Perth And Kinross Council

26 June 2024

ANNUAL TREASURY REPORT 2023/24

Report by the Strategic Lead – Finance & Business Support
(Report No. 24/202)

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. the Annual Treasury Report).

1.2 The Council meeting on 10 May 2023 approved the Treasury Strategy for the 5 financial years 2023/24 to 2027/28 and the annual Investment Strategy for 2023/24 (Report No. 23/135 refers). The consideration of this Annual Treasury Report for 2023/24 ensures compliance with the latter requirement.

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 2023/24
- The actual economic situation for 2023/24
- Actual long-term borrowing and repayments in 2023/24
- The Investment Strategy and outturn for 2023/24
- Compliance with treasury policies and limits during 2023/24
- 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 2023/24 to 2027/28 at its meeting on 1 March 2023 (Report No. 23/73 refers). The updated Prudential Indicators for this period were approved by the Council on 10 May 2023 (Report No. 23/135 refers).

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 2023 £M	Average Rate %	Principal 31 Mar 2024 £M	Average Rate %
Fixed Rate/Long Term Funding				
• Public Works Loan Board (PWLB)	560.0	2.40	585.0	2.49
• Market & Local Authority Bonds	43.2	4.59	43.2	4.59
• Other Loans & Bonds*	0.1	0.00	0.0	0.00
	603.3	2.56	628.2	2.64
Variable Rate/Short Term Funding				
• Temporary Loans	3.1	3.63	2.2	4.58
• Internal Loans	2.3	3.93	2.4	4.81
	5.4	3.76	4.6	4.69
TOTAL DEBT	**608.7**	**2.57**	**632.8**	**2.66**
TOTAL INVESTMENTS	**173.7**	**3.76**	**65.5**	**6.48**

*Interest free loan from the Scottish Government

5. THE FORECAST ECONOMIC OUTLOOK AND BORROWING STRATEGY 2023/24

5.1 Following a period of significant rises in inflation to over 10%, the Bank of England's Monetary Policy Committee (MPC) increased the Bank Base Rate to 4.25% in March 2023. It was anticipated that inflation had peaked and would steadily fall over the coming year. However, as it was still high, further increases in interest rates were expected during 2023/24, before falling in subsequent years. The forecast was that the base rate would rise to around 4.5% by September 2023. Gilt yields, which determine the UK Government's borrowing costs and are used to set PWLB rates, continued to rise early in the year, but were then also expected to fall over the remainder of 2023/24, subject to economic data and volatility. However, shorter-term borrowing rates were expected to remain cheaper than longer-term rates for a few years.

5.2 The estimated capital borrowing requirement for 2023/24 at the start of the year was **£155.7 million**, with further significant borrowing totalling **£417.7 million** required in the subsequent 4 years. These amounts reflected the borrowing requirement of the Council's Capital Budget approved in March 2023. However, much of the borrowing requirement for 2023/24 had effectively already been borrowed in previous years.

5.3 Therefore, the Council's Treasury Strategy for 2023/24 assumed that there was no immediate need or expectation to borrow until late in 2023/24. Any borrowing earlier in the year would only be undertaken if capital expenditure was incurred quicker than expected, or if opportunities arose to borrow at low rates. However, with short term rates expected to remain cheaper than medium and long-term rates, short term borrowing could have been undertaken if required and with long-term borrowing being deferred.

5.4 Consideration has previously been given to borrowing for future year requirements earlier than immediately required, if rates reached a 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 lower returns from the resultant short-term increase in the level of investments. However, given the interest rate projections, this was unlikely to arise in 2023/24.

