**PERTH AND KINROSS COUNCIL**

**28 June 2023**

# ANNUAL TREASURY REPORT 2022/23

**Report by the Head of Finance**
(Report No. 23/204)

## 1. PURPOSE OF REPORT

1.1 A requirement of the Council's approved Treasury Management Practice 6 (TMP6 – Reporting Requirements & Management Information Arrangements) is the reporting to Council of the expected treasury activity for the forthcoming year (i.e. the Treasury and Investment Strategy) and the subsequent reporting of the actual results and activities (i.e. this Annual Treasury Report). The Council meeting on 9 March 2022 approved the Treasury Strategy for the 6 financial years 2022/23 to 2027/28 and the annual Investment Strategy for 2022/23 (Report No. 22/47 refers).

## 2. RECOMMENDATION

2.1 It is recommended that the Council notes the content of this report,

## 3. STRUCTURE OF REPORT

3.1 This Annual Treasury Report covers:

- The Council's treasury position
- The forecast economic outlook and borrowing strategy for 2022/23
- The actual economic situation for 2022/23
- Actual long-term borrowing and repayments in 2022/23
- The Investment Strategy and outturn for 2022/23
- Compliance with treasury policies and limits during 2022/23
- The Statutory Loans Fund position

3.2 The Treasury and Investment Strategy details the expected activities of the Council's treasury function for the relevant financial years. The Investment Strategy also details the Permitted Investments of the Council, and outlines the risks associated with the expected investment activities. The submission of an annual Investment Strategy is a requirement of the Local Government Investments (Scotland) Regulations 2010.

3.3 In determining the Treasury Strategy, the Council is required to review its Prudential Indicators. The Council approved the Composite Capital Budget for the 6-years 2022/23 to 2027/28 at its meeting on 23 February 2022 (report 22/36 refers). The updated Prudential Indicators for this period were approved by the Council on 9 March 2022.

## 4. THE TREASURY POSITION

4.1 In order to place this report in context, the Council's Treasury position at the beginning and at the end of the year is shown below:

| | Principal 31 Mar 2022 £M | Average Rate % | Principal 31 Mar 2023 £M | Average Rate % |
|---|---|---|---|---|
| Fixed Rate/Long Term Funding | | | | |
| • Public Works Loan Board (PWLB) | 568.0 | 2.41 | 560.0 | 2.40 |
| • Market & Local Authority Bonds | 43.2 | 4.59 | 43.2 | 4.59 |
| • Other Loans & Bonds* | 0.1 | 0.00 | 0.1 | 0.00 |
| | 611.3 | 2.57 | 603.3 | 2.56 |
| Variable Rate/Short Term Funding | | | | |
| • Temporary Loans | 3.0 | 0.20 | 3.1 | 3.63 |
| • Internal Loans | 2.2 | 1.05 | 2.3 | 3.93 |
| | 5.2 | 0.56 | 5.4 | 3.76 |
| **TOTAL DEBT** | **616.5** | **2.55** | **608.7** | **2.57** |
| **TOTAL INVESTMENTS** | **252.0** | **0.88** | **173.7** | **3.76** |

*Interest free loan from the Scottish Government

## 5. THE FORECAST ECONOMIC OUTLOOK AND BORROWING STRATEGY 2022/23

5.1 In the aftermath of lifting the lockdown restrictions, the Bank of England's Monetary Policy Committee (MPC) increased the Bank Base Rate to 0.5% in February 2022. Following the pandemic it was anticipated that economic growth and inflation would steadily increase, and consequently interest rates were also expected to increase. The forecast was that the base rate would rise to around 1.25% by March 2023. Gilt yields, which determine the UK Government's borrowing costs and are used to set PWLB rates, were also at exceptionally low levels during the pandemic before increasing at the start of 2022. They were also anticipated to rise gradually throughout 2022/23, subject to any new economic restrictions.

5.2 The estimated capital borrowing requirement for 2022/23 at the start of the year was £148.8M, with further significant borrowing totalling £276.4M required in the subsequent 2 years. These amounts reflected the borrowing requirement of the Council's Capital Budget approved in February 2022. However, much of this borrowing requirement had effectively already been borrowed in the previous year.

5.3 Therefore, the Council's Treasury Strategy for 2022/23 was that with no immediate long-term borrowing required as a result of the significant borrowing undertaken in 2019 and 2021, any such borrowing would only be undertaken if capital expenditure recovered quicker than expected, or if opportunities arose to borrow at low rates. With short term rates expected to rise slower than medium and long-term rates, short term borrowing could be undertaken if required and long-term borrowing would then be deferred.

