From:	Deputy Leader and Cabinet Member for Finance, Corporate and Traded Services Interim Corporate Director - Finance
To:	Governance and Audit Committee – 23 July 2024
Subject:	Treasury Management Outturn 2023-24
Classification:	Unrestricted
Future Pathway of report	County Council

Summary: This report provides an overview of Treasury Management activity in 2023-24 and developments in 2024-25.

Recommendation: The Committee is asked to endorse this report and recommend that it is submitted to County Council.

1. Introduction

1.1 This report covers Treasury Management activity in 2023-24 and developments in 2024-25 up to the date of this report.

1.2 If agreed by the Committee, this report will be presented to County Council.

1.3 The Council's Treasury Management Strategy for 2023-24 was approved by the County Council on 9 February 2023.

1.4 The Council has both 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 are therefore central to the Council's treasury management strategy. This report covers treasury activity and the associated monitoring and control of risk.

1.5 Treasury risk management at the Council is conducted within the framework of CIPFA's Treasury Management in the Public Services: Code of Practice (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.

1.6 The Council has nominated the Governance & Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

2. External context

2.1 **Economic background:** The following economic commentary has been provided by the Council's retained treasury advisor, Link Group.

UK Economy

a) *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.*

b) *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.*

c) *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.*

	UK	Eurozone	US
Bank Rate	5.25%	4%	5.25%-5.5%
GDP	-0.3%q/q Q4 (-0.2%y/y)	+0.0%q/q Q4 (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)

d) *The Bank of England sprung no surprises in their March meeting, leaving interest rates at 5.25% for the fifth time in a row and, despite no MPC members no longer voting to raise interest rates, it retained its relatively hawkish guidance. The Bank's communications suggest the MPC is gaining confidence that inflation will fall sustainably back to the 2.0% target. However, although the MPC noted that "the restrictive stance of monetary policy is weighing on activity in the real economy, is leading to a looser labour market and is bearing down on inflationary pressures", conversely it noted that key indicators of inflation persistence remain elevated and policy will be "restrictive for sufficiently long" and "restrictive for an extended period".*

e) *Of course, the UK economy has started to perform a little better in Q1 2024 but is still recovering from a shallow recession through the second half of 2023. Indeed, Q4 2023 saw negative GDP growth of -0.3% while y/y growth was also negative at -0.2%.*

f) *But it was a strange recession. Unemployment is currently sub 4%, against a backdrop of still over 900k of job vacancies, and annual wage inflation is running at above 5%. With gas and electricity price caps falling in April 2024, the CPI measure of inflation - which peaked at 11.1% in October 2022 – is now due to slide below the 2% target rate in April and to remain below that Bank of England* *benchmark for the next couple of years, according to Capital Economics. The Bank of England still needs some convincing on that score, but upcoming inflation and employment releases will settle that argument shortly. It is noted that core CPI was still a heady 4.5% in February and, ideally, needs to fall further.*

g) *Shoppers largely shrugged off the unusually wet weather in February, whilst rising real household incomes should support retail activity throughout 2024. Furthermore, the impact of higher interest rates on household interest payments is getting close to its peak, even though fixed rate mortgage rates on new loans have shifted up a little since falling close to 4.5% in early 2024.*