5.5 The strategy was therefore to continue to use existing investment balances initially to meet capital expenditure. It was anticipated that borrowing would not be required until late in 2023/24. The use of short-term borrowing would be initially cheaper, whilst the use of longer-term borrowing would reduce the refinancing risk in later years. Therefore, if rates stayed high, new long-term borrowing would 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 2023/24

6.1 By August 2023, the MPC had increased the Bank Base Rate on three occasions, to 5.25%. This was in response to inflation remaining at high levels despite having fallen over the period from 10.1% to 6.8%. Subsequently, there were no further changes to the Bank Base Rate, which currently remains at 5.25%, as inflation continued to fall steadily over the remainder of the year and stood at 3.2% in March 2024 (and is currently 2.3% for April 2024). Whilst there was some economic growth in the UK at the start of the year, the UK entered a technical recession in the 6 months to December 2023. However, the UK returned to growth in the first 3 months of 2024 (0.6%).

6.2 Whilst the Bank of England's Monetary Policy Committee (MPC) increased the Bank base rate at each of its meetings between March and August 2023 to 5.25%, further rises to 6% were expected by the financial markets later in the year, before gradually reducing in 2024. This economic sentiment led to further rises in gilt yields and interest rates in the financial markets.

6.3 As Base Rate and inflation expectations remained high, 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 in the first half of the year. However, PWLB rates did reduce in the following months, but remained at elevated levels, before rising again between January and March 2024. The PWLB rates for various periods over 2023/24 are shown at **Appendix I**.

6.4 The graph **in Appendix I** highlights the volatility and uncertainty that existed around interest rates as the year progressed. The 50-year rate was 4.41% at the start of the year and steadily rose and peaked at 5.7% in October 2023. It subsequently reduced to 4.52% by the end of December 2023 before rising again to 5.01% on 31 March 2024. All other durations followed a similar pattern, but with 5-year rates being the lowest available for much of the year, but also being subject to higher levels of volatility.

6.5 Investment deposit rates also increased over the first half of the year, in line with future interest rate expectations. This reflected the Bank base rate during the year, as well as expectations of further increases in the Bank Rate later in the future. The average rate on the Council's investments at the start of the year was 3.76% and increased to 6.48% by the end of the year.

7. ACTUAL LONG-TERM BORROWING & REPAYMENTS

7.1 Treasury activity during 2023/24 is detailed in the three Treasury Activity and Compliance reports previously submitted to the Finance & Resources Committee (Report No's 23/244, 23/317 and 24/132).

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 2023/24 was **£155.7 million**. As much of this had already been borrowed previously, no new borrowing was required nor expected to be undertaken until later in the year, unless, for example, interest rates started to increase rapidly or fell to historic low levels.

7.3 However, with interest rates being relatively high at the start of the year, and subsequently gradually rising higher than had been forecast, no new long-term borrowing was undertaken until December 2023. Consequently, **£20 million** was borrowed in December 2023 (for 6.5 years at 4.34% at the PWLB's discounted HRA rate), and a further **£10 million** was borrowed in March 2024 (for 4 years at 4.84%).

7.4 The Council's scheduled repayments to the PWLB during the year related to one **£5 million** maturing loan which had been borrowed for 9 years at an interest rate of 3.3%. The average PWLB debt portfolio rate for the Council increased from 2.4% at the start of the year, to 2.5% for the total of **£585 million** of PWLB debt held by the Council on 31 March 2024.

7.5 The balance of **£140,000** on the interest free loan from the Scottish Government for the Empty Homes Initiative was also repaid in the year. Overall, the Council's total fixed rate borrowing increased by **£24.86 million** to **£628.2 million**, whilst the average rate increased from 2.56% to 2.64%.

7.6 Short term variable funding at the year-end reduced slightly from **£5.4 million** at 31 March 2023 to **£4.6 million** at 31 March 2024. 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 increased from **2.67%** in 2022/23 to **2.76%** in 2023/24 (based on applying statutory guidance). This increase reflects the rising interest rates, and also that during the course of the year the Council moved from an "over-borrowed" position to an "under-borrowed" position. Consequently, the short-term benefits received by the Council on its short-term investments reduced as the investments were applied to meet increased capital expenditure and cashflow requirements.