5.4 Consideration would also be given to borrowing for future year requirements earlier within the 6-year period, whilst rates were at their forecast low point. This approach is consistent with the Prudential Code but should be considered in conjunction with the assessment of the additional risks and potentially low returns from the resultant short-term increase in the level of investments, which were already at a high level at that time following previous year’s borrowing.

5.5 The strategy was to use the existing investment balances initially to meet capital expenditure. It was anticipated that borrowing would not be required until late in 2022/23. Whilst the use of short-term borrowing would then be initially cheaper, the use of longer-term borrowing would give rise to longer term savings and reduce the refinancing risk in later years. However, if rates stayed low, new borrowing could be delayed and short-term borrowing used to meet immediate cashflow requirements.

5.6 The approved Treasury Strategy also allowed for consideration of other market borrowing instruments where they offered favourable rates, or the ability to arrange borrowing to be drawn down at a given future date. However, the associated risks due to their variable rate nature and/or less flexible terms in comparison to the Public Works Loan Board would also need to be considered.

5.7 Whilst minimising risk by favouring fixed longer-term borrowing, it was acknowledged that there were several factors which could impact on interest rates over the year. Therefore, the Council applies an approach of managing risk and monitoring interest rates on an ongoing basis with a view to reviewing this strategy should circumstances change.

## 6. ACTUAL ECONOMIC SITUATION 2022/23

6.1 2022/23 was another volatile year for the financial markets. Economic growth in the UK initially grew at the start of the year before falling over the remainder of the year. It was also forecast that the UK economy was heading into a recession by the end of the year. Consumer Price Index (CPIH) inflation continued to steadily rise over the year and peaked at 11.1% in October 2022. This was due to an increase in demand and disruption to the commodities markets, particularly oil, gas, and foodstuffs, as a result of the war in Ukraine which affected global commodity supplies. Subsequently, inflation started to fall as supply pressures started to ease, however only at a gradual rate, with inflation remaining higher than had been forecast. Inflation affecting food prices remained particularly high. The high level of inflation also led to higher wage growth, however this was still below the rate of inflation. Industrial action in various sectors of the economy also affected economic growth.

6.2 Over the course of 2022/23, with the rapid rise in inflation, the Bank of England's Monetary Policy Committee (MPC) increased the Bank base rate at each of its meetings, increasing it from 0.75% in March 2022 to 4.25% by March 2023, with a further rise to 4.5% in May 2023. Financial markets are expecting a further increase later this year, before the MPC start gradually reducing the rate next year.

6.3 As inflationary expectations continued to increase PWLB rates also rose, with rates for all periods ending significantly higher than at the start of the year. The increase in rates was particularly pronounced around the end of September and in October 2022 following the UK Governments Growth plan, resulting in significant market volatility at that time. However, PWLB rates did reduce in the following months, but remained at elevated levels for the year as a whole. The PWLB rates for various periods are shown at Appendix I.

6.4 The 50-year rate was 2.37% at the start of the year and steadily rose and peaked at 5.51% on 28 September 2022. This was followed by a period of volatility before the rate reduced to 3.56% in November. Thereafter they started to rise steadily as inflationary expectations remained high and economic activity was low, and ended the year at 4.41% in March 2023. All other durations followed a similar pattern, but with rates up to 10 years being lower than the 50-year rate at the start and at the end of the year, whilst the 50 year was lower than shorter periods around the middle of the year.

6.5 Investment deposit rates also increased over the year, and more significantly in the second half of the year. This reflected the increased Bank base rate during the year, as well as expectations of further increases in the Bank Rate in the future. The average rate on the Council's investments at the start of the year was 0.88% and increased to 3.76% by the end of the year.

## 7. ACTUAL LONG-TERM BORROWING & REPAYMENTS

7.1 Treasury activity during 2022/23 is detailed in the four quarterly Treasury reports previously submitted to the Finance & Resources Committee (Report No's 22/210, 22/295, 23/32 and 23/122).

7.2 As noted in paragraph 5.2 above, based on the approved Capital Programme before the start of the year, the Council's estimated new capital borrowing for 2022/23 was £148.8M. As this had already been borrowed in a previous year, no new actual borrowing was required nor expected to be undertaken in the year, unless, for example, interest rates started to increase rapidly or fell to historic low levels. This would have included borrowing of future year's requirements.

7.3 However, with interest rates being relatively high at the start of the year, and subsequently rising significantly higher than had been forecast, no new long-term borrowing was undertaken in 2022/23.

