 'over borrowed' suggests an unusual situation it is simply caused by the Council setting aside money each year so that when loans become due they can be repaid. Historically this situation did not arise because new borrowing was undertaken each year. For the last ten years and more, there has been no requirement to undertake new borrowing to fund the capital programme (which leads to debt financing costs that fall on the revenue budget), linked to the Government's change of approach to award grants to fund the capital programme rather than the previous approach of supported borrowing (i.e. support for capital expenditure by providing revenue funding to cover borrowing costs). Ideally the situation would be remedied by repaying loans early. However, given the large penalties that would be incurred, early repayment options have been limited and this is likely to be increasingly the case as interest rates reduce.

33. Furthermore, it is expected that the overborrowed position will reverse during the MTFS period anyway due to the requirement to fund the new capital programme for 2024-28. As mentioned earlier in the report there is a funding requirement of £93.4m for the new capital programme. Due to the level of cash balances held, it is expected that the additional funding requirement will be funded internally without raising any new external debt.
34. At the end of the financial year, after the repayment of debt and setting aside funding for the Minimum Revenue Provision (MRP) of £6.2m, to ensure that loans raised to finance capital expenditure are paid off over the longer term, the Council was £17.9m over-borrowed.
35. During the year, there were three favourable opportunities to reduce the Council's debt portfolio, as reported in quarterly treasury management updates. These opportunities arose due to the prevailing economic conditions at the time of repayment, with Gilt yields (which underpin PWLB rates) remaining at levels sufficient to consider long term debt rescheduling opportunities. The total debt repaid was £42.6m, of which £42.1m was as a direct result of debt rescheduling activities. At the end of the financial year, the debt portfolio stood at £219.5m with an average pool rate of 6.08%, as shown in the table above.
36. The maturity profile of the Council's debt portfolio is shown in the chart below. This illustrates the long-term nature of the historic debt.



Investments

37. The loan portfolio produced an average return of 5.08% in 2023/2024, compared to an average base rate of 5.03% and a Sterling Overnight Index Average (SONIA) of 4.97% published daily by the BoE. The SONIA rate is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors. It is therefore a good proxy for the risk-free rate of investing surplus cash.

38. The loan portfolio has outperformed both the average base rate and the average SONIA in four of the last five years. The average rate of interest earned on the portfolio in the last five years is 1.79% which compares favourably to average base rate and the SONIA which have reported returns of 1.65% and 1.61% respectively.
39. The variability of balances makes it difficult to calculate the excess interest that the over performance has achieved over the whole of the five-year period, but it is estimated to be at least £2.25m.
40. Link produces a quarterly benchmarking analysis of the Council's investment performance against comparator local authorities. A copy of the report for March 2024 is included as an appendix to this report.
41. The Link benchmarking report shows the weighted average rate of return for Leicestershire County Council (5.49%) against other councils in its benchmarking group (5.24%) and an average for other County Councils (5.26%) and indicates that the Council is currently performing slightly better than its peers. This represents an improvement in comparative performance compared to last year - Leicestershire County Council (2.16%) against other councils in its benchmarking group (1.76%) and other County Councils (1.79%).
42. The above paragraphs exclude investments relating to private debt and bank risk sharing funds. The capital value of these investments as at 31st March 2024 was £42.6m. Since inception (January 2018) the Council has received interest payments totalling £5.9m from these investments and the current performance as measured by the internal rate of return is 6.85%.

Summary

43. Treasury Management is an integral part of the Council's overall finances, and the performance of this area is very important. Whilst individual years obviously matter, performance is best viewed on a medium to long term basis. The action taken in respect of the debt portfolio in recent years has been extremely beneficial and has resulted in significant savings. Short term gains might, on occasions, be sacrificed for longer term certainty and stability.

Recommendations

44. That the contents of the annual report for 2023/24 be noted.
45. That the Committee further notes that the annual report will be submitted to the Cabinet for consideration at its meeting in June 2024.

Equality and Human Rights Implications

46. None.

Background Papers

Report to County Council on 22 February 2023 – 'Medium Term Financial Strategy 2023/24 - 2026/27. Appendix N, 'TMS 2023-24:

<https://democracy.leics.gov.uk/mgAi.aspx?ID=74188#mgDocuments>

Circulation under local issues alert procedure

None.

Appendices

Appendix A – Economic Update from Link

Appendix B – Prudential and Treasury Indicators

Appendix C – Local Authority Lending Checklist (*misidentified as Appendix A*)

Appendix D – Link Benchmarking Report March 2024

Officers to Contact

Declan Keegan, Director of Corporate Resources,
Corporate Resources Department,

Tel: 0116 305 6199 E-mail: declan.keegan@leics.gov.uk

Simone Hines, Assistant Director (Finance, Strategic Property and Commissioning)
Corporate Resources Department,

Tel: 0116 305 7668 Email: simone.hines@leics.gov.uk