South Tyneside Council

item 5

Report to the Executive (Cabinet) and Council

Cabinet Portfolio/Lead Member: Councillor Jane Carter, Lead Member Governance, Finance and Corporate Services
Report of Stuart Reid, Director of Business and Resources

Subject: Treasury Management Annual Report 2023/24

Date: Cabinet 7th August 2024

Wards affected: All

Council ambitions: All

Does the report and any appendices contain information which has been identified as confidential or exempt?

☐ **Yes**
State the applicable paragraph number(s) under Schedule 12A Local Government Act 1972:

☒ **No**, this report does not contain information identified as confidential or exempt.

For Executive Decisions only:

Is the decision a Key Decision?	☐ **Yes**	☒ **No**
Is it included in the Forward Plan?	☒ **Yes**	☐ **No**
If not in the Forward Plan is the report:	☐ **General Exception Rule** ☐ **Special Urgency Rule**	

Relevant Scrutiny Chair:

Is the decision eligible for call-in by Scrutiny? ☐ **Yes** ☒ **No**
(If the decision is anything other than any executive decision made by the Cabinet or a Key Decision made by an officer under delegated powers, call-in is not applicable. This should be explained in the report.)

Purpose of Report

1. The Director of Business and Resources is required to submit an annual report on Treasury Management activities to Council in order to comply with the Chartered Institute of Public Finance and Accountancy Code of Practice on Treasury Management.

2. It is recommended that:

   - Cabinet notes this report;
   - The report is referred to the next meeting of Council for consideration.

Background Information

3. Treasury Management is the process by which the Council's cash flow, investments and borrowing activities are managed.

4. The Council complies with the requirements of the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management.

5. This Code requires the Director of Business and Resources to submit an annual report on Treasury Management activities to Council.

6. This report covers the financial year 2023/24.

7. Further details of the capital programme supported by Treasury Management activities can be found in the Medium-Term Financial Plan which contains the Treasury Management Strategy.

Main issues and Options to be Considered

Economic Background

8. Since the start of the Covid-19 pandemic, markets have seen an increase in volatility with the wars in Ukraine and Gaza and geopolitical uncertainty. This is a challenging environment for financial decision-making.

9. The UK economy has weathered the impacts of higher inflation better than was widely expected. The recent resilience has been due to a confluence of factors including the continued rebound in activity after the pandemic, increasing household spending, and the tight labour market. The global economic outlook is still challenging although showing signs of a recovery with global growth now expected to slow modestly rather than the previously forecast recession. Central bank interest rate reductions are still expected in 2024 but will now be later in the year.

10. The UK entered a technical recession at the end of 2023, but output has been increasing at a steady pace since then and financial markets have performed strongly. The commercial property market is also showing signing of stabilising although the outlook remains challenging.

11. Inflation, as measured by the Consumer Price Index (CPI), was high during the start of 2023/24, with a peak reading of 7.9% in May 2023, well above the long term target of 2%. The inflation rate has steadily been coming down and was at 3.8% by March 2024.

Interest Rates - Investments

12. Bank Rate started 2023/2024 at 4.25%, in May the rate increased to 4.5%, in June the rate increased to 5% and then finally increased in August to 5.25% which it remained at until the end of the financial year. It is forecasted that the rate will decrease to 3.75% by the end of 2024/25.

13. Investment rates started the year, in April 2023, at 4.40% for three month deposits and 4.90% for one year deposits. Returns increased throughout 2023/24, as the Bank Rate rose.

14. At year end, the three month investment rate was at 5.20% and the one year rate was at 5.10%.

Interest Rates - Borrowing

15. The Council's main source of long term borrowing is the Public Works Loans Board (PWLB). The movement in rates over the year is shown below:

Period	Rate at March 2023	Rate at September 2023	Rate at March 2024
1 year	4.78%	5.69%	5.36%
5 years	4.31%	5.22%	4.68%
25 years	4.70%	5.67%	5.22%
50 years	4.41%	5.43%	5.01%

16. The table shows that the borrowing rates over the first half of the year rose significantly in all periods. The upward trend continued after September 2023, before dropping slightly towards March 2024. Throughout the year rates have been volatile right across all periods.

17. In this environment, it was considered appropriate to defer any long term borrowing.

Capital Financing Requirement and the Consolidated Loans

18. The Council's borrowings to finance its capital schemes are pooled together into a Consolidated Loans Fund. Individual schemes are then financed out of this Fund.

19. The Fund started the year underfinanced by £59.2 million and ended the year at £54.4 million underfinanced.

20. The term "underfinanced" means that the value of capital schemes is greater than the total borrowing in place. The underfinancing is covered temporarily from the

Council's cash balances. It is shown in the table below as "Temporary Variable Rate Borrowing".

21. This strategy was adopted because the interest rate earned on investments was below the rate paid on borrowing. It was, therefore, financially advantageous to adopt this approach.

