Agenda Item No. 5(c)

South Ayrshire Council

Report by Head of Finance, ICT and Procurement to Cabinet of 12 March 2024

Subject: **Treasury Management and Investment Strategy Quarter 3 Update Report 2023/24**

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1. Purpose

1.1 The purpose of this report is to provide Members with an update on the 2023/24 treasury prudential indicators for the period October-December 2023 (Quarter 3) and provide an update on the latest wider economic position.

2. Recommendation

2.1 It is recommended that the Cabinet approves the Quarter 3 Update Report as attached as Appendix 1.

3. Background

Treasury Management

3.1 CIPFA published revised Treasury management and Prudential Codes in December 2021 which stated that revisions contained within the codes needed to be included in the reporting framework from the 2023/24 financial year.

3.2 The Council's Treasury Management and Investment Strategy for 2023/24 approved by the Council in March 2023, contained the requirements of the updated codes. For reporting purposes, the Strategy incorporated the intention to introduce two further quarterly update Treasury management and Investment Strategy reports in addition to the mid-year and out-turn reports.

3.3 The Chief Finance Officer (CFO) is required to establish procedures to monitor and report performance against all forward-looking prudential indicators at least quarterly. Per the Prudential code 2021:

'monitoring of prudential indicators, including forecast debt and investments, is not required to be taken to Full Council and should be reported as part of the authority's integrated capital and Balance Sheet monitoring.'

3.4 The Council reports these two additional quarterly update reports to the Audit and Governance Panel and thereafter to Cabinet. This report fulfils the additional reporting requirements of the 2021 Treasury Management and Prudential codes.

3.5 The council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned to meet expenditure commitments but also to invest surplus monies in low-risk counterparties (organisations with which the council has a financial relationship in terms of borrowing and investments), providing adequate liquidity initially before considering optimising investment return.

3.6 The other main function of the treasury management service is the funding of the council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cashflow planning to ensure the council can meet its capital spending operations. This management of longer-term cash will involve arranging long or short-term loans or using longer term cash flow surpluses. In addition, in certain interest rate environments debt previously drawn may be restructured to meet Council risk or cost objectives.

3.7 The Audit and Governance Panel of 22 February 2024 considered the Quarter 3 Update Report (attached at Appendix 1) and agreed that it be remitted to the Cabinet for approval.

4. Proposals

4.1 This Quarter 3 report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management and provides an update on Economic activity and Interest rates in Appendix 1 and Prudential and Treasury Indicators in Appendix 2.

4.2 The Cabinet is requested to approve the Quarter 3 report.

5. Legal and Procurement Implications

5.1 There are no legal implications arising from this report.

5.2 There are no procurement implications arising from this report.

6. Financial Implications

6.1 *General Services*

6.1.1 **Interest on Revenue Balances** - the Council budgeted for investment income of £0.965m in 2023/24, based on an estimate of the average revenue balances held during the year. Budgeted at achieving an assumed interest rate return of 2.50% on these balances.

At December 2023 (Qtr3) the full year budgeted income is projected at £1.950m, a surplus of £0.985m.

6.1.2 **Capital Financing Costs** - the budget for loan charges in 2023/24 is £14.826, comprising £6.271m for loan principal, £8.371m for interest costs and £0.184m for loans fund expenses.

The current projection for loans charges to the General Fund is an over-spend of £1.872m in interest and expenses. Budget has been allocated from reserves to reduce this overspend to £1.115m This is further offset

10. by the projected surplus of income of £0.985m bringing an overall overspend of £0.130m.

This overspend is currently being reviewed in conjunction with the capital programme and will be monitored closely.

6.2 ***Housing Revenue Account (HRA)***

6.2.1 **Interest on Revenue Balances** - the HRA budgeted for investment income of £0.200m in 2023/24, based on an estimate of the average revenue balances held during the year. Budgeted at achieving an assumed interest rate return of 2.50% on these balances.

At December 2023 (Qtr3) the full year estimate for investment income earned is £0.467m resulting in a surplus of £0.267m.

6.2.2 **Capital Financing Costs -** the budget for HRA loan charges in 2023/24 is £4.463m, comprising £1.674m for loan principal, £2.729m for interest costs and £0.060m for loans fund expenses.

The current projection for HRA loan charges is an overspend of £0.134m in interest and expenses. This is offset by the projected surplus of income of £0.267m bringing an overall underspend of £0.133m.