8. INVESTMENT STRATEGY AND OUTURN 2023/24

8.1 Investment rates increased from the start the year following the increases in the Bank Base Rate as well as future expectations for rates. These rates peaked around November/December 2023 before gradually drifting lower as it became apparent that the Bank Base Rate had reached its peak and that cuts would be considered during 2024.

8.2 The original Strategy anticipated that the level of investments would continue to reduce gradually over the year unless, for example, new borrowing was undertaken early in the year or the Council's expenditure during the year was later than anticipated. As described in paragraph 7.3, no new borrowing was undertaken until December 2024, and so consequentially, the level of investments gradually reduced over the course of the year. The level of investments stood at **£173.65 million** at the start of the year, peaked at **£191.9 million** on 20 April 2023, before steadily reducing to **£65.5 million** on 31 March 2024.

8.3 In the first half of the year, longer fixed deposit rates (up to 1 year) offered higher returns than shorter investment periods or notice and money market funds. Consequently the opportunity was taken to invest in these periods where possible within cashflow requirements. As the year progressed, and the level of investments reduced, there were fewer such opportunities within the Council's cashflow projections and consequently any fixed deposits were for shorter durations.

This coincided with the investment rates available also starting to reduce. However, at the end of March 2024, as a result of positive cashflow balances (including new long-term borrowing), several loans to other local authorities were made, mostly for periods of up to one month. Due to very low liquidity in the local authority market, interest rates available increased significantly to over 7%.

8.4 The various money market funds used by the Council were used to meet short term cashflow requirements and keep within counterparty limits. Notice accounts were only used to a very limited extent due to the less competitive rates offered on such investment products.

8.5 During the year, no investment was made for more than 12 months, and all investment activities were in line with the approved strategy for 2023/24. The average rate on investments outstanding at 31 March 2024 was **6.48%** (3.76% at 31 March 2023). This increase in the average rate over the year reflected the longer duration deposits undertaken when rates were higher as well as local authority lending when such rates were at a premium. In comparison, the average temporary borrowing rate for the year was **4.54%.**

8.6 Total interest receivable at maturity on investment activity in 2023/24 amounted to **£4.076 million**. Although this is lower than the previous year (£6.469 million in 2022/23), it was achieved on balances that were around 50% lower on average. On an accruals basis, investment income credited in 2023/24 amounts to **£6.422 million** (£4.865 million in 2022/23).

8.7 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, **£2.426 million** of Common Good funds and Charitable Trusts were on deposit with the Loans Fund at 31 March 2024 for periods of between 3 and 12 months at an average rate of **4.8%.**

8.8 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.

8.9 The Annual Property Investment Strategy for 2023/24 was also approved by the Council at its meeting on the 10 May 2023 and was complied with in full, with no breaches in compliance with permitted investment limits. The projected income from the Council's property portfolio for 2023/24 was originally set at **£1.866 million**, whilst the latest estimate is **£1.821 million**. 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 2023/24. 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 cash 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 2024 is **£667.120 million** (subject to completion and audit of the Council's Annual Accounts). This is made up as follows:

- Capital Advances outstanding 1 April 2023 **- £557.778 million**
- Add New capital Advances 2023/24 **- £118.314 million**
- Less Capital Advances repaid in the year **- £8.972 million**

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)	(£'000)	**(£'000)**	(£'000)	**(£'000)**
Within 1 Year	1,969	2,797	**4,766**	1,768	**6,534**
Between 1 and 2 Years	3,830	2,791	**6,621**	1,977	**8,598**
Between 2 and 5 Years	8,459	6,302	**14,761**	7,169	**21,930**
Between 5 and 10 Years	8,248	5,831	**14,079**	25,171	**39,250**
Between 10 and 15 Years	16,262	4,590	**20,852**	20,990	**41,842**
Between 15 and 20 Years	35,126	3,708	**38,834**	12,452	**51,286**
Between 20 and 25 Years	47,750	3,996	**51,746**	7,128	**58,874**
Between 25 and 30 Years	55,722	4,698	**60,420**	12,117	**72,537**
Between 30 and 35 Years	66,404	5,052	**71,456**	15,327	**86,783**
Between 35 and 40 Years	84,710	3,632	**88,342**	17,259	**105,601**
Between 40 and 45 Years	81,255	2,931	**84,186**	16,626	**100,812**
Between 45 and 50 Years	56,251	273	**56,524**	8,181	**64,705**
Over 50 Years	8,368	0	**8,368**	0	**8,368**
TOTAL	**474,354**	**46,601**	**520,955**	**146,165**	**667,120**