22. The structure of the Consolidated Loans Fund at 31st March 2024 was:

	£'m	%
Fixed Rate Borrowing	618.5	84.4
Short Term & Variable Rate Borrowing	60.0	8.2
Total Borrowing	678.5	92.6
Capital Financing Requirement	732.9	100.0
Temporary Variable Rate Borrowing (Underfinancing)	54.4	7.4

23. The capital financing requirement from borrowing was £732.9 million at the year end.

24. Four one-year loans were taken from the PWLB during 2023/24. One was taken in December 2023 for £15 million which was allocated to the HRA, two loans were taken in February 2024, both loans were for £10 million which were allocated to the GF and another loan was taken out in March 2024 for £15 million which was allocated to the GF. These PWLB loans were taken to cover the cash flow throughout the year.

25. PWLB loans to the value of £21 million were repaid during the year, £14.5 million was allocated to HRA and £6.5 million was allocated to the GF.

26. The interest charges to the General Fund and the Housing Revenue Account are governed by accounting regulations. A comparison of the outturn interest charges against the forecast is shown below:

	General Fund Interest Payable £'m	HRA Interest Payable £'m	Total Interest Payable £'m
Outturn	12.928	10.563	23.490
Forecast	11.113	10.083	21.196
Costs	1.814	0.480	2.294

27. The table shows that the outturn interest charge for both the General Fund and the HRA were over budget. The original forecasts assumed new loans would be taken at a lower interest rate, also more borrowing was taking through the year than budgeted in order to cover cashflow.

28. The activity on the Consolidated Loans Fund is summarised in Appendix A.

Management of Cash Balances

29. At 31st March 2024, £14.5 million of Council cash was invested in the money markets.

30. The Council earned investment income of £1.19 million at an average rate of 4.25% during 2023/24. This was below the budgeted figure of £1.75 million, which was based on an expected return of 3.50%. The actual return was lower than expected due to the expected return being based on an average of £50 million being invested but due to cashflow there was only an average of £26.4 million in investments.

31. The rate of return is shown below against the agreed benchmarks:

	%
Council return for the year	4.25
Seven day market rate (annual average)	4.96
Three month market rate (annual average)	4.84

32. The Council's return was below the seven day and three month rates. This is to be expected in a rising interest rate environment, especially one that has been so sharp. This is because the benchmark itself will have risen almost every day throughout the year, however investments aren't placed every day, meaning there will always be a lag on the return achieved.

33. The Council subscribes to a benchmarking club run by Link Asset Services. The analysis examines the investment portfolio at quarter end dates and compares the investment return and risk being taken against the position at other councils.

34. The return being achieved, based on the investments held at each quarter end, compared to the Link Asset Services benchmarking data is shown below:

	Q1 %	Q2 %	Q3 %	Q4 %
Council average return	3.75	4.19	4.46	4.60
Met. Districts average return	4.47	5.08	5.04	5.06
Benchmarking Group average return	4.56	5.25	5.39	5.31

35. The Council's returns have been compared against two groups, the Metropolitan District Councils, and the councils within the Link Benchmarking Group.

36. The Council's returns were below those of the Metropolitan Districts in each period of 2023/24. The Council's returns were below those of the Benchmarking Club in each period of the financial year. Generally, the performance against the peer groups dropped off this year. This was mainly due to low investment balances throughout the year as a result of the strategy to minimise borrowing, which meant less funds could be invested for longer periods to achieve higher rates.

37. The benchmarking club also measures risk through the credit strength of the borrowers and the lending periods. Link Asset Services has concluded that the risk taken by the Council is relatively low, and that the return achieved has either been in-line or above expectations, based on the level of risk taken.

Credit Rating Methodology and Lending Lists

38. The organisations that the Council lends to, the periods for which it can lend and the maximum amounts to be invested with each organisation are set in consultation and agreement with Link Asset Services.

39. In addition to applying the Link Asset Services methodology, the Council forms its own view based on market information and the level of Government support for banks.

40. The Council's lending list is reviewed on a weekly cycle, or more regularly if an organisation's credit rating changes in the interim period.

41. The Council restricted its lending to UK banks and building societies, local authorities and to a limited number of overseas institutions that are domiciled in a country with AAA credit rating, and which are included on the Link Asset Services approved credit rating list with a lending period of 100 days or more.

42. The Council also invests in AAA rated money market funds. These funds are separate legal entities from the organisations that manage them and have the benefit of diversifying risk.

43. During the year there were no changes to the lending list.

44. These processes ensure the security of investments made on behalf of the Council.

Other Credit Liabilities

45. The Council has one finance lease in the form of a long-term property lease. At the end of 2023/24, this liability totalled £1.5 million.

46. The Council has liabilities of £83.3 million from contracts arranged through the Private Finance Initiative in relation to the former South Shields School, Boldon School, Jarrow School, Street Lighting, and the Waste Facility. These liabilities are payable over the next 8-16 years and are accounted for within the Medium Term Financial Plan.