As with the General Fund this will also be monitored closely.

7. Human Resources Implications

7.1 Not applicable.

8. Risk

8.1 ***Risk Implications of Adopting the Recommendations***

8.1.1 There are no risks associated with adopting the recommendations.

8.2 ***Risk Implications of Rejecting the Recommendations***

8.2.1 Should the recommendations be rejected, then the Council will not be in compliance with the CIPFA Code of Practice on Treasury Management.

9. Equalities

9.1 The proposals in this report have been assessed through the Equality Impact Assessment Scoping process. There are no significant potential positive or negative equality impacts of agreeing the recommendations and therefore an Equalities Impact Assessment is not required. A copy of the Equalities Scoping Assessment is attached as Appendix 3.

10. Sustainable Development Implications

10.1 ***Considering Strategic Environmental Assessment (SEA)*** **-** This report does not propose or seek approval for a plan, policy, programme or strategy or document otherwise described which could be considered to constitute a plan, programme, policy or strategy.

11. Options Appraisal

11.1 An options appraisal has not been carried out in relation to the subject matter of this report.

12. Link to Council Plan

12.1 The matters referred to in this report contribute to Priority 4 of the Council Plan: Efficient and effective enabling services.

13. Results of Consultation

13.1 There has been no public consultation on the contents of this report.

13.2 Consultation has taken place with Councillor Ian Davis, Portfolio Holder for Finance, Human Resources and ICT, and the contents of this report reflect any feedback provided.

14. Next Steps for Decision Tracking

14.1 If the recommendations above are approved by Members, the Head of Finance, ICT and Procurement will ensure that all necessary steps are taken to ensure full implementation of the decision within the following timescales, with the completion status reported to the Cabinet in the 'Council and Cabinet Decision Log' at each of its meetings until such time as the decision is fully implemented:

Implementation	Due date	Managed by
No further action required	Not applicable	Not applicable

Background Papers	**CIPFA Code of Practice for Treasury Management in the Public Services** **Report to South Ayrshire Council of 1 March 2023 – Treasury Management and Investment Strategy 2023/24** **Report to Audit and Governance Panel of 22 February 2024 - Treasury Management and Investment Strategy Quarter 3 Update Report 2023/24**
Person to Contact	**Tim Baulk, Head of Finance, ICT and Procurement** **County Buildings, Wellington Square, Ayr, KA7 1DR** **Phone 01292 612620** **E-mail tim.baulk@south-ayrshire.gov.uk**