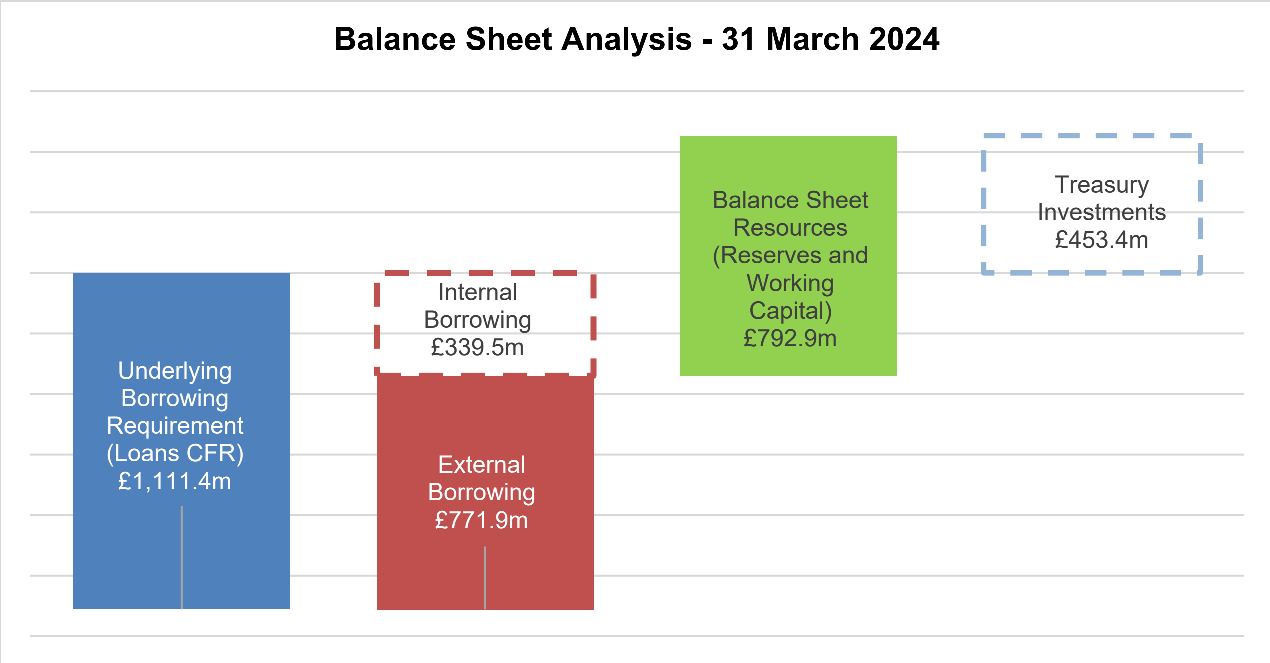
h) *From a fiscal perspective, the further cuts to national insurance tax (from April) announced in the March Budget will boost real household disposable income by 0.5 - 1.0%. After real household disposable income rose by 1.9% in 2023, Capital Economics forecast it will rise by 1.7% in 2024 and by 2.4% in 2025. These rises in real household disposable income, combined with the earlier fading of the drag from previous rises in interest rates, means GDP growth of 0.5% is envisaged in 2024 and 1.5% in 2025. The Bank of England is less optimistic than that, seeing growth struggling to get near 1% over the next two to three years.*

i) *As for equity markets, the FTSE 100 has risen to nearly 8,000 and is now only 1% below the all-time high it reached in February 2023. The modest rise in UK equities in February was driven by strong performances in the cyclical industrials and consumer discretionary sectors, whilst communications and basic materials have fared poorly.*

j) *Despite its performance, the FTSE 100 is still lagging behind the S&P 500, which has been at an all-time high for several weeks.*

3. Local context

3.1 At 31 March 2024 the Council had borrowings of £771.9m and investments of £453.4m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These are shown in the following table.



3.2 The Council followed its strategy to maintain borrowing and investments below their underlying levels, known as internal borrowing, in order to reduce risk and keep interest costs low. This strategy is regularly reviewed with the Council's treasury advisors taking account of capital spending plans and available cash resources.

3.3 The treasury management position on 31 March 2024 and the change during the year is shown in the following table.

	31-Mar-23 Balance £m	2023-24 Movement £m	31-Mar-24 Balance £m	31-Mar-24 Average Rate %
Long-term borrowing	802.5	-30.6	771.9	4.39
Total borrowing	**802.5**	**-30.6**	**771.9**	**4.39**
Long-term investments	312.0	-31.9	280.1	4.58
Short-term investments	45.7	-1.3	44.4	4.83
Cash and cash equivalents	134.7	-5.8	128.9	5.24
Total investments	**492.4**	**-39.0**	**453.4**	**4.83**
Net borrowing	**310.1**	**8.4**	**318.5**	

4 Borrowing Update

4.1 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 Authority. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield unless these loans are for refinancing purposes.

5 Borrowing Strategy During the Period

5.1 The Council's chief objective 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 the Council's long-term plans change being a secondary objective.

5.2 At 31 March 2024 the Council held £771.9m of loans as part of its strategy for funding previous capital programmes. No net new borrowing was undertaken in the year and £30.6m of existing loans were allowed to mature without replacement.