7.4 The Council's scheduled repayments to the PWLB during the year related to 2 maturing loans which had been borrowed for 10 and 11.5 years totalling £8.0M at an average interest rate of 3.44%. The average PWLB debt portfolio rate for the Council reduced from 2.41% at the start of the year, to 2.40% for the total of £560M of PWLB debt held by the Council on 31 March 2023. There were no other repayments of long-term debt in the year.

7.5 Overall, the Council's total Fixed Rate borrowing reduced by £8.0M to £603.3M, whilst the average rate reduced from 2.57% to 2.56%.

7.6 Short term variable funding at the year-end increased slightly from £5.2M at 31 March 2022 to £5.4M at 31 March 2023. These funds relate to internal loans from local associated bodies and Common Good Funds, with the balances determined by their own cashflow requirements.

7.7 As a result of the above strategy and actual treasury activities in the year, the Council's average Consolidated Loans Fund (CLF) interest rate reduced from 3.11% in 2021/22 to 2.67% in 2022/23 (based on applying statutory guidance). The impact of rising interest rates in the year on short term funding was significantly lower than the impact on the Council's investment balances which reflects a large increase in investment returns.

## 8. INVESTMENT STRATEGY AND OUTURN 2022/23

8.1 Short term deposit increased over the year following the increases in the Bank base rate. In addition, deposit rates available from banks for longer deposits of up to 12 months increased further in anticipation of further increases in the Bank base rate.

8.2 The original Strategy anticipated that the level of investments would reduce gradually over the year unless, for example, new borrowing was undertaken in the year or the Council's expenditure during the year was later than anticipated. As described in paragraph 7.2, no new borrowing was undertaken in 2022/23, and so consequentially, the level of investments gradually reduced over the course of the year. The level of investments stood at £252M at the start of the year, peaked at £272.5M in August, before steadily reducing to £173.7M on 31 March 2023.

8.3 For shorter investment periods, money market funds held by the Council provided a higher return on investments than rates available on instant access and notice bank accounts and shorter-term fixed deposits up to 3 months. The various money market funds used by the Council were used to meet short term cashflow requirements and keep within counterparty limits. Fixed deposit rates between 3 and 12 months with some of the banks were particularly competitive and increased relative to other investment rates. As the investment rates increased, short term fixed deposit rates also become more attractive relative to other accounts. With the expectation of rates increasing further as the year progressed, the strategy was to invest in shorter term fixed deposits (up to 3 months) in order to benefit from the rising interest rates as they matured. As the year progressed, fixed deposits up to 12 months became more attractive, with several deposits then being undertaken for this period.

8.4 During the year, no investment was made for more than 12 months, and all investment activities were in line with the approved strategy for 2022/23. The average rate on investments outstanding at 31 March 2023 was 3.76% (0.88% at 31 March 2022). This increase in the average rate over the year reflected the increase in the Bank base rate. In comparison, the average temporary borrowing rate for the year was 1.51%. Total interest receivable on investment activity in 2022/23 amounts to £6,469,000, which is significantly higher than the previous year (£1,546,000 in 2021/22). On an accruals basis, investment income credited in 2022/23 amounts to £4,865,000, with the balance from above accruing to 2023/24.

8.5 All financial investments by the Council's Common Good Funds and Charitable Trusts were made through the Council's Loans Fund, in accordance with the Council's and Common Good Fund's policy for Permitted Investments. As a result, £2,294,000 of Common Good funds and Charitable Trusts were on deposit with the Loans Fund at 31 March 2023 for periods of between 3 and 12 months at an average rate of 3.93%.

8.6 Any investments held with external fund managers are outside the scope of the investment regulations, as they all relate to funds held by Council administered Charities or Trusts.

8.7 The Annual Property Investment Strategy for 2022/23 was also approved by the Council at its meeting on the 9 March 2022 and was complied with in full, with no breaches in compliance with permitted investment limits. The budgeted income from the Council's property portfolio for 2022/23 was originally set at £1,815,000, whilst the final position (subject to audit) was £1,868,000. There were no additional risks identified or new property investments entered into over the year. The strategy action plan remained on programme.

## 9. COMPLIANCE WITH TREASURY POLICIES AND LIMITS

9.1 There were no breaches of compliance with the Council's approved borrowing and investment policies and strategy in 2022/23. All aspects of the Prudential Code, including Prudential Indicators and limits, were also fully adhered to throughout the year.

## 10. STATUTORY LOANS FUND

10.1 The Loans Fund is an internal fund operated by the Council to manage:

- The write down (repayments or "amortisation") of capital expenditure (capital advances) over the life of the various assets being funded by borrowing as part of the Council's Loan Charges, and
- To manage the external borrowing raised to finance the capital expenditure.