Date: 1 March 2024

Appendix 1

1. Economic Activity

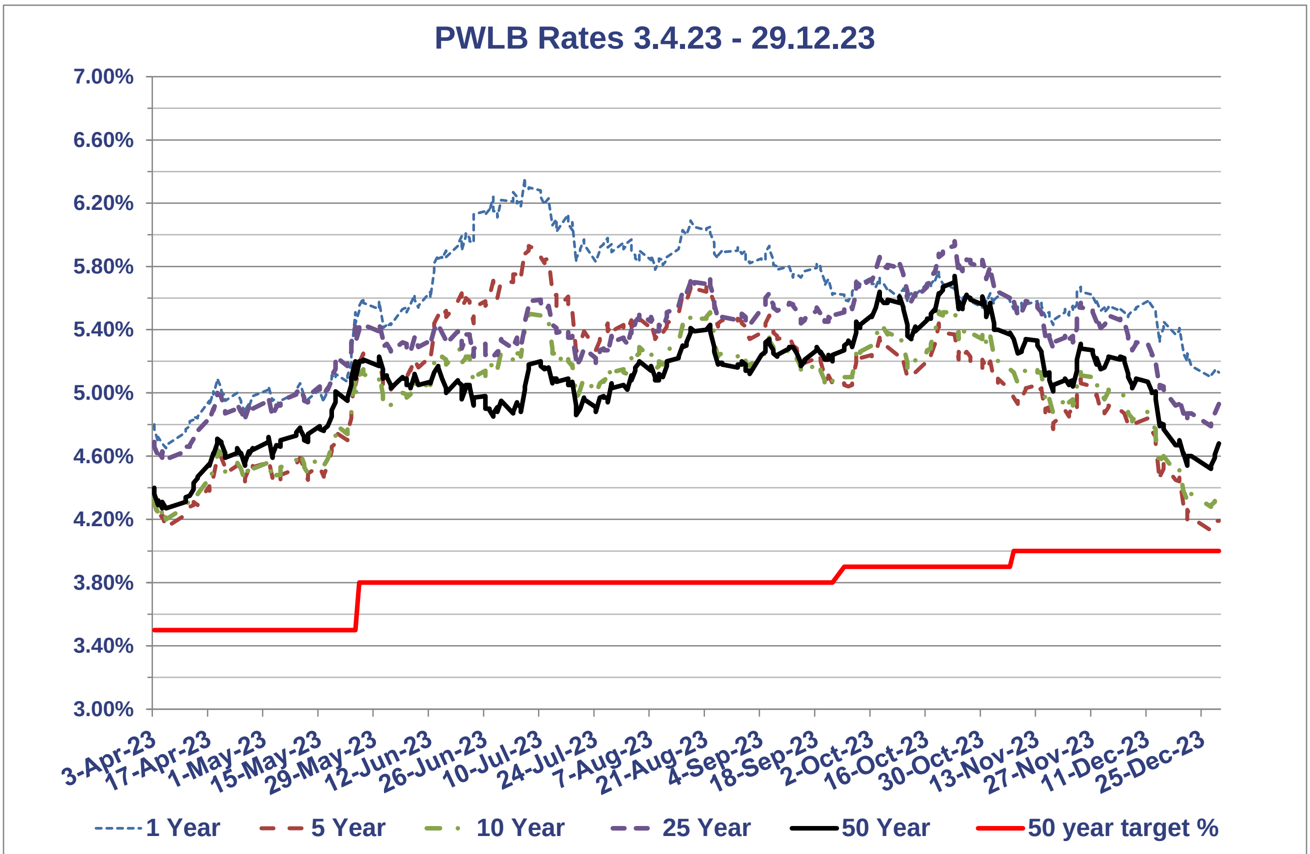
- The third quarter of 2023/24 saw:
  - A 0.3% m/m decline in real GDP in October, potentially partly due to unseasonably wet weather, but also due to the ongoing effect from higher interest rates. Growth for the second quarter, ending 30th September, was revised downwards to -0.1% and growth on an annual basis was also revised downwards, to 0.3%.
  - A sharp fall in wage growth, with the headline 3myy rate declining from 8.0% in September to 7.2% in October, although the ONS rate of unemployment has remained low at 4.2%.
  - Consumer Price Index (CPI) inflation continuing on its downward trajectory, from 8.7% in April to 4.6% in October, to 3.9% in November with a slight increase to 4.0% in December
  - Core CPI inflation decreasing from April and May's 31 years' high of 7.1% to 5.2% in December. This is slight increase to November's figure of. 5.1% which was the lowest rate since January 2022.
  - The Bank of England holding rates at 5.25% in November and December.
  - A steady fall in 10-year gilt yields as investors revised their interest rate expectations lower.
- Higher interest rates have weakened the housing market but, overall, it remains resilient with only marginal falls showing year on year on the Halifax (-1%) and Nationwide (-1.8%) indices. However, the full impact in real consumer spending and real business investment has yet to come as currently it is estimated that around two thirds to a half of the impact of higher interest rates on household interest payments has yet to be felt.
- Overall, we expect real GDP growth to remain low throughout 2024 as the effect from higher interest rates is prolonged but as the cost-of-living crisis diminishes and interest rates are cut in the second half of 2024, this will support a recovery in GDP growth in 2025.
- The labour market remains tight, but the sharp fall in wage growth seen in October will reinforce the overall thoughts in markets that interest rates will be cut mid-2024. Wage growth eased in October much faster than the consensus expected. Total earnings fell by 1.6% m/m, which meant the headline 3myy rate eased from 8.0% in September to 7.2% in October. This news will be welcomed by the Bank of England. Indeed, the timelier three-month annualised rate of average earnings growth fell from +2.4% to -1.2%. Excluding bonuses, it fell from 5.3% to 2.0%.
- The fall in wage growth occurred despite labour demand being stronger in October than expected. The three-month change in employment eased slightly from +52,000 in September to +50,000 in October. But resilient labour demand was offset by a further 63,000 rise in the supply of workers in the three months to October. That meant labour supply exceeded its pre-pandemic level for the first time, and the unemployment rate remained at 4.2% in October. In the three months to November, the number of job vacancies fell for the 17th month in a row, from around 959,000 in October to around 949,000. That has reduced the vacancy to unemployment ratio as demand for labour eases relative to supply, which may support a further easing in wage growth in the coming months.
- CPI inflation fell from 6.7% in September to 4.6% in October, and then again to 3.9% in November. Both these falls were bigger than expected and there are clear signs of easing in domestic inflationary pressures. The fall in core CPI inflation from 5.7% to 5.1% in November was bigger than expected (consensus forecast 5.6%). That is the lowest rate since January 2022. Some of the decline in core inflation was due to the global influence of core goods inflation, which slowed from 4.3% to 3.3%. But some of it was due to services inflation falling from 6.6% to 6.3%. The Bank views the latter as a key barometer of the persistence of inflation and it came in further below the Bank's forecast of 6.9% in its November Monetary Policy Report. This will give the Bank more confidence that services inflation is now on a firmly downward path.
- The Bank of England left interest rates at 5.25% for the third time in a row at the December monetary policy committee (MPC) meeting. The MPC continue to maintain its tightening bias