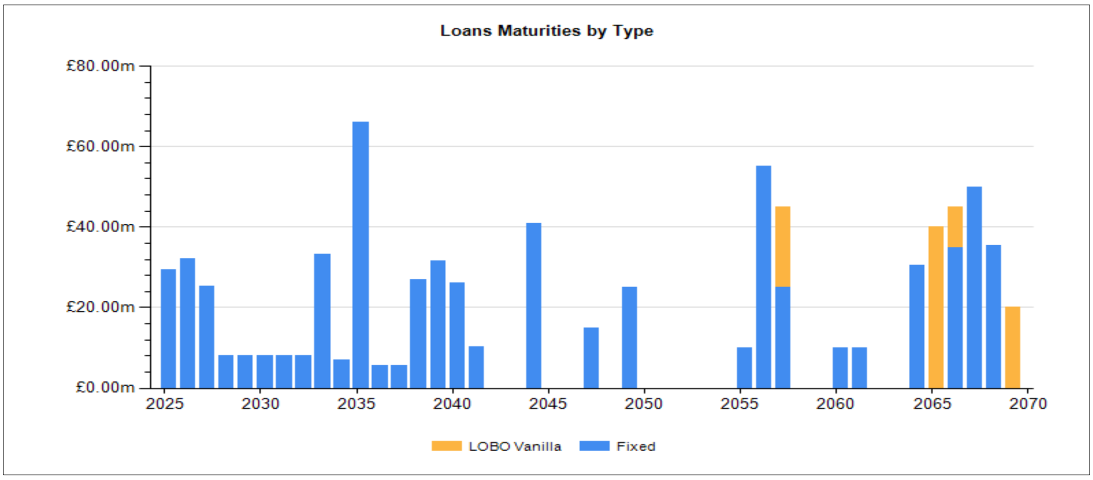
5.3 Interest rates rose over the year in both the long and short term, with rates at the end of March around 0.36% - 0.43% higher than those at the beginning of April. The PWLB 10-year maturity certainty rate stood at 4.78% at 31 March 2024, 20 years at 5.19% and 30 years at 5.21%.

5.4 The Council continues to hold LOBO (Lender's Option Borrower's Option) loans where the lender has 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. Rising interest rates increases the likelihood of a lender exercising their option although no banks exercised their option during the period.

5.5 The Council's borrowing activity in 2023-24 is as follows:

	31/03/2023	2023-24	31/03/2024	31/03/2024	31/03/2024
	Balance	**Movement**	**Balance**	**Average Rate**	**Value Weighted Average Life**
	£m	**£m**	**£m**	**%**	**yrs.**
Public Works Loan Board	484.0	-27.7	456.3	4.41%	14.90
Banks (LOBO)	90.0	0.0	90.0	4.15%	39.88
Banks (Fixed Term)	216.1	0.0	216.1	4.54%	38.23
Streetlighting project	12.4	-2.9	9.5	2.55%	14.59
Total borrowing	**802.5**	**-30.6**	**771.9**	**4.39%**	**24.34**

5.6 The maturity profile of the Council's outstanding debt at 31 March 2024 was as follows:



6 Treasury Investment Activity

6.1 CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes on 20th December 2021. These define treasury management investments as investments that arise from the organisation's cash flows or treasury risk management activity that represents balances that need to be invested until the cash is required for use in the course of business.

6.2 The Council holds significant invested funds representing income received in advance of expenditure plus balances and reserves held. During the year, the Council's investment balance ranged between £401.6m and £640.6m due to timing differences between income and expenditure.

6.3 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 highest 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.

6.4 Bank Rate increased from 4.25% at the beginning of the year to 5.25% at the end of March 2024. Short-dated cash rates, which had ranged between 4.1% - 4.9% at the beginning of April, rose by around 1.1% for overnight/7-day maturities and 0.4% for 6-12 month maturities.

6.5 The Council continues to hold significant cash balances in money market funds as well as in bank call accounts which have same day availability. This liquid cash was diversified over several counterparties and money market funds to manage both credit and liquidity risks.

6.6 During the year the Council loaned £7.4m to the no use empty loans programme. At 31 March 2024, the Council had loans outstanding totalling £16.0m to the programme now achieving a return of 4.5% which is available to fund general services. A £28.5m net decrease in covered bonds in the year brings the total bond portfolio down to £88.2m. These instruments are negotiable and have the benefit of collateral cover.

