Audit and Governance Committee
Monday, 23 September 2024
Treasury Management Annual Report 2023/24

For Decision

Portfolio Holder: Cllr S Clifford, Finance, Commerical & Capital Strategy

Local Councillor(s): All

Executive Director: A Dunn, Executive Director, Corporate Development

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Report Status: Public

Brief Summary

This report summarises the treasury management performance and position information for Dorset Council for the year ended 31 March 2024.

Treasury management at the Council is conducted within the framework of CIPFA's Treasury Management Code of Practice. In adopting the code, recommended best practice is for members to approve an annual treasury management strategy report, and to then receive a mid-year update on progress against the strategy and a year-end review of actual performance against the strategy (this report).

The Council's Capital Financing Requirement (CFR), or underlying need to borrow, at 31 March 2024 was £388m, compared to £367m at the start of the year and an estimated £400m when the capital strategy was approved in February 2023.

As at 31 March 2024, the Council had outstanding external borrowing of £225m plus other capital financing liabilities of £18m equalling £243m total external debt, with £7.9m total interest paid servicing this external debt for the year.

The difference between the CFR and external debt was approximately £145m, financed temporarily by ‘internal borrowing’ (the use of reserves, working capital and other balance sheet resources that could otherwise have been invested had they not been uses to ‘offset’ the Council’s borrowing requirement).

As at 31 March 2024 the Council held cash and cash equivalents of £22m and treasury investments valued at £52m, in total £74m, down from £115m from 31 March 2023. The total interest receivable and investment income for the Council for the year was approximately £6.2m.

Recommendation:

That the Committee note and comment upon the report.

Reason for Recommendation:

To better inform members of treasury management activity, in accordance with the corporate requirement to ensure money and resources are used wisely.

1. Introduction

1.1 The Council’s treasury management strategy for 2023/24 was approved by a meeting of Dorset Council on 13 February 2024.

1.2 The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Council’s treasury management strategy.

1.3 Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy’s Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report. This report fulfils the Council’s legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

1.4 The Council employs professionally qualified and experienced staff with responsibility for making borrowing and investment decisions. Officers are supported by external advisers who are specialists in their fields. The Council currently employs Arlingclose Limited as treasury management advisers.

1.5 This approach ensures that the Council has access to a wide pool of relevant market intelligence, knowledge and skills that would be very difficult and costly to replicate internally. However, whilst advisers provide support to the internal treasury function, final decisions on treasury matters always remain with the Council.

2. External Context

2.1 Treasury management decisions made by the Council must take into consideration external factors, particularly the wider economic backdrop and the outlook for financial markets and interest rates, and the wider regulatory framework.

2.2 The most significant external factors over the year were the continued decline of inflation in the UK from the 8.7% rate seen at the start of 2023/24. By the last quarter of the financial year headline consumer price inflation (CPI), had fallen to 3.2% in March but was still above the Bank of England's 2% target at the end of the period. In response the Bank of England increased Bank Rate to 5.25% in August 2023 this rate was maintained at every meeting of the Monetary Policy Committee (MPC) during the period to March 2024.

2.3 The main impacts of these external factors for the Council's treasury management activities were higher than budgeted increases in costs, higher returns on cash investments, and increased costs of new borrowing.

2.4 A detailed commentary on the external context provided by Arlingclose is included in Appendix 1.

3. Local Context

3.1 The Council's balance sheet is summarised in table 1 below.

Table 1: Balance Sheet Summary

	31.3.23 Balance £m	2023/24 Movement £m	31.3.24 Balance £m
Total CFR	**367.0**	21.2	**388.2**
Less other debt liabilities	21.0	-2.4	18.6
Loans CFR	**346.0**	23.6	**369.6**
External borrowing	**198.4**	26.2	**224.6**
Internal borrowing	**147.6**	-2.6	**145.0**
Cash and investments	**114.4**	-40.5	**73.9**

3.2 The treasury management position at 31 March 2024 and the change during the year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.23 Balance £m	2023/24 Movement £m	31.3.24 Balance £m
Long-term borrowing	158.4	16.6	175.0
Short-term borrowing	40.0	9.6	49.6
Total borrowing	**198.4**	**26.2**	**224.6**
Long-term investments	19.9	-0.8	19.0
Short-term investments	53.7	-21.2	32.5
Cash and cash equivalents	41.1	-18.7	22.4
Total investments	**114.6**	**-40.7**	**73.9**
Net borrowing	**83.8**	**66.9**	**150.7**

3.3 The increase in net borrowing over the year is a result of financing the unfunded element of the capital programme.

3.4 All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council’s own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The Council’s cumulative outstanding amount of debt finance is measured by the Capital Financing Requirement (CFR).