saying that “further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures”. And it continued by, saying that policy will be “sufficiently restrictive for sufficiently long” and that “monetary policy is likely to need to be restrictive for an extended period of time”. Meaning that the MPC is not yet willing to endorse investors’ expectations that rates will be cut as soon as May 2024.

- Looking ahead, Capital Economics forecast that the recent downward trends in CPI and core inflation will pause over the next few months before starting to decline more decisively again in February. This is the reasoning that the Bank of England won’t feel comfortable cutting interest rates until the second half of 2024.
- The fall in UK market interest rate expectations in December has driven most of the decline in 10-year gilt yields, which have fallen in line with 10-year US Treasury and euro-zone yields. 10-year gilt yields have fallen from 4.68% in October 2023 to around 3.70% at the time of writing, with further declines likely if falling inflation is maintained.
- Investors’ growing expectations that the Federal Reserve will cut interest rates soon has led to an improvement in risk sentiment, which has boosted the pound and other risky assets. In addition, the rise in the pound, from \$1.21 in November to \$1.27 now, has also been supported by the recent relative decline in UK wholesale gas prices.
- The further fall in 10-year real gilt yields in December has supported the recent rise in the FTSE 100. That said, the index remains 5% below its record high in February. This modest rise in equities appears to have been mostly driven by strong performances in the industrials and rate-sensitive technology sectors. But UK equities have continued to underperform US and euro-zone equities. The FTSE 100 has risen by 2.2% in December, while the S&P 500 has risen by 3.8%. This is partly due to lower energy prices, which have been a relatively bigger drag on the FTSE 100, due to the index’s high concentration of energy companies.

In the chart below, the rise in gilt yields across the curve in the first half of 2023/24, and therein PWLB rates, is clear to see, prior to the end of year change based on a mix of supportive domestic and international factors.

PWLB RATES 3.4.23 - 29.12.23



MPC meetings 2 November and 14 December 2023

- On 2nd November, the Bank of England's MPC voted to keep Bank Rate on hold at 5.25%, and on 14th December reiterated that view. Both increases reflected a split vote, the latter by 6 votes to 3, with the minority grouping voting for an increase of 0.25% as concerns about stagnant inflation remained in place.
- However, with UK CPI inflation now at 3.9%, and core inflating beginning to moderate (5.1%), markets may carry the opinion that rate cuts should begin in Q1 2024/25, some way ahead of the indications from MPC members. The data will be the determining factor, so future publications of employment, wages and inflation numbers will be of particular importance, and on-going volatility in Bank Rate expectations and the gilt yield curve can be expected.
- In addition, what happens outside of the UK is also critical to movement in gilt yields. The US Federal Open Market Committee (FOMC) has kept short-term rates in the range of 5.25%-5.50%, whilst the European Central Bank (ECB) has moved its Deposit rate to a probable peak of 4%. Markets currently expect both central banks to start cutting rates in 2024.

2. Interest Rates Forecast

The Council has appointed Link Group as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. The PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1st November 2012.

The latest forecast on 25th September sets out a view that both short, medium and long-dated interest rates will be elevated for some little while, as the Bank of England seeks to reduce the inflation within the economy.

Link Group's PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps, calculated as gilts plus 80bps) which has been accessible to most authorities since 1st November 2012.

