Audit Committee – 28 June 2024

Title of paper:	Treasury Management 2023/24 Annual Report	
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Does this report contain any information that is exempt from publication?
No

Brief Summary

The Treasury Management function is governed by provisions set out under Part 1 of the Local Government Act 2003, whereby the City Council must have regard to the CIPFA Prudential Code and the CIPFA Code of Practice. Under the latter Code, an annual report is required to be submitted to and considered by councillors.

The Council's Treasury Management Strategy for 2023/24 was approved by full Council on 6 March 2023. The Investment Strategy was amended on the 4th of March 2024 to adjust counterparty investment limits and make a technical change.

The Council borrows and invests substantial sums of money as part of its business-as-usual activity. In common with all local authorities, it is therefore exposed to financial risks including the loss of invested funds and the revenue account impact of changing interest rates. This report covers performance in relation to treasury management activity and the associated monitoring and control of risk.

Recommendation(s):

1	• To take assurance from this report that the Treasury management controls and risk management practises in place that have operated in 2023/24 are working effectively.

1 Reasons for recommendations

1.1 The Audit Committee's terms of reference include to:

- effectively scrutinise, review and monitor treasury management strategies and policies in accordance with guidance issued to local authorities, and make appropriate recommendations to the responsible body

2 Background

2.1 The Council is required to operate a balanced budget, which broadly means cash raised during the financial year will meet its cash expenditure. Treasury management operations ensure that this cash flow is adequately planned, with surplus monies being invested by prioritising low risk counterparties and ensuring liquidity of funds before considering and optimising investment return.

2.2 The treasury management function also services the financing of the Council's capital expenditure plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer-term cash may involve arranging long or short-term loans or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

2.3 Accordingly, Treasury Management is defined as: "The management of the local authority's borrowing, 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."

2.4 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2021).

3 Treasury Management Activity in 2023/24

3.1 The UK Economy, Growth, Monetary Policy and Inflation

3.1.1 Against a backdrop of stubborn inflationary pressures, the Russian invasion of Ukraine, and war in the Middle East, UK interest rates have continued to be volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2023/24.

3.1.2 Markets have sought an end to central banks' on-going phase of keeping restrictive monetary policy in place on at least one occasion during 2023/24 but to date only the Swiss National Bank has cut rates and that was at the end of March 2024.

3.1.3 UK, EZ and US 10-year yields have all stayed stubbornly high throughout 2023/24. The table below provides a snapshot of the conundrum facing central banks: inflation is easing, albeit gradually, but labour markets remain very tight by historical comparisons, making it an issue of fine judgment as to when rates can be cut.

Table 1: Economic Data 2023/24			
	UK	**Eurozone**	**US**
Bank Rate	5.25%	4%	5.25%-5.5%
GDP	-0.2%y/y	+0.1%y/y	2.0% Q1 Annualised
Inflation	3.4%y/y (Feb)	2.4%y/y (Mar)	3.2%y/y (Feb)
Unemployment Rate	3.9% (Jan)	6.4% (Feb)	3.9% (Feb)

3.1.4 **Appendix 2** shows the money market interest rates and the Public Works Loans Board (PWLB) borrowing rates for 2023-24

3.2 Local Context

3.2.1 There were a number of significant events that took place throughout 2023-24, and shortly afterward, that affect the context within which the treasury management activities took place. In November 2023 the S151 officer issued a s114 notice, In

February 2024 commissioners were appointed to oversee the council for a period of two years and the final report of the Improvement and Assurance Board (IAB) was issued in May 2024.

3.2.2 In 2023/24 the council's Corporate Director for Finance and Resources issued a report under section 114(3) of the Local Government Finance Act 1988 Act in their role as Section 151 Officer to all councillors, because in their professional opinion, despite the introduction of spend control measures in July, the council could not balance the budget for the financial year 2023/24, which the council must do by law. The Council applied to Government for Exceptional Financial Support to assist in balancing the budget (see paragraph 4.7).

3.2.3 In February Ministers wrote to the council to say that they have put Directions in place to appoint Commissioners until 22 February 2026. The appointment of Commissioners means that will oversee the full range of the council's improvement activities. It is intended that most decisions should still be made by the authority but with the oversight of the Commissioners.