10.2 Whilst both these elements of the Loans Fund operate independently of each other, because they are based on the same capital plans of the Council, they are consistent with each other over the long term. However, significant differences may arise in the short-term due to, for example, delaying external borrowing, or borrowing in advance in light of prevailing interest rates, or where the Council has significant levels of Reserves.

10.3 The approved Loans Fund policies allow the amortisation of capital expenditure (advances) for periods of up to 50 years in line with the asset useful lives, using the annuity method. The repayment of Loans Fund advances are also deferred until the asset being funded is completed and operational. As a result, some of the repayments may fall due after 50 years from the time of the original advance.

10.4 It is a requirement of the Loans Fund regulations that the outstanding amount of Loans Fund advances at the end of each financial year is reported as part of the annual report. The value of Loans Fund advances outstanding at 31 March 2023 is £557,756,000 (subject to completion and audit of the Council's Annual Accounts). This is made up as follows:

- Capital Advances outstanding 1 April 2021 - £491,270,000
- Add New capital Advances 2022/23 - £76,312,000
- Less Capital Advances repaid in the year - £9,826,000

10.5 The future repayment of these advances is summarised in the table below:

| | Core Composite Programme | Prudential Borrowing | **Sub-Total: General Fund** | Housing Revenue Account | **TOTAL** |
|---|---|---|---|---|---|
| (£'000) | | | | | |
| Within 1 Year | 4,580 | 2,866 | **7,446** | 3,253 | **10,699** |
| Between 1 and 2 Years | 3,991 | 2,663 | **6,654** | 2,941 | **9,595** |
| Between 2 and 5 Years | 8,145 | 5,977 | **14,122** | 8,022 | **22,144** |
| Between 5 and 10 Years | 787 | 5,433 | **6,220** | 22,874 | **29,094** |
| Between 10 and 15 Years | 8,202 | 4,374 | **12,576** | 20,436 | **33,012** |
| Between 15 and 20 Years | 17,638 | 3,498 | **21,136** | 9,131 | **30,267** |
| Between 20 and 25 Years | 27,029 | 3,703 | **30,732** | 3,940 | **34,672** |
| Between 25 and 30 Years | 45,594 | 4,505 | **50,099** | 9,331 | **59,430** |
| Between 30 and 35 Years | 58,227 | 5,890 | **64,117** | 14,047 | **78,164** |
| Between 35 and 40 Years | 75,803 | 3,387 | **79,190** | 15,266 | **94,456** |
| Between 40 and 45 Years | 77,813 | 3,000 | **80,813** | 15,371 | **96,184** |
| Between 45 and 50 Years | 44,415 | 98 | **44,513** | 8,015 | **52,528** |
| Over 50 Years | 7,511 | 0 | **7,511** | 0 | **7,511** |
| | | | | | |
| **TOTAL** | **379,735** | **45,394** | **425,129** | **132,627** | **557,756** |

10.6 Comparison of the outstanding capital advances above with the long-term external debt shown in paragraph 3.1 demonstrates that actual capital expenditure funded by borrowing is lower than the actual borrowing undertaken to date by around £45M. This reflects the strategy adopted in recent years of undertaking new borrowing whilst rates were at historic low levels, in order to fund the significant borrowing requirement approved by the Council over the next 2-3 years. This strategy has reduced the risks and the interest charges of borrowing in future at higher interest rates.

10.7 The last report to the Finance & Resources Committee on 26 April 2023 (report 23/121) approved adjustments to the General Fund Composite Capital Budget and Housing Investment Programmes. The amount of capital expenditure to be funded by borrowing (ie new Loans Fund advances) in each of the next 5 years as approved in April is as follows:

| | Composite Programme | Housing Investment Programme | **TOTAL** |
|---|---|---|---|
| (£'000) | | | |
| 2023/24 | 151,420 | 18,367 | **169,787** |
| 2024/25 | 175,187 | 11,935 | **187,122** |
| 2025/26 | 93,069 | 13,271 | **106,340** |
| 2026/27 | 46,776 | 16,524 | **63,300** |
| 2027/28 | 25,377 | 16,292 | **41,669** |
| | | | |
| **TOTAL** | **491,829** | **76,389** | **568,218** |

10.8 All the above Loans Fund repayments and new borrowing have been included in the Loan Charge estimates within the approved Medium Term Financial Plan, and therefore remain affordable under the current Loan Charge Budget strategy. This also includes estimates of new borrowing in the years beyond 2027/28.