47. Specific Government funding is received which offsets, in part, the cost of these contracts.

Compliance with Treasury Management Prudential Limits

48. The Council has operated throughout the year within the Treasury Management Prudential Limits, as set out in the Annual Treasury Strategy Statement.

Financial and Resources

49. This report summarises the Treasury Management activity for the year ended 31st March 2024. The financial implications of this activity are reflected in the Council's Report and Accounts.

50. The current economic environment means that achieving a favourable variance against the budget for borrowing and investment activities will be challenging. Levels of borrowing are more than offset by the value of assets, such as housing, land, buildings and vehicles, which the Council owns and are held on the balance sheet.

Legal and Governance

51. Under the Local Government Act 2003, local authorities must have regard to proper practices in their treasury management activities. In effect this means the Council must adhere to the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code for Capital Finance in Local Authorities and CIPFA's 'Treasury Management in the Public Services: Code of Practice' (the CIPFA Code). The activity outlined in the report reflects the Councils approach to treasury management as set out in the Treasury Management Strategy, which is in accordance with the CIPFA Treasury Management Code.

52. There are no significant legal or governance implications arising from the proposed recommendations in this report.

Risk

53. Risk Management within the treasury function requires the ongoing adjustment of debt and investment exposures to changing market, counterparty and regulatory conditions, in order to help achieve the Council's objectives.

54. The Treasury Management Strategy and Annual Investment Strategy set out the Council's approach to treasury management including how risks are mitigated and managed.

Equality and Diversity and Community

55. There are no significant equality, diversity, community and integration implications arising from the proposed recommendations in this report.

Environmental and Sustainability

56. The Council's prime objectives when investing cash, are the security of the capital sum and the liquidity of those investments. Where appropriate the Council places funds in sustainable investments.

57. Environmental and sustainability issues are more typically associated with longer term Pension Fund investments although the CIPFA Code now expects local authorities to consider these issues across all treasury management activities. These issues are now reflected in the Council's Annual Investment Strategy.

Council Ambitions, Policies, Strategies and Plans

58. The Council's Treasury Management Strategy Statement supports the Council ambitions, policies, strategies and plans.

Consultation and Engagement

59. The Council Budget is subject to regular consultation and engagement throughout the year in the development of the Medium Term Financial Plan (MTFP), with further engagement planned in the development of the 2025-2030 MTFP.

Recommendations

60. Cabinet is recommended to:

- note this report;
- refer the report to the next meeting of Council for consideration.

Reasons for Recommendations

61. To comply with the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management in Public Services.

List of Appendices

Appendix A – Summary of Activity on the South Tyneside Consolidated Loans Fund

Appendix A

Summary of Activity on the South Tyneside Consolidated Loans Fund

	Internal Borrowing	Short Term & Variable Rate Debt	Fixed Rate Debt	Total
	£'m	**£'m**	**£'m**	**£'m**
Brought Forward, 1st April 2023 *	**59.1**	**21.0**	**628.5**	**708.6**
Maturing Financing	-	(21.0)	-	(21.0)
Loans due < 1 year **	-	-	60.0	60.0
New Financing	-	-	-	-
Increase in Internal Borrowing	(14.7)	-	-	(14.7)
Closing Balance 31st March 2024 *	**44.4**	**0.0**	**688.5**	**732.9**

* The opening and closing balances for fixed rate debt includes a Lenders Option/Borrowers Option (LOBO) loan which can, strictly, be classified as a variable rate loan. This type of loan gives the lender the option of changing the interest rate at pre-determined dates. If this option is exercised, the borrower then has the option of repaying the loan. However, the loan structure and the current interest rate environment means that, for practical purposes, the options are unlikely to be exercised. Therefore, the loan is classed as a fixed rate loan.

** This line reflects the movement of loans previously classified under fixed rate debt at the start of the year which are now short term debt at the end of the year due to the fact that the maturity dates are now less than one year.

Movement in the Capital Financing Requirement

The table below shows how the Capital Financing Requirement has changed during 2023/24. The figures exclude Private Finance Initiative projects and Leasing as these are not financed from borrowing. This reconciles to the Closing Balance in the table above.

	£'m
Opening Capital Financing Requirement	**708.6**
Capital Investment	90.6
Revenue Contributions to Capital	(2.3)
Government Grants and Contributions	(19.7)
Third Party Repayments	(0.4)
Capital Receipts	(2.3)
Major Repairs Reserve	(29.6)
Minimum Revenue Provision for Repayment	(12.0)
Closing Capital Financing Requirement	**732.9**

background papers background papers background papers

Treasury Management Annual Report 2023/24

The following is a list of the background papers (excluding exempt papers) relied upon in the preparation of the above report:

Background Paper	File Ref:	File Location
Treasury Management File 2023/24		Investment Office, South Shields Town Hall