3.5 Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as Minimum Revenue Provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. The CFR increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt.

4. Borrowing

4.1 At 31 March 2024 the Council held £225m of loans, a net increase of £26m from 31 March 2023, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans as at 31 March 2024 are summarised in Table 3 below.

Table 3: Borrowing

	31.3.23 Balance £m	Net Movement £m	31.3.24 Balance £m	31.3.24 Weighted Average Rate %	31.4.24 Weighted Average Maturity (years)
Public Works Loan Board	61.8	29.2	91.0	4.3%	17.4
Banks (LOBO)	11.0	0.0	11.0	4.6%	52.6
Banks (fixed-term)	25.6	0.0	25.6	4.7%	53.1
Local authorities (long-term)	15.0	0.0	15.0	4.4%	35.7
Local authorities (short-term)	40.0	-3.0	37.0	5.5%	0.3
Other lenders (fixed-term)	45.0	0.0	45.0	3.3%	42.5
Total borrowing	**198.4**	**26.2**	**224.6**	**4.4%**	**28.8**

4.2 The chief objective of Dorset Council and its predecessors when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should long-term plans change being a secondary objective.

4.3 The Council's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short and long-term borrowing has been maintained.

4.4 The Council held £11m of Lender's Option Borrower's Option (LOBO) at 31 March 2024. These are loans where the lender has the option to propose an increase in the interest rate at set dates (lender's option), following which the Council has the option to either accept the new rate or to repay the loan at no additional cost (borrower's option).

4.5 In addition, capital finance may be raised by the following methods that are not borrowing but are classed as other debt liabilities: leasing, hire purchase, Private Finance Initiative (PFI) and sale and leaseback. Total debt other than borrowing at 31 March 2024 was £18.6m.

4.6 CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement and so may lead to new borrowing, unless directly and primarily related to the functions of the Council. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield unless these loans are for refinancing purposes.

4.7 The Council has not invested in assets primarily for financial return or that are not primarily related to the functions of the Council.

5. Cash and Treasury Investments

5.1 The CIPFA Treasury Management Code defines treasury management investments as those investments which arise from an authority's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

5.2 Cash, cash equivalents and treasury investments held on 31 March 2024 are summarised in Table 4 below.

Table 4: Cash and Treasury Investments

	31.3.23 Balance £m	Net Movement £m	31.3.24 Balance £m
Cash & Cash Equivalents	**41.2**	**-18.8**	**22.4**
Investments:			
Short-dated bond funds	4.2	-1.3	2.8
Strategic bond funds	9.5	0.4	10.0
Equity income funds	26.0	-12.3	13.7
Property funds	19.9	-0.8	19.0
Multi asset income funds	14.0	-8.0	6.0
Total Investments	**73.5**	**-22.0**	**51.5**
Total Cash & Investments	**114.7**	**-40.8**	**73.9**

5.3 Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

5.4 The Council holds investments in bond, equity, multi-asset and property funds which were 'inherited' from a number of the predecessor councils. These investments are held for the longer term with the acceptance that capital values will fluctuate over the short term but with the expectation that over a three to five-year period total returns will exceed cash interest rates. These 'strategic investments' were valued at £51.5m in total as at 31 March 2024.

6. Treasury Performance

6.1 The Council measures the financial performance of its treasury management as shown in table 5 below.

Table 5: Treasury Performance

	Budget 31.03.24 £m	**Actual 31.03.24 £m**	**Variance £m**	
Interest Payable	8.0	7.9	0.1	F
Interest and Investment Income	-5.8	-6.2	0.4	F
Net Payable / (Receivable)	**2.2**	**1.7**	**0.5**	**F**
Unrealised (Gains) / Losses in Fair Value	0.0	-0.7	0.7	F
Net (Surplus) / Deficit	**2.2**	**1.0**	**1.2**	**F**

6.2 The unrealised gains of £0.7m in the fair value of investments relate to the Council's investments in strategic pooled investment vehicles.