3.2.4 The final IAB report provided an account of the progress, or otherwise, in achieving fundamental change in the Council's operation. It paid particular attention to the Council's response to the IAB 'Instructions' issued in February 2023, following the Minister's decision to give the Board powers of direction. It outlined the progress the council had made in its Improvement and Recovery Plan.

3.2.5 Following a non-statutory review in 2021, the Council implemented a Voluntary Debt Reduction Policy (VDRP) with the aim to support the Council in returning to financial and operational stability. The borrowing and debt management strategies aim to reduce the Council's future requirement to borrow, known as the Capital Financing Requirement (CFR), and to reduce the level of debt held by the Council.

3.2.6 The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources based on robust financial modelling, the capital expenditure will give rise to a borrowing need, however this route is strictly limited by the Capital Strategy.

3.2.7 The CFR is a gauge of the Council's indebtedness and results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2023/24 unfinanced capital expenditure, and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

3.2.8 At 31 March 2024 the Council's underlying need to borrow for capital purposes as measured by the CFR was £1.277bn.

3.2.9 Table 1 below shows the original and the actual financing arrangements of the capital programme. The borrowing element of the table increases the underlying indebtedness of the Council by way of the CFR, although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision).

This direct borrowing need will also be increased by maturing debt and other treasury requirements.

Table 1: Capital Outturn 2023/24			
	2023/24 Original Budget £m	**2023/24 Actual £m**	**Variance to Budget £m**
Capital Expenditure			
General Fund	113.5	96.6	(16.9)
Housing Revenue Account	50.1	47.2	(2.9)
Total Expenditure	163.6	143.8	(19.8)
Financed by:			
Capital Receipts	47.2	38.5	(8.6)
Capital Grants & Contributions	67.1	67.1	0.0
Internal Funds / Revenue (Inc. Major Repairs Reserve)	31.4	36.2	4.8
Total Funding	**145.6**	**141.8**	**(3.8)**
Borrowing	14.2	1.9	(12.3)
Borrowing - Exceptional Financial Support	3.7	0	3.7

3.3 Borrowing

3.3.1 To finance the CFR, the Council may borrow externally from the Public Works Loans Board (PWLB) or the market, or from its own internal balances on a temporary basis (internal borrowing), by using its cash balances that are not immediately needed for the delivery of services. The balance of external and internal borrowing is generally driven by market conditions. At present the council is operation a Voluntary Debt reduction Policy so no new borrowing is planned.

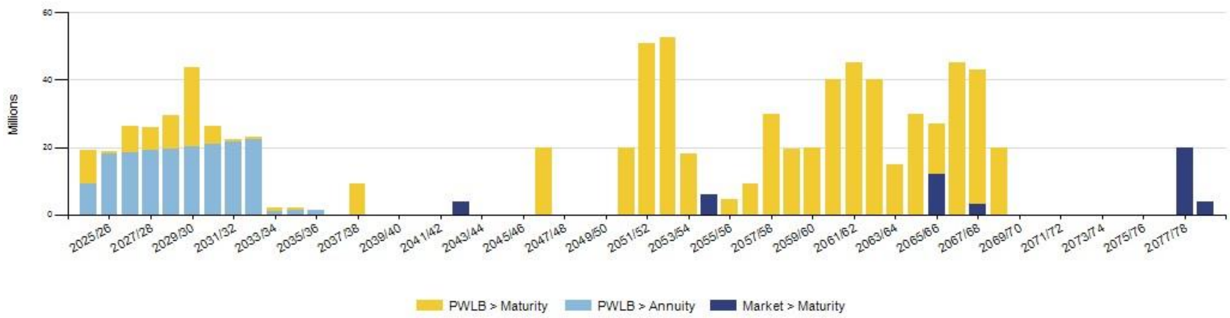
3.3.2 During 2023/24, as part of the Voluntary Debt Reduction Policy, the Council continued its strategy to reduce the CFR and external debt balances by repaying maturing loans with its cash balances and by internal borrowing. This means that the overall capital borrowing need (known as the CFR), has not been fully funded by taking external loan debt.

