POLICY AND RESOURCES COMMITTEE **27 NOVEMBER 2024**

ANNUAL TREASURY REPORT 2023/24

Report by Chief Financial Officer

PURPOSE

1.1 The purpose of the Report is to provide Members with a Report of the Treasury Management activity for 2023/24.

EXECUTIVE SUMMARY

2.1 The Comhairle embraces Best Practice in accordance with CIPFA's recommendations which requires that Members are informed on Treasury Management activities of the previous year. In the aftermath of the cyber-attack of November 2023, the information which would normally have been provided to Members in this report was not available.

2.2 Treasury Management is defined as "The management of the local authority's 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".

2.3 Loan charges are calculated on all Comhairle treasury activities: revenue and capital cash flow, borrowing and investments. The management and operation of the Loans Fund during 2023/24 generated a saving of £1.08m compared to budget.

RECOMMENDATION

3.1 It is recommended that the Comhairle note the Report

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Background Papers:	None

IMPLICATIONS

4.1 The following implications are applicable in terms of the Report.

Resource Implications	**Implications/None**
Financial	This Report is entirely concerned with financial matters
Legal	Section 1 of The Local Government in Scotland Act 2003 Section 35 of The Local Government in Scotland Act 2003 Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition The Local Government Investments (Scotland) Regulations 2010
Staffing	None
Assets and Property	None
Strategic Implications	**Implications/None**
Risk	The risks associated with the Comhairle's Management Strategy are set out in sections 9.3 and 9.4 of the Report
Equalities	None
Corporate Strategy	None
Environmental Impact	None
Consultation	None

INTRODUCTION

5.1 The Treasury Management Strategy for 2023/24, which was approved by the Comhairle on 26 April 2023, included the recommended Prudential Indicator estimates for the year. This report also confirms the Comhairle's compliance with the Prudential Indicators which were set for 2023/24.

5.2 The Comhairle borrows and invests substantial sums of money and therefore has potentially large exposures to financial risks including the loss of invested funds and the effect of changing interest rates. The successful identification, monitoring and control of risk is therefore central to the Comhairle's Treasury Management Strategy.

5.3 This Annual Report covers:

a) The Comhairle's debt and investment portfolio positions at the beginning and end of the year;
b) The prevailing economic background during the year;
c) The strategy for borrowing and other financing options for the year and its outturn;
d) Debt Restructuring Activity;
e) The annual investment strategy and its outturn;
f) Compliance with Treasury Limits and Prudential indicators; and
g) Other relevant factors.

DEBT PORTFOLIO AT 31 MARCH 2024

7.1

	Balance 31.03.23 £'000	Average Rate %	Debt Matured £'000	New Borrowing £'000	Balance 31.03.24 £'000	Average Rate %
PWLB	130,407	6.29	-3,141	0	127,266	6.18
	Balance 31.03.23 £'000	**Average Rate %**	**Invests Made £'000**	**invests Repaid £'000**	**Balance 31.03.24 £'000**	**Average Rate %**
Investments	47,533	3.57	586,379	-600,905	33,007	5.43

ECONOMIC BACKGROUND

6.1 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.

6.2 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.

6.3 Labour market data provided a mixed message for policymakers. Employment and vacancies declined, and unemployment rose to 4.3% 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% 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.

6.4 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.

6.5 Having begun the financial year at 4.25%, the Bank of England's Monetary Policy Committee (MPC) increased Base 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. Base 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

LONG-TERM BORROWING STRATEGY AND OUTTURN

7.1 No long-term borrowing took place during the financial year ended 31 March 2024.

7.2 The use of internal resources to fund in lieu of borrowing has therefore continued to be the most cost-effective means of financing capital expenditure and financing loan maturities. In addition, this has lowered the overall treasury risk by reducing external debt and has contributed to loan charge savings.

DEBT RESTRUCTURING STRATEGY AND OUTTURN

9.1 The main objective of debt restructuring is to reduce the Comhairle's overall exposure to the risk of interest rate movements, to lower the long-term interest charges paid on its debt, to smooth the maturity profile without compromising the overall longer-term stability, or to alter its volatility profile.

9.2 There were no opportunities for debt restructuring during the financial year ended March 2024.

ANNUAL INVESTMENT STRATEGY AND OUTTURN

10.1 **Investment Strategy:** The Scottish Government's Investment Regulations give priority to security and liquidity and the Comhairle's aim is to achieve a yield commensurate with these principles. The Comhairle's prime objective is to invest its surplus funds prudently and whilst the Comhairle may borrow in advance of requirement in the financial year, which would result in a short-term excess of cash, the Comhairle will not borrow purely with the intention to invest.