6.3 Unrealised gains or losses in the fair value of pooled investment funds, that otherwise must be recognised in profit or loss under International Financial Reporting Standard (IFRS) 9, are not charged to the revenue account, and must be taken into an unusable reserve account.

7. Compliance

7.1 All treasury management activities undertaken during the year complied with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

7.2 Compliance with the limits on cash and treasury investments is demonstrated in the table below.

Table 6: Cash and Investments Limits

	2023/24 Maximum	31.3.24 Actual	2023/24 Limit	Complied Yes/No
Any single organisation, except the UK Government	16.2	1.1	20.0	Yes
Any group of organisations under the same ownership	16.2	1.1	20.0	Yes
Any group of pooled funds under the same management	20.4	0.0	50.0	Yes
Negotiable instruments held in a broker's nominee account	0.0	0.0	50.0	Yes
Limit per non-UK country	0.0	0.0	20.0	Yes
Registered providers and registered social landlords	0.0	0.0	50.0	Yes
Unsecured investments with banks and building societies	16.2	1.1	20.0	Yes
Loans to unrated corporates	0.0	0.0	20.0	Yes
Money Market Funds	108.1	33.8	unlimited	Yes
Strategic pooled funds	73.7	51.5	unlimited	Yes
Real Estate Investment Trusts	0.0	0.0	50.0	Yes

7.3 The Council is legally obliged to set an affordable "authorised limit" for external debt each year. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit. Compliance with the authorised limit and operational boundary for external debt is demonstrated in the table below.

Table 7: Debt Limits

	2023/24 Maximum £m	31.3.24 Actual £m	2023/24 Operational Boundary £m	2023/24 Authorised Limit £m	Complied Yes/No
External borrowing	224.6	224.6	400	420	Yes
PFI and Finance Leases	21.0	18.6	30	35	Yes
Total debt	**245.6**	**243.1**	**430**	**455**	

8. Treasury Management Indicators

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

8.2 Liability Benchmark: This new indicator compares the Council's actual existing borrowing against a liability benchmark that has been calculated to show the lowest risk level of borrowing. The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. It represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping cash and investments at a minimum 'liquidity allowance' of £30m to manage day-to-day cash flows.

Table 8: Liability Benchmark

	31.3.23 Actual	31.3.24 Actual	31.3.25 Forecast	31.3.26 Forecast
Loans CFR	346.0	369.6	463.0	525.0
Less estimated balance sheet resources	263.0	218.9	240.0	230.0
Net loans requirement	**83.0**	**150.7**	**223.0**	**295.0**
Plus liquidity allowance	30.0	30.0	30.0	30.0
Liability benchmark	**113.0**	**180.7**	**253.0**	**325.0**
Actual borrowing	**198.4**	**224.6**	**313.0**	**374.0**

8.3 Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA = 1, AA+ = 2 etc.) and taking the average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Table 9: Security

	2023/24 Target	31.3.24 Actual	Complied? Yes/No
Portfolio average credit rating	< 6	5.18	Yes

8.4 Liquidity: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period without additional borrowing. In addition, the Council aims to hold a minimum of £30m readily available in same day access bank accounts and Money Market Funds.

Table 10: Liquidity

	31.3.24 Actual	2023/24 Target	Complied? Yes/No
Total cash available within 100 days	74%	> 30%	Yes
Total sum borrowed in past 100 days without prior notice	0%	0%	Yes

8.5 Interest Rate Exposure: This indicator is set to control the Council's exposure to interest rate risk. Bank Rate rose by 1.00% from 4.25% on 1st April 2023 to 5.25% by 31st March 2024. The upper limits on the one-year revenue impact of a 1% rise or fall in interests were:

Table 11: Interest Rate Exposure

Interest rate risk indicator	**2023/24 Target £000's**	**31.3.24 Actual £000's**	**Complied? Yes/No**
Upper limit on one-year revenue impact of a 1% rise in interest rates	< 1,000	867	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	< 1,000	-867	Yes

8.6 The impact of a change in interest rates is calculated on the assumption that maturing borrowing and investments will be replaced.