## 11. CONCLUSION

11.1 Global economic and political volatility meant that global and UK interest rates were high during the year and remained on a rising trend. This was a result of rapidly rising inflation, which continued to rise faster than forecast following the start of the war in Ukraine. The Bank base rate also increased at a faster rate than anticipated.

11.2 In light of the above economic conditions and interest rates, no new long-term borrowing was undertaken in the year. Consequently, the Treasury activity focussed on investment activity and the management of existing investment balances. As interest rates rose over the year, the investment Strategy moved from notice accounts to money market funds and term fixed deposits for periods up to 12 months.

11.3 There were no breaches of compliance with the lending policy and all Prudential Indicators were complied with throughout the year. As a result of the activities undertaken during 2022/23 the Council's plans remain affordable, prudent and sustainable. The report also includes detailed information on the repayment profiles and future estimates of Loans Fund Advances.

11.4 The Council's Consolidated Loans Fund (CLF) rate for the year reduced from 3.11% in 2021/22 to 2.67% in 2022/23. This was achieved as a result of the investment activity at higher (and rising) interest rates at a time when no long-term borrowing was undertaken. However, the CLF rate in future years is projected to rise steadily when new borrowing will be required and is estimated to average around 3.1% over the next few years on current projections.

**Author(s)**


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**Approved**

| Name | Designation | Date |
|---|---|---|
| Stewart MacKenzie | Head of Finance | 21 June 2023 |
| Karen Donaldson | Chief Operating Officer | 21 June 2023 |

**ANNEX**

## 1. IMPLICATIONS, ASSESSMENTS, CONSULTATION AND COMMUNICATION

| **Strategic Implications** | **Yes / None** |
|---|---|
| Community Plan / Single Outcome Agreement | None |
| Corporate Plan | Yes |
| **Resource Implications** | |
| Financial | Yes |
| Workforce | Yes |
| Asset Management (land, property, IST) | Yes |
| **Assessments** | |
| Equality Impact Assessment | Yes |
| Strategic Environmental Assessment | Yes |
| Sustainability (community, economic, environmental) | Yes |
| Legal and Governance | None |
| Risk | None |
| **Consultation** | |
| Internal | Yes |
| External | None |
| **Communication** | |
| Communications Plan | None |

## 1. Strategic Implications

Corporate Plan

1.1 The Council's Corporate Plan 2022 – 2027 lays out seven outcome focussed strategic objectives which provide clear strategic direction, inform decisions at a corporate and service level and shape resources allocation. They are as follows:

- Tackling Poverty
- Tackling climate change and supporting sustainable places
- Growing a sustainable and inclusive local economy
- Enabling our children and young people to achieve their full potential
- Protecting and caring for our most vulnerable people
- Supporting and promoting physical and mental wellbeing
- Placing communities at the heart of how we work

1.2 This report relates to all of these objectives.

## 2. Resource Implications

Financial

2.1 There are no direct financial implications arising from this report other than those reported within the body of the main report.

Workforce

2.2 There are no direct workforce implications arising from this report.

Asset Management (land, property, IT)

2.3 There are no direct asset management implications arising from this report other than those reported within the body of the main report.

## 3. Assessments

Equality Impact Assessment

3.1 Under the Equality Act 2010, the Council is required to eliminate discrimination, advance equality of opportunity, and foster good relations between equality groups. Carrying out Equality Impact Assessments for plans and policies allows the Council to demonstrate that it is meeting these duties.

3.2 The information contained within this report has been considered under the Corporate Equalities Impact Assessment process (EqIA) and has been assessed as **not relevant** for the purposes of EqIA.

Strategic Environmental Assessment

3.3 The Environmental Assessment (Scotland) Act 2005 places a duty on the Council to identify and assess the environmental consequences of its proposals.

3.4 The information contained within this report has been considered under the Act. However, no action is required as the Act does not apply to the matters presented in this report.

Sustainability

3.5 Under the provisions of the Local Government in Scotland Act 2003 the Council has to discharge its duties in a way which contributes to the achievement of sustainable development. In terms of the Climate Change Act, the Council has a general duty to demonstrate its commitment to sustainability and the community, environmental and economic impacts of its actions.

3.6 The information contained within this report has been considered under the Act. However, no action is required as the Act does not apply to the matters presented in this report.

## 4. Consultation

4.1 The Chief Executive and the Council's Treasury advisors, Link Asset Services, have been consulted in the preparation of this report.

## 2. BACKGROUND PAPERS

2.1 No background papers, as defined by Section 50D of the Local Government (Scotland) Act 1973 (other than any containing confidential or exempt information) were relied on to any material extent in preparing the above report.

## 3. APPENDICES

Appendix I – PWLB Interest rates 2022/23.