10.6 Comparison of the outstanding capital advances above with the long-term external debt shown in paragraph 4.1 demonstrates that actual capital expenditure funded by borrowing is higher than the actual borrowing undertaken to date by around **£38.9 milllion**. This reflects the strategy adopted in recent years of deferring new borrowing whilst rates were at high levels, and applying maturing investment balances to meet immediate cashflow requirements. New borrowing would only be undertaken when there were insufficient available balances. The Council started the year in an "over-borrowed" position of around £45M, whilst the position at the end of the year reflects an "under-borrowed" position of £34M, highlighting the strategy of deferring borrowing where possible. It should also be noted that the Council has approved a significant borrowing requirement over the next 6 years on its Capital programmes.

10.7 The Council approved its new Composite Capital Budget to 2029/30 on 28 February 2024 (Report No. 24/64 refers), whilst the Housing and Social Wellbeing Committee approved the HRA Capital Investment Programme to 2028/29 on 24 January 2024 (Report No. 24/24 refers). The last report to the Finance & Resources Committee on 24 April 2024 (Report No. 24/131 refers) approved adjustments to these Programmes. Consequently, the amount of approved capital expenditure to be funded by borrowing (ie new Loans Fund advances) in each of the next 6 years is as follows:

	Composite Programme	Housing Investment Programme	**TOTAL**
	(£'000)	(£'000)	**(£'000)**
2024/25	169,923	19,703	**189,626**
2025/26	74,024	17,864	**91,888**
2026/27	81,816	13,629	**95,445**
2027/28	100,221	17,720	**117,941**
2028/29	19,739	17,704	**37,443**
2029/30	16,222	-	**16,222**
TOTAL	**461,945**	**86,620**	**548,565**

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 2029/30.

10.9 This borrowing will be funded through a combination of existing budgets, and the decisions taken by Council on 28 February 2024, i.e. to increase the loan charges budget by **£800,000** in 2024/25 and to apply 1% of future Council Tax increases from 2025/26.

11. CONCLUSION

11.1 Global economic volatility meant that interest rates were high during the year and remained on a rising trend. This was a result of rapidly rising inflation in the previous year and which was only slowly starting to fall as 2023/24 progressed. The Bank base rate also increased at a faster rate than anticipated.

11.2 In light of the above economic conditions and interest rates, long-term borrowing was deferred until later in the year, with only **£30 million** of new borrowing undertaken between December 2023 and March 2024. Consequently, the Treasury activity initially focussed on investment activity and the management of existing investment balances. As interest rates rose over the first half of the year, the Investment Strategy moved to fixed deposits for periods up to 12 months, with use of money market funds only to manage immediate cashflow requirements. Fixed deposits for shorter durations were favoured in the second half of the year as interest rates reduced and cashflow requirements increased.

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 2023/24 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 increased from 2.67% in 2022/23 to 2.76% in 2023/24. This was due to higher interest rates on the new borrowing and reducing returns as investment balances reduced. The CLF rate in future years is projected to rise further when new borrowing will be required and is estimated to average around 3.1% over future years on current projections.

Author(s)

Name	Designation	Contact Details
John Jennings	Senior Accountant	CHXFinance@pkc.gov.uk

Approved

Name	Designation	Date
Scott Walker	Strategic Lead – Finance & Business Support	22 May 2024
Clare Mailer	Director (Strategy, People & Resources)	22 May 2024

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

<u>Corporate Plan</u>

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 2023/24.