8.7 Sums invested for periods longer than a year: 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 long-term principal sum invested to final maturities beyond the period end were:

Table 12: Investments longer than one year

	2023/24	2024/25	2025/26
	£m	£m	£m
Limit on principal invested beyond one year	20.0	20.0	20.0
Actual principal invested beyond one year	0.0	0.0	0.0
Complied (Yes/No)	Yes	Yes	Yes

8.8 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 borrowing were:

Table 13: Maturity Structure of Borrowing

	31.3.24 Actual	% of Total Borrowing	Upper Limit	Lower Limit	Complied Yes/No
Under 12 months	49.5	22.0%	25%	0%	Yes
12 Months to 2 Years	2.5	1.1%	25%	0%	Yes
2 Years to 5 Years	7.6	3.4%	25%	0%	Yes
5 Years to 10 Years	22.7	10.1%	35%	0%	Yes
10 Years to 15 Years	3.8	1.7%	35%	0%	Yes
15 Years to 20 Years	0.0	0.0%	35%	0%	Yes
20 Years to 25 Years	0.0	0.0%	45%	0%	Yes
25 Years to 30 Years	42.0	18.7%	45%	0%	Yes
30 Years to 35 Years	15.0	6.7%	45%	0%	Yes
35 Years to 40 Years	0.0	0.0%	45%	0%	Yes
40 Years to 45 Years	45.0	20.0%	45%	0%	Yes
45 Years to 50 Years	0.0	0.0%	45%	0%	Yes
50 Years and above	36.6	16.3%	75%	0%	Yes
Total	**224.8**	**100.0%**			

9. Financial Implications

This report summarises the performance of the Council's treasury management activity in 2023/24. There are no other financial implications arising from this report.

10. Natural Environment, Climate & Ecology Implications

There are no direct natural environment, climate and ecology implications arising from this report.

11. Well-being and Health Implications

There are no well-being and health implications arising from this report.

12. Other Implications

There are no other implications arising from this report.

13. Risk Assessment

Having considered the risks associated with this decision, the level of risk has been identified as:
Current Risk: HIGH
Residual Risk: Medium

Treasury management is an inherently risky area of activity and a number of controls are embedded in its operation. The key treasury management risks are highlighted as part of the treasury management strategy approved by Council as part of the budget setting process. This report highlights any variances from this strategy and draws out any specific risks which have arisen

14. Equalities Impact Assessment

There are no equalities implications arising from this report.

15. Appendices

Appendix 1: External Context (Arlingclose April 2024)

16. Background Papers

Treasury Management Strategy 2023/24
Capital Strategy 2023/24

Appendix 1: External Context (Arlingclose April 2024)

Economic background

UK inflation continued to decline from the 8.7% rate seen at the start of 2023/24. By the last quarter of the financial year headline consumer price inflation (CPI) had fallen to 3.4% in February, but was still above the Bank of England's 2% target at the end of the period. The core measure of CPI, i.e. excluding food and energy, also slowed in February to 4.5% from 5.1% in January, a rate that had stubbornly persisted for three consecutive months.

The UK economy entered a technical recession in the second half of 2023, as growth rates of -0.1% and -0.3% respectively were recorded for Q3 and Q4. Over the 2023 calendar year GDP growth only expanded by 0.1% compared to 2022. Of the recent monthly data, the Office for National Statistics reported a rebound in activity with economy expanding 0.2% in January 2024. While the economy may somewhat recover in Q1 2024, the data suggests that prior increases in interest rates and higher price levels are depressing growth, which will continue to bear down on inflation throughout 2024.

Labour market data provided a mixed message for policymakers. Employment and vacancies declined, and unemployment rose to 4.3% (3mth/year) in July 2023. The same month saw the highest annual growth rate of 8.5% for total pay (i.e. including bonuses) and 7.8% for regular pay growth (i.e. excluding bonuses). Thereafter, unemployment began to decline, falling to 3.9% (3mth/year) in January and pay growth also edged lower to 5.6% for total pay and 6.1% for regular pay, but remained above the Bank of England's forecast.

Having begun the financial year at 4.25%, the Bank of England's Monetary Policy Committee (MPC) increased Bank Rate to 5.25% in August 2023 with a 3-way split in the Committee's voting as the UK economy appeared resilient in the face of the dual headwinds of higher inflation and interest rates. Bank Rate was maintained at 5.25% through to March 2024. The vote at the March was 8-1 in favour of maintaining rates at this level, with the single dissenter preferring to cut rates immediately by 0.25%. Although financial markets shifted their interest rate expectations downwards with expectations of a cut in June, the MPC's focus remained on assessing how long interest rates would need to be restrictive in order to control inflation over the medium term.