6.7 The Council's investments during the year are summarised in the table below and a detailed schedule of investments as at 31 March 2024 is in Appendix 1.

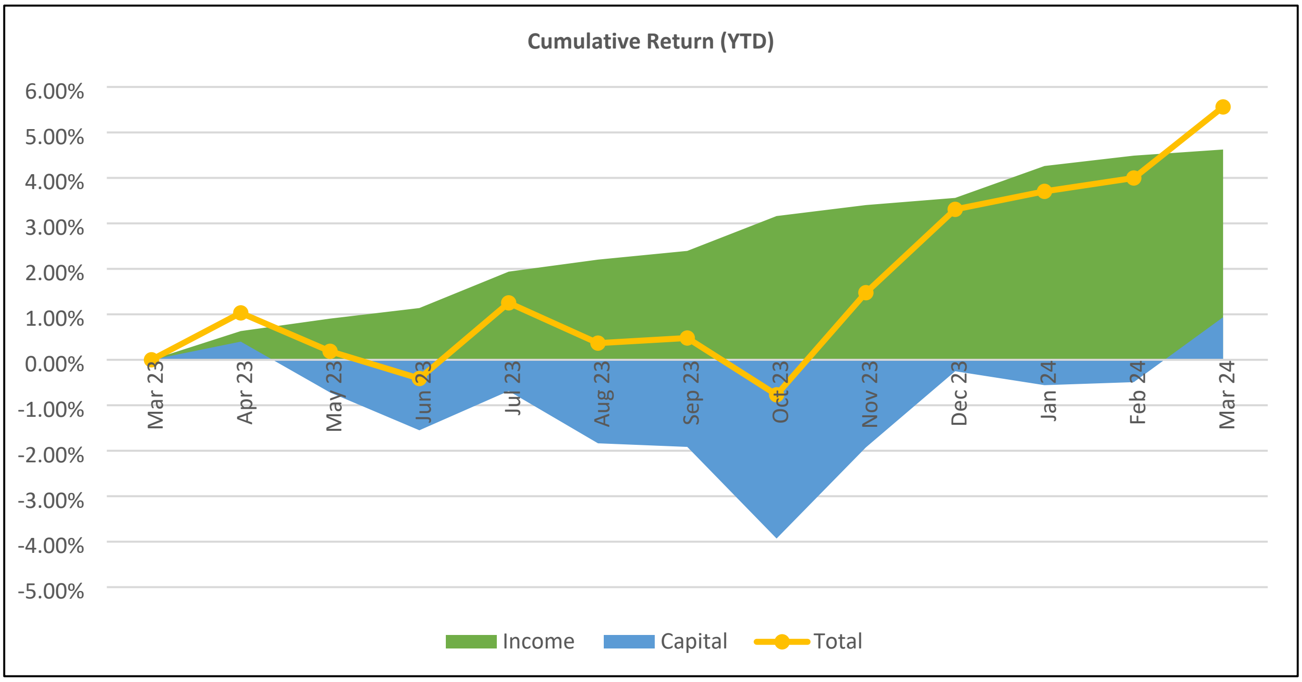
	31-Mar-23	**2023-24**	**31-Mar-24**	**31-Mar-24**	**31-Mar-24**
	Balance	**Movement**	**Balance**	**Rate of Return**	**Average Credit Rating**
	£m	**£m**	**£m**	**%**	
Call Deposits (Banks)	1.3	12.4	13.6	3.94	A+
Money Market Funds	134.7	-5.8	128.9	5.24	AAA
Covered Bonds	116.7	-28.5	88.2	4.59	AAA
DMADF Deposits (DMO)	34.6	-34.6	0.0	0.00	
Treasury Bills (UK Government)	9.8	21.0	30.8	5.22	AA-
No Use Empty Loans	22.0	-6.0	16.0	4.50	
Equity	1.3	0.0	1.3		
Internally Managed Cash	**320.4**	**-41.6**	**278.8**	**4.95**	AA+
Strategic Pooled Funds	**172.0**	**2.6**	**174.6**	**4.62**	
Total	**492.4**	**-39.0**	**453.4**	**4.83**	

7 Externally managed investments

7.1 The Council is invested in equity, multi-asset and property funds. Because the pooled funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives are regularly reviewed.