3.3.3 Total outstanding external loan debt in 2023/24 decreased by £77.4m (-8.8%) to £800.6m at 31 March 2024. The average rate of interest on total external loan debt decreased, from 3.42% at 31 March 2023 to 3.31% at 31 March 2024. Table 2 below analyses the debt portfolio:

Table 2: Debt Portfolio					
Debt	01-Apr-23		31-Mar-24		Movement
	£m	Average Interest %	£m	Average Interest %	£m
PWLB borrowing	824.7	3.36%	757.3	3.37%	(67.4)
Market loans inc LOBO	49.0	4.35%	41.0	4.26%	(8.0)
Temporary borrowing	4.3	2.29%	2.3	2.29%	(2.0)
TOTAL LOANS DEBT	**878**	**3.42%**	**800.6**	**3.31%**	**(77.4)**
Other including PFI	158.3		146.2		(12.1)
TOTAL DEBT	**1,036.3**		**946.8**		**(89.5)**

3.3.4 The graph below shows the maturity profile of the debt portfolio and total debt each year. These graphs should be reviewed together with the Prudential Indicator for Debt Maturity shown in paragraph 4.11.4.

Graph 1 Debt Maturity profile



3.3.5 In 2023/24 the Council did not take any further long-term borrowing from the Public Works Loans Board (PWLB) or from banks in line with VDRP

3.3.6 The Council's internal borrowing position at 31 March 2023 was £346.1m. This meant that c.27% of the overall capital borrowing need including prior year capital expenditure but excluding PFI liabilities (known as the CFR), was not funded with loan debt as cash held by the Council for reserves, balances and cash flow was used as a temporary measure.

3.3.7 The strategy of using internal borrowing avoids the cost of interest payable on external borrowing in the short term until actual new borrowing is taken or the borrowing requirement reduces.

3.3.8 The Council expects to retain this internal borrowing position as a prudent and cost-effective approach in view of the reducing CFR and the current forecast for balances available to support this position.

3.3.9 The continuation of this existing strategy will further support managing the Council's cost of financing in the coming years and supports the aims of the VDRP in reducing the Council's debt levels.

3.4 Lender Option Borrower Option (LOBOs) and Market Loans

3.4.1 The Council held £34m of LOBO loans at the 1st of April 2023. The terms on these loans gave the lender the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. £8m of these loans had the option called during the year and the Council chose to repay these loans at par. The interest rate on these loans was 4.9% which means the repayment has reduced the council's debt charges by £392,000 annually. At the 31st of April 2024 the council had £26m of LOBO loans remaining. Market Loans, loans with private sector counterparties that have no options and are fixed for the remaining term of the loan, totalled £15m at the 31st of March 2024.

3.5 Borrowing in advance of need

3.5.1 The Treasury Management Code of Practice states an organisation may only borrow in advance of the need in order to reduce financing and interest rate risks i.e. not purely in order to profit from the investment of the extra sums borrowed. The Council has complied with the Code in this respect.

3.6 Debt Rescheduling

3.6.1 The PWLB continued to operate a spread of approximately 1% between "premature repayment rate" and "new loan" rates so the premium charge for early repayment of PWLB debt has made rescheduling unviable for the existing loans in the Council's portfolio. The Council chose to repay 2 loans during the year totalling £50m in value. These were repaid at a discount and will mean an interest saving of £1.1m annually. The total discount received amounted to £16.35m and the benefit of this will be spread over the next 10 years in accordance with the CIPFA Code of Practise.

3.7 Exceptional Financial Support

3.7.1 The council applied for and received permission to capitalise revenue expenditure in 2023/24 and 2024/25. This is known as 'Exceptional Financial Support' (EFS) and has implications for borrowing. If the council capitalises expenditure, it can be funded through borrowing or through the application of capital receipts. The EFS utilised in 2023/24 was funded by capital receipts.

3.8 Housing Revenue Account (HRA) Borrowing

3.8.1 From 1 April 2002, the Council's HRA was allocated a separate debt portfolio based on the appropriate proportion of the Council's existing debt at that time. No new HRA borrowing was taken in 2023-24.

3.8.2 The HRA element of the CFR was £286.5m at the 31st March 2024 and is fully financed at an average rate of 4.3%. This includes £53.2m of long-term fixed rate loans from the General Fund (known as internal loans). The HRA interest charge for 2023-24 was £11.1m.