In the Bank's quarterly Monetary Policy Report (MPR) released in August 2023 the near-term projection for services price inflation was revised upwards, goods price inflation widespread across products, indicating stronger domestic inflationary pressure with second-round effects in domestic prices and wages likely taking longer to unwind than they did to emerge. In the February 2024 MPR the Bank's expectations for the UK economy were positive for the first half of 2024, with a recovery from the mild recession in calendar H2 2023 being gradual. Headline CPI was forecast to dip below the 2% target quicker than previously thought due to declining energy prices, these effects would hold inflation slightly above target for much of the forecast horizon.

Following this MPC meeting, Arlingclose, the authority's treasury adviser, maintained its central view that 5.25% remains the peak in Bank Rate and that interest rates will most likely start to be cut later in H2 2024. The risks in the short-term are deemed to be to the downside as a rate cut may come sooner than expected, but then more broadly balanced over the medium term.

The US Federal Reserve also pushed up rates over the period, reaching a peak range of between 5.25-5.50% in August 2023, where it has stayed since. US policymakers have maintained the relatively dovish stance from the December FOMC meeting and at the meeting in March, economic projections pointed to interest rates being cut by a total of 0.75% in 2024.

Following a similarly sharp upward trajectory, the European Central Bank hiked rates to historically high levels over period, pushing its main refinancing rate to 4.5% in September 2023, where it has remained. Economic growth in the region remains weak, with a potential recession on the cards, but inflation remains sticky and above the ECB's target, putting pressure on policymakers on how to balance these factors.

Financial markets

Sentiment in financial markets remained uncertain and bond yields continued to be volatile over the year. During the first half of the year, yields rose as interest rates continued to be pushed up in response to rising inflation. From October they started declining again before falling sharply in December as falling inflation and dovish central bank attitudes caused financial markets to expect cuts in interest rates in 2024. When it emerged in January that inflation was stickier than expected and the BoE and the Federal Reserve were data dependent and not inclined to cut rates soon, yields rose once again, ending the period some 50+ bps higher than when it started.

Over the financial year, the 10-year UK benchmark gilt yield rose from 3.44% to peak at 4.75% in August, before then dropping to 3.44% in late December 2023 and rising again to 3.92% (28th March 2024). The Sterling Overnight Rate (SONIA) averaged 4.96% over the period to 31st March.

Credit review

In response to an improving outlook for credit markets, in January 2024 Arlingclose moved away from its previous temporary stance of a 35-day maximum duration and increased its advised recommended maximum unsecured duration limit on all banks on its counterparty list to 100 days.

Earlier in the period, S&P revised the UK sovereign outlook to stable and upgraded Barclays Bank to A+. Moody's also revised the UK outlook to stable, Handelsbanken's outlook to negative, downgraded five local authorities, and affirmed HSBC's outlook at stable while upgrading its Baseline Credit Assessment. Fitch revised UOB's and BMO's outlooks to stable.

In the final quarter of the financial year, Fitch revised the outlook on the UK sovereign rating to stable from negative based on their assessment that the risks to the UK's public finances had decreased since its previous review in October 2022, the time of the mini- budget.

Moody's, meanwhile, upgraded the long-term ratings of German lenders Helaba, Bayern LB and LBBW on better solvency and capital positions, despite challenges from a slowing German economy and exposure to the commercial real estate sector. Moody's also upgraded or placed on review for an upgrade, Australian banks including ANZ, CBA NAB and Westpac on the back of the introduction of a new bank resolution regime.

Credit default swap prices began the financial year at elevated levels following the fallout from Silicon Valley Bank and collapse/takeover of other lenders. From then the general trend was one of falling prices and UK lenders' CDS ended the period at similar levels to those seen in early 2023. Earlier in the year some Canadian lenders saw their CDS prices rise due to concerns over a slowing domestic economy and housing market, while some German lenders were impacted by similar economic concerns and exposure to commercial real estate towards the end of the period, with LBBW remaining the most elevated.

Heightened market volatility is expected to remain a feature, at least in the near term and, credit default swap levels will be monitored for signs of ongoing credit stress. As ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remain under constant review.