7.2 Although expected returns are higher over the long term than comparable short term cash instruments, returns on pooled fund investments can be volatile from one year to the next, and therefore the Council only holds long term (strategic) cash balances in the strategic pooled funds' portfolio.

7.3 **Performance YTD**. The value of our holdings increased to £174.6m at the end of March 2024, showing an unrealised gain of £1.7m (0.94%) since the end of March 2023. The total return (comprised of both income and capital returns) on the pooled fund investments over the year since 31 March 2023 was £10.0m (5.56%), as shown in the table below.

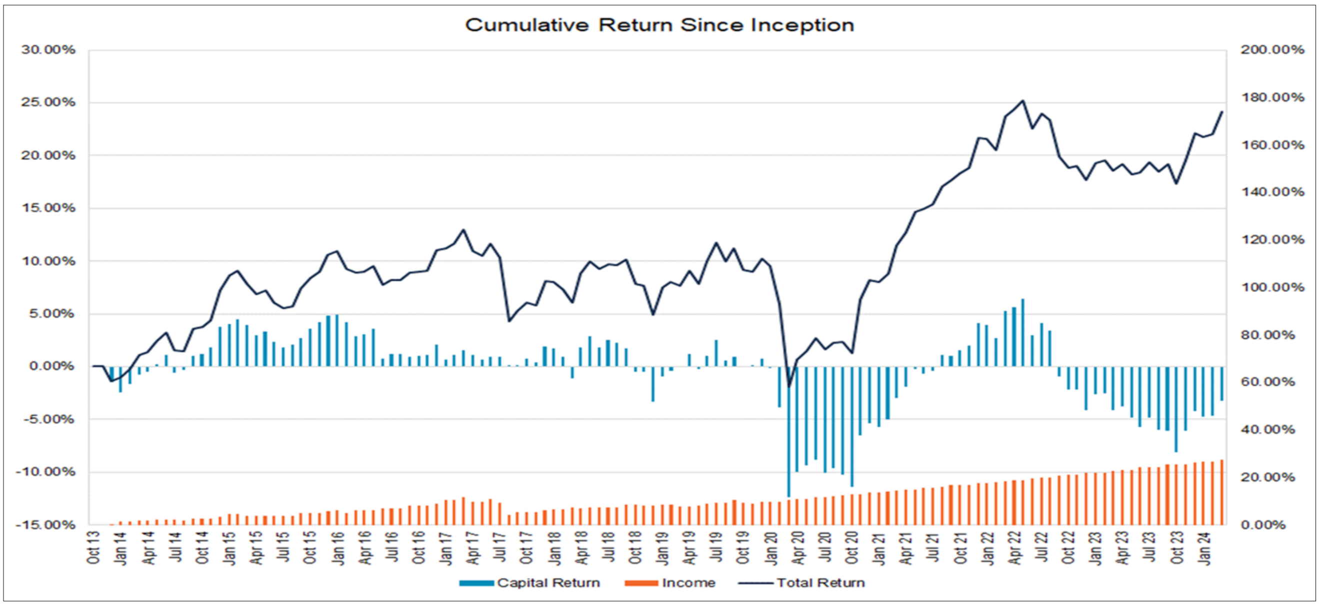


7.4 The market value of the pooled fund investments as at 31 March 2024 compared to the position as at 31 March 2023 is shown in the table below.

		31-Mar-23	2023-24	31-Mar-24	31-Mar-24	
Investment Fund	**Book cost**	**Market Value**	**Movement**	**Market Value**	**12 months return**	
					Income	**Total**
	£m	**£m**	**£m**	**£m**	**%**	**%**
Aegon (Kames) Diversified Monthly Income Fund	20.0	17.7	1.0	18.7	5.79%	10.61%
CCLA - Diversified Income Fund	5.0	4.7	0.2	5.0	3.20%	7.85%
CCLA – LAMIT Property Fund	60.0	56.4	-2.2	54.2	4.56%	0.89%
Fidelity Global Multi Asset Income Fund	25.0	22.7	0.3	23.0	4.32%	3.74%
M&G Global Dividend Fund	10.0	13.8	1.3	15.1	4.60%	14.33%
Ninety-One (Investec) Diversified Income Fund	10.0	9.1	0.0	9.1	4.15%	3.76%
Pyrford Global Total Return Sterling Fund	5.0	5.1	0.3	5.4	2.19%	5.03%
Schroder Income Maximiser Fund	25.0	20.4	0.1	20.5	6.05%	6.47%