3.8.3 In October 2018 the Government announced the HRA debt cap was to be abolished, but the now notional cap has been retained as a useful indicator shown in Appendix 1. Any capital expenditure financed by borrowing needs to comply with the requirements of the CIPFA prudential code including ensuring the scheme was affordable, sustainable and in proportion to the resources available.

3.8.4 The HRA has 2 local indicators to manage its debt as shown below:

	2023/24 Estimate	2023/24 Actual
Ratio of Debt to Revenues		
HRA Debt £m	300.7	286.5
HRA Revenues £m	111.8	111.2
Ratio of Debt to Revenues	**2.7**	**2.5**
Debt per Dwelling		
HRA Debt £m	300.7	286.5
No. of Dwellings	25,082	24,546
Debt per Dwelling £	**11,990**	**11,670**

3.9 Investments

3.9.1 The Council's investment policy is governed by the Department of Levelling Up, Housing and Communities (DLUHC) investment guidance, which has been implemented in the annual investment strategy approved by the Council on 7 March 2024. This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.).

3.9.2 The investment activity during the year conformed to the approved strategy as approved on 7 March 2024.

3.9.3 The Council held £333.9m of investments at 31 March 2024 (£308.0m at 31 March 2022) and the investment portfolio yield for the year was 5.35%, above the benchmark 7 day SONIA (sterling overnight index average rate of 4.96%).

3.9.4 Table 4 below summarises investment activity in 2023-24.

TABLE 4: Investment Activity for 2023-24	Balance on 31.03.2023	Balances on 31.3.24	Average Rate 31.3.24
Short term investments:			
- Banking Sector	95.0	234.5	5.5%
- UK Government	40.0	13.2	5.0%
- Local Authorities	41.0	0.0	
- Overseas Government	9.9	9.7	5.0%
- Money Market funds	112.2	76.6	5.3%
Long term investments			

TABLE 4: Investment Activity for 2023-24	Balance on 31.03.2023	Balances on 31.3.24	Average Rate 31.3.24
- Local Authorities	0.0	0.0	0.0
- Overseas Government	9.9	0.0	0.0
TOTAL INVESTMENTS	**308.0**	**333.9**	**5.4%**
Increase / (Decrease) in Investments		**25.9**	

3.10 External advisors

3.10.1 External treasury management advisors are retained to provide additional input on treasury management matters. The service comprises economic and interest rate forecasting, advice on strategy, portfolio structure, debt restructuring, investment policy and credit ratings and technical assistance on other matters, as required.

3.10.2 The Council has retained Link Group as its treasury management advisors.

3.11 Compliance with Prudential Indicators

3.11.1 The Council confirms compliance with its Prudential Indicators for 2023-24 set on 7 March 2023 as part of the Council's Treasury Management Strategy Statement. The Prudential Indicators can be found in Appendix 1.

3.11.2 The Council measures and manages its exposures to treasury management risks using the following indicators.

3.11.3 Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The limit on variable rate interest rate exposures are:

	2021/22 £m	2022/23 £m	2023/24 £m
Upper limit on variable interest rate exposure	300.0	200.0	200.0
Actual	41.3	38.3	76.6

3.11.4 **Maturity Structure of Borrowing**: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Lower	Upper	Actual
Under 12 months	0%	25%	8%
12 months and within 24 months	0%	25%	6%
24 months and within 5 years	0%	25%	14%
5 years and within 10 years	0%	25%	19%

10 years and within 25 years	0%	50%	6%
25 years and within 40 years	0%	50%	26%
40 years and above	0%	50%	21%

3.11.5 **Principal Sums Invested for Periods Longer than 365 days**: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end is:

	2021/22 £m	2022/23 £m	2023/24 £m
Limit on principal invested beyond year end	100.0	100.0	100.0
Actual	35.0	10.0	13.2

3.11.6 **Operational Boundary and Authorised Limit for External Debt**: The operational boundary is based on the Council's estimate of most likely, i.e. prudent, but not worst case scenario for external debt. The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

	2023/24 £m
Borrowing	784.2
Other Long-term Liabilities *	146.2
Total External Debt	**930.4**
Operational Boundary	1,299.5
Authorised Limit	1,329.9

