Leicestershire County Council

CABINET – 21 JUNE 2024

ANNUAL TREASURY MANAGEMENT REPORT 2023/24

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

PART A

Purpose of the Report

1. The purpose of this report is to advise the Cabinet of the action taken and the performance achieved in respect of the treasury management activities of the Council in 2023/24.

Recommendation

2. The Cabinet is asked to note this report.

Reason for Recommendation

3. The Authority's full adoption of the CIPFA Code of Practice for treasury management requires an annual report on Treasury Management activity and performance to be considered by both the Cabinet and the Corporate Governance Committee before the end of September each year.

Timetable for Decisions (including Scrutiny)

4. 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.

5. The Corporate Governance Committee considered the matter at its meeting on 20 May 2024.

Policy Framework and Previous Decisions

6. The Authority has adopted the CIPFA Code of Practice for treasury management. Treasury management issues are reported to either the Corporate Governance Committee or the Cabinet. Approval of the Annual Treasury Management Strategy remains the responsibility of the full Council which it considers as part of the Medium Term Financial Strategy (MTFS) each year.

Resource Implications

7. Treasury management is an integral part of the Council's finances. Interest of £21.3m was generated through treasury management activities and interest paid on external debts was £13.9m.

Circulation under the Local Issues Alert procedure

8. None.

Officer to Contact

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PART B

Background

9. 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".

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

Treasury Management 2023/24

11. The Treasury Management Policy Statement for 2023/24 was agreed by the full Council on 22 February 2023, in relation to the sources and methods of borrowing and approved organisations for lending temporarily surplus funds.

12. The criteria for lending to Banks are derived from the list of approved counter parties provided by the Council's Treasury Management advisors, Link Asset Services (Link). The list is amended to reduce the risk to the Council by removing the lowest rated counterparties and reducing the maximum loan duration.

13. During the year all outstanding loans were repaid on time with the interest due.

14. 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 the Council would want to lend to another local authority going forwards. Attached as Appendix A 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 is 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, but it is anticipated that the checks will be refined over time to balance time taken with focus on the most relevant areas.

15. 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 quarterly treasury management report to the Corporate Governance Committee. There was one such Incident during 2023/24, with three loans affected.

16. On 12 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 20 February. The Council had £35m invested across three 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 30 April 2024.

17. Investment returns picked up throughout the course of 2023/24 before generally plateauing from September 2023 onwards.

18. 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.

19. 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

20. 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.

21. The Council's external debt position at the beginning and end of the year was as follows: -

	31 March 2023 Principal	Average Rate	Average Life	31 March 2024 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.

22. 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 31 March 2024

23. 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

24. 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.

25. 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 borrow to fund the capital programme (which leads to debt financing costs that fall on the revenue budget), and also the Government's change of approach, a number of years ago, to award grants to fund the capital programme rather than the previous approach of supported borrowing. Ideally the situation would be remedied by repaying loans early. However, given the large penalties that would

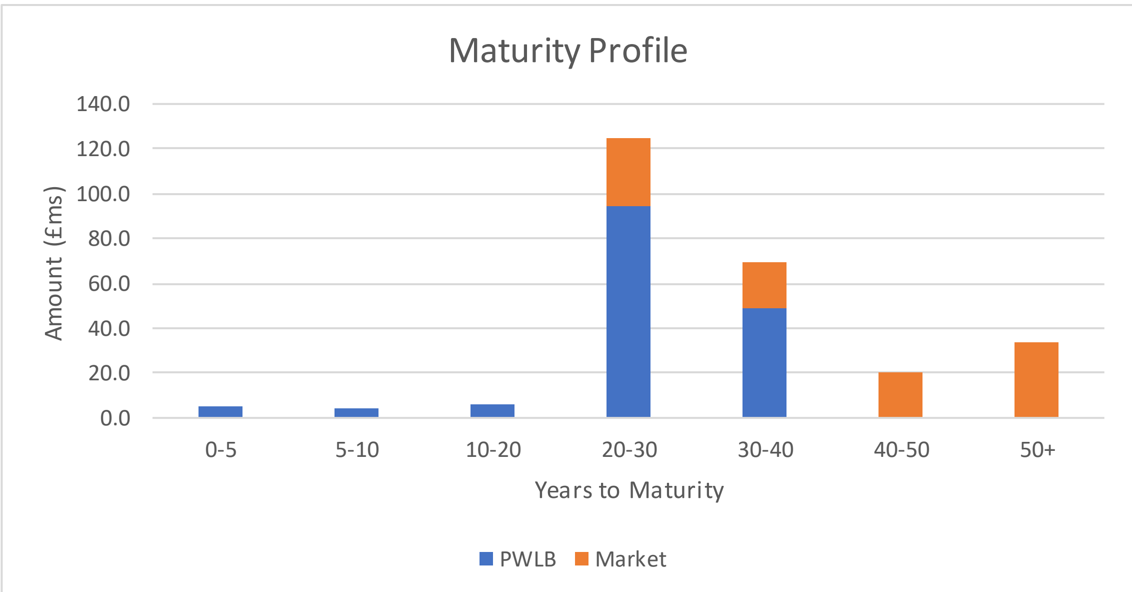
be incurred, early repayment options have been limited and this is likely to increasingly the case as interest rates reduce.

26. Furthermore, it is expected that the overborrowed position will reverse during the MTFS period 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.

27. 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.

28. 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.

29. 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

30. 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.

31. 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.

32. 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.

33. The Link benchmarking report, Appendix B, 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%).

34. 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

35. 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.

Equality and Human Rights Implications

36. There are no equality or human rights implications arising from the recommendations in this report.

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

Appendices

Appendix A – Local Authority Lending Checklist
Appendix B – Link Benchmarking Report March 2024

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