Threadneedle Global Equity Income Fund	10.0	11.8	1.2	13.0	3.14%	15.61%
Threadneedle UK Equity Income Fund	10.0	10.3	0.4	10.7	3.77%	7.84%
Total Externally Managed Investments	**180.0**	**172.0**	**2.6**	**174.6**	**4.62%**	**5.56%**

7.5 **Performance since inception:** KCC initially invested in pooled funds in 2013. By the end of March 2024 they had achieved a total income return of £49.4m, 27.37%, with a fall in the capital value of the portfolio of £5.9m, -3.25%. Total returns since inception have been far in excess of the returns available from cash and these instruments are an effective way of managing the Council's longer term cash balances. The following chart tracks the returns earned on the pooled funds over the period from inception.



8 Investment benchmarking at 31 March 2024

8.1 The Council's retained treasury advisor, Link Group monitors the risk and return of some 230 local authority investment portfolios. The metrics over the 12 months to 31 March 2024 extracted from their quarterly investment benchmarking, per the table below, show that the risk within the Kent internally managed funds having been consistent throughout the 12-month period is in line with that of other local authorities. The income return has risen reflecting increased rates payable on our cash investments.

Internally managed investments	Weighted Average Risk Score	Weighted Average Risk Rating	Weighted Average Time to Maturity (days)	Weighted Average Rate of Return (%)
Kent - 31.03.2023	3.26	AA	315	3.93
Kent - 31.03.2024	**1.14**	**AA+**	**207**	**4.95**
English Counties (17)	2.12	AA	96	5.26
Population Average (230)	2.53	AA	56	5.17

9 Actual and forecast outturn

9.1 Outturn net debt costs are £5.53m lower than budget as yields from short-term and variable long-term cash investments have increased and MRP reduced.

10 Treasury Management Group

10.1 The Treasury Management group (TMG) is an informal, non-decision-making body whose role is to support the County Council in oversight and assurance of the treasury management strategy and implementation of it. The TMG last met on 4 June 2024, where it reviewed a copy of this report, alongside other matters. A summary of the meeting discussion is included at Appendix 3.

11 Compliance

11.1 The Interim Corporate Director - Finance reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

12 Treasury Management Indicators

12.1 The Council measures and manages its exposures to treasury management risks using the following indicators:

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

Credit risk indicator	Actual 31/03/2024	Minimum
Portfolio average credit rating	AA+	AA-

12.3 **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.

Liquidity risk indicator	**Actual 31/03/2024**	**Minimum**
Total cash available within 3 months	£168.73m	£100m

12.4 **Interest rate exposures**: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates was:

Interest rate risk indicator	**Actual 31/03/2024**	**Limit**
One-year revenue impact of a 1% rise in interest rates	£2.62m	£10m
One-year revenue impact of a 1% fall in interest rates	-£2.62m	-£10m

12.5 **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:

	Actual 31/03/2024	**Upper limit**	**Lower limit**
Under 12 months	2.73%	100%	0%
12 months and within 5 years	5.31%	50%	0%
5 years and within 10 years	6.52%	50%	0%
10 years and within 20 years	34.79%	50%	0%
20 years and within 40 years	25.96%	50%	0%
40 years and longer	24.68%	50%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

12.6 **Principal 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:

	Actual	**Limit**	**Limit**	**Limit**
Price risk indicator	**2024/25**	**2025/26**	**2026/27**	**No Fixed Date**
Limit on principal invested beyond year end	£150m	£100m	£50m	£250m
Actual as at 31 March 2024	£53.00m	£32.06m	£7.00m	£191.85m

13 Recommendation

Members are asked to endorse this report and recommend that it is submitted to Council.

Appendices

Appendix 1 – Investments as at 31 March 2024
Appendix 2 – Glossary of Terms
Appendix 3 – TMG Meeting Notes, 4 June 2024

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8 July 2024