* Includes PFI and Leases liabilities

3.12 Treasury Management Reserve

3.12.1 The Treasury Management Reserve is maintained to smooth the impact of any volatility in treasury management revenue charges in any one year including new technical accounting entries relating to IFRS 9 (which stipulates the treatment of expected loss model-based impairments on Treasury related investments and capital investments such as loans to third parties and financial guarantees). There was no expected loss impairment made to treasury investments in 2023/24. Treasury management reserves also include the Financial Adjustment Account, which contains any balances arising from early repayment of debt, resulting in either a premium or a discount.

3.12.2 The combined reserves at 31 March 2024 was £24.2m, a net increase over the year of £15.7m due to the discount received on the early repayment of debt. This net increase is an unusable reserve held for accounting purposes and will gradually be gradually recognised in revenue over the next 9 years. The appropriateness of the other balance held will be reviewed as part of the annual reserves review, which forms part of the 2025/26 budget setting process.

3.13 Risk Management

3.13.1 Risk management plays a fundamental role in treasury activities, due to the value and nature of transactions involved. The management of specific treasury management risks is set out in the Manual of Treasury Management Practices and Procedures and a risk register is maintained for the treasury function.

3.13.2 The treasury management risk register's overall risk rating 4.23 at 31 March 2023, (Likelihood = unlikely, Impact = minor) and it remains at that level at 31 March 24. This means the current score is over the targeted risk rating of 2.94 (Likelihood = remote, Impact = minor). The maximum score on the risk matrix is 25 while the minimum risk is 1.

3.13.3 In practical terms this score of 4.23 means that the level of risk in Treasury management represents a low seriousness on the scale of 1 to 25 but there is still some improvements that can be made to reduce the risk to target.

3.13.4 Actions have been taken to reduce risks in the areas of code of practise compliance, cashflow management and business continuity throughout the year and these changes will impact the risk review that will take place in Q1 2024.

4 Finance colleague comments (including implications and value for money/VAT)

4.1 General Fund Revenue Implications

4.1.1 Revenue costs associated with borrowing and lending can be volatile, being affected by a number of factors including movements in interest rates, the timing of capital spending, the extent of reserves held and actual cash flows during the year.

4.1.2 The General Fund outturn in 2023/24 for treasury management costs was £71.43m comprising of interest charges, provisions for the repayment of debt, PFI related expenditure and investment income. The PFI expenditure accounted for £35.35m which includes the NET lines 1 & 2 (the Nottingham Tram Network). A proportion of the Council's debt relates to capital expenditure on HRA housing and an additional £11.1m of debt costs was charged to the HRA. The HRA also received their share of investment income on their cash balances which totalled £5.7m.

4.1.3 The General Fund budget and outturn for 2023/24 treasury management costs are summarised in the table below:

Treasury Management	Budget 2023/24 £m	Outturn 2023/24 £m	Variance 2023/24 £m
Interest Receivable	(4.1)	(10.6)	(6.5)
Interest Payable Debt	18.9	18.3	(0.6)
PFI	23.5	23.5	0.0
Debt Repayment (MRP) Non-PFI	32.0	27.8	(4.2)
PFI	11.9	11.9	0.0
Total	**81.2**	**71.4**	**(9.5)**

4.2 Value for Money

4.2.1 Management of borrowing and investments is undertaken in conjunction with our appointed external advisors, with the aim of minimising net revenue costs, maintaining an even debt maturity profile and ensuring the security and liquidity of investments.

5 Background papers other than published works or those disclosing exempt or confidential information

5.1 None.

6 Published documents referred to in compiling this report

6.1 Treasury Management Strategy 2023-24 and Capital Investment Strategy 2023-24

6.2 Together for Nottingham Plan

6.3 Money Market and PWLB loan rates

6.4 Treasury Management in the Public Services Code of Practice 2021–CIPFA

6.5 Prudential Code 2021 -CIPFA

6.6 Treasury Management in the Public Services Guidance Notes 2021– CIPFA

6.7 Statutory guidance on local government investments 3rd Edition 2018

6.8 Statutory guidance on Minimum Revenue Provision (MRP) 2024