10.2 **Investment Outturn:**

a) Investments decreased from £47.533m at the beginning of the year to £33.007m at the year end. The Comhairle continued to maintain a counterparty list based on its criteria of security of capital monies invested and constantly monitored and updated the credit standing of the institutions. This assessment included credit ratings, other alternative assessments of credit strength, information on corporate developments of and market sentiment towards investment counterparties and was guided in this by its Treasury Advisors.

b) The Comhairle's investments attracted an average rate of 4.43% during the year and produced a total of £2m of income.

c) The principal objective throughout the year was the security of investments. In view of the regulatory changes which promote deposits of individuals and small and medium sized enterprises (SMEs) above those of public authorities, the Comhairle has reduced the sums invested with banks and building societies and has subsequently placed these investments with other local authorities.

d) In any period of significant stress in the markets, the default position continued to be to place investments with the Governments deposit facility the DMADF. The rates of interest are below equivalent money market rates, but this is an acceptable trade-off for the guarantee that the Comhairle's capital is secure.

e) All investments made during the year complied with the Comhairle's agreed Treasury Management Strategy, Prudential Indicators, Treasury Management Practices and prescribed limits. Maturing investments were repaid to the Comhairle in full and in a timely manner.

COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

11.1 The Prudential Code for Capital Finance in Local Authorities requires the Comhairle to set a number of Prudential Indicators for the financial year and the two succeeding years. Indicators may if necessary be revised during the year with Comhairle approval.

11.2 The recommended Prudential Indicators for 2023/24 were approved by the Comhairle on 26 April 2023. The indicators are local to the Comhairle.

11.3 **Capital Expenditure**

This indicator is set to ensure that the level of proposed investment in capital assets remains within sustainable limits.

	2023/24	2023/24
Indicator	**Estimate**	**Actual**
	£000	**£000**
Net Capital Expenditure Funded by Borrowing	14,328	12,048

11.3 **Ratio of Financing Costs to Net Revenue Stream**

This is an indicator of affordability which highlights the proportion of the revenue budget required to meet the borrowing costs associated with capital expenditure.

	2023/24	2023/24
Indicator	**Estimate**	**Actual**
	%	**%**
Financing costs to net revenue stream	7.12	6.40

11.5 **Capital Financing Requirement**

The Capital Finance Requirement (CFR) measures a Council's underlying need to borrow for a capital purpose. In order to ensure that over the medium-term net borrowing will only be for a capital purpose, the Comhairle ensures that net external borrowing does not, except in the short-term, exceed the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years.

	2023/24	2023/24
Indicator	**Estimate**	**Actual**
	£000	**£000**
Capital Financing Requirement	149,100	147,403

11.6 **Authorised Limit and Operational Boundary for External Debt**

The Prudential Code requires limits to be set in order to keep borrowing within an affordable range. These limits are referred to as the Authorised Limit and the Operational Boundary. There were no breaches to the Authorised Limit and the Operational Boundary during 2023/24.

a) The Comhairle's Authorised Limit was set at £167m for 2023/24. The Comhairle maintained its total external borrowing and other long-term liabilities within this limit.

b) The Operational Boundary was based on the same estimates as the Authorised Limit but reflected the most likely, prudent, but not worst-case scenario, without the additional headroom included within the Authorised Limit. The Operational Boundary was set at £167m for 2023/24.

11.7 **Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure**

These indicators allow the Comhairle to manage the extent to which it is exposed to changes in interest rates. The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	2023/24	2023/24	Compliance with Limit
Indicator	**Estimate**	**Actual**	
Upper limit for Variable Interest Rate Exposure on Debt	**40%**	**40%**	**Yes**
Upper limit for Variable Interest Rate Exposure on Investments	**100%**	**100%**	**Yes**

ADDITIONAL SIGNIFICANT FACTORS

12.1 With the introduction of the second Financial Instruments Directive (MiFID 11), the Comhairle opted up to professional client status with its providers of financial services, allowing access to a greater range of services but without the greater regulatory protections afforded to individual and small companies. Given the size and range of the Comhairle's treasury management activities, this has been judged to be the most appropriate status for the Comhairle.

12.2 The Comhairle has provided funding to the Stornoway Port Authority (SPA) by way of two loans, totalling £40.29m, to facilitate the building of the new Deep Water Port. One loan is for a period of 25 years with the second being repaid over 40 years. For each drawdown advanced to the SPA, the repayments are being made on bi-annual basis with the first repayment being received in April 2023.

12.3 CIPFA's Code of Practice requires the responsible officer to ensure that all those tasked with treasury management responsibilities, receive appropriate training relevant to their needs. Treasury Management staff regularly attend training courses and workshops delivered by Arlingclose on specific relevant topics.

12.4 CIPFA require that Members charged with the responsibility for the effective scrutiny of the Comhairle's Treasury function receive the appropriate training to allow them to carry out this role. To comply with this requirement, Member training was provided in September 2022 and was delivered by the Comhairle's Treasury Advisors, Arlingclose.