Link Group Interest Rate View	07.11.23												
	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26
BANK RATE	5.25	5.25	5.25	5.00	4.50	4.00	3.50	3.25	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.30	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.40	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.50	3.30	3.30	3.30	3.30	3.30
5 yr PWLB	5.00	4.90	4.80	4.70	4.40	4.20	4.00	3.80	3.70	3.60	3.50	3.50	3.50
10 yr PWLB	5.10	5.00	4.80	4.70	4.40	4.20	4.00	3.80	3.70	3.70	3.60	3.60	3.50
25 yr PWLB	5.50	5.30	5.10	4.90	4.70	4.50	4.30	4.20	4.10	4.10	4.00	4.00	4.00
50 yr PWLB	5.30	5.10	4.90	4.70	4.50	4.30	4.10	4.00	3.90	3.90	3.80	3.80	3.80

Treasury Activity

1.1 The Council's Capital Expenditure and Prudential Indicators

(1) The following section provides the information relating to the 2023/24 capital position and prudential indicators.

- The Council's capital expenditure plans.
- How these plans are being financed.
- The impact of the capital expenditure plans on the prudential indicators and the underlying need to borrow.
- Compliance with the limits in place for borrowing activity.

(2) The tables below draw together the main movement in terms of the capital expenditure plans compared to the original plan, highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements for capital expenditure. The borrowing element of Table 1 for both General Services and HRA below revises the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR).

Table 1

	2023/24 Original Estimate £'000	***2023/24 Latest Estimate £'000***
Prudential Indicator – General Services		
Capital Expenditure	**99,145**	**63,806**
General Services - Financed By		
General and Specific Grant	20,407	13,969
Capital Receipts/Other	24,331	8,925
Borrowing	54,407	40,912
Prudential Indicator – HRA		
Capital Expenditure	**75,740**	**46,550**
HRA - Financed By		
Borrowing	53,671	30,641
CFCR, Draw on surplus	7,510	7,510
Other Receipts/ Grants	14,559	8,399
	75,740	**46,550**

1.2 *Capital Financing Requirement, Debt Position and Operational Boundary Indicators*

(1) Table 2 shows the CFR, which is the underlying need to incur borrowing for a capital purpose.

Table 2

Prudential Indicator – CFR	***2023/24 Original Estimate £'000***	***2023/24 Updated Estimate £'000***
Capital Financing Requirement – GS	455,043	440,133
Capital Financing Requirement – HRA	129,426	106,243
Total Capital Financing Requirement	**584,469**	**546,375**

(2) **Prudential Indicators Chart**

The chart shown at (2) above shows estimated key prudential indicators in graph format:

1. **External Borrowing –** shows significant increase in the next two years as the Council utilises borrowing to fund capital investment

2. **Capital Financing Requirement –** shows increases in CFR in line with external debt. The Council ended 2022/23 in an under borrowed position (CFR compared with external debt) of £32,272m. The current strategy will be to reflect an under-borrowed position in the short/medium term as reflected in the graph.

3. **Operational Boundary –** this indicator is higher than external debt and CFR as it includes provision for other long term financing liabilities such as PPP and Finance leases, and short term cash flow variations.

4. **Authorised Limit –** the limit which cannot be exceeded in terms of the Council's debt position. This indicatior is higher than the operational limit as provision is made for other cash flow variation and potential borrowing in advance.

Table 3

Prudential Indicators – Debt	***2023/24 Original £'000***	***2023/24 Updated £'000***
Authorised Limit	641,000	600,000
Operational Limit	590,000	550,000
External Debt	435,660	409,660

(3) **Liability Benchmark**

A third and new prudential indicator for 2023/24 is the Liability Benchmark (LB). The Authority is required to estimate and measure the LB for the forthcoming financial year and the following two financial years, as a minimum.

CIPFA notes on page 13 of the 2021 TM Code: "The liability benchmark should be analysed as part of the annual treasury management strategy, and any substantial mismatches between actual loan debt outstanding and the liability benchmark should be explained. Any years where actual loans are less than the benchmark indicate a future borrowing requirement; any years where actual loans outstanding exceed the benchmark represent an overborrowed position, which will result in excess cash requiring investment (unless any currently unknown future borrowing plans increase the benchmark loan debt requirement). The treasury strategy should explain how the treasury risks inherent in these mismatched positions will be managed."

There are four components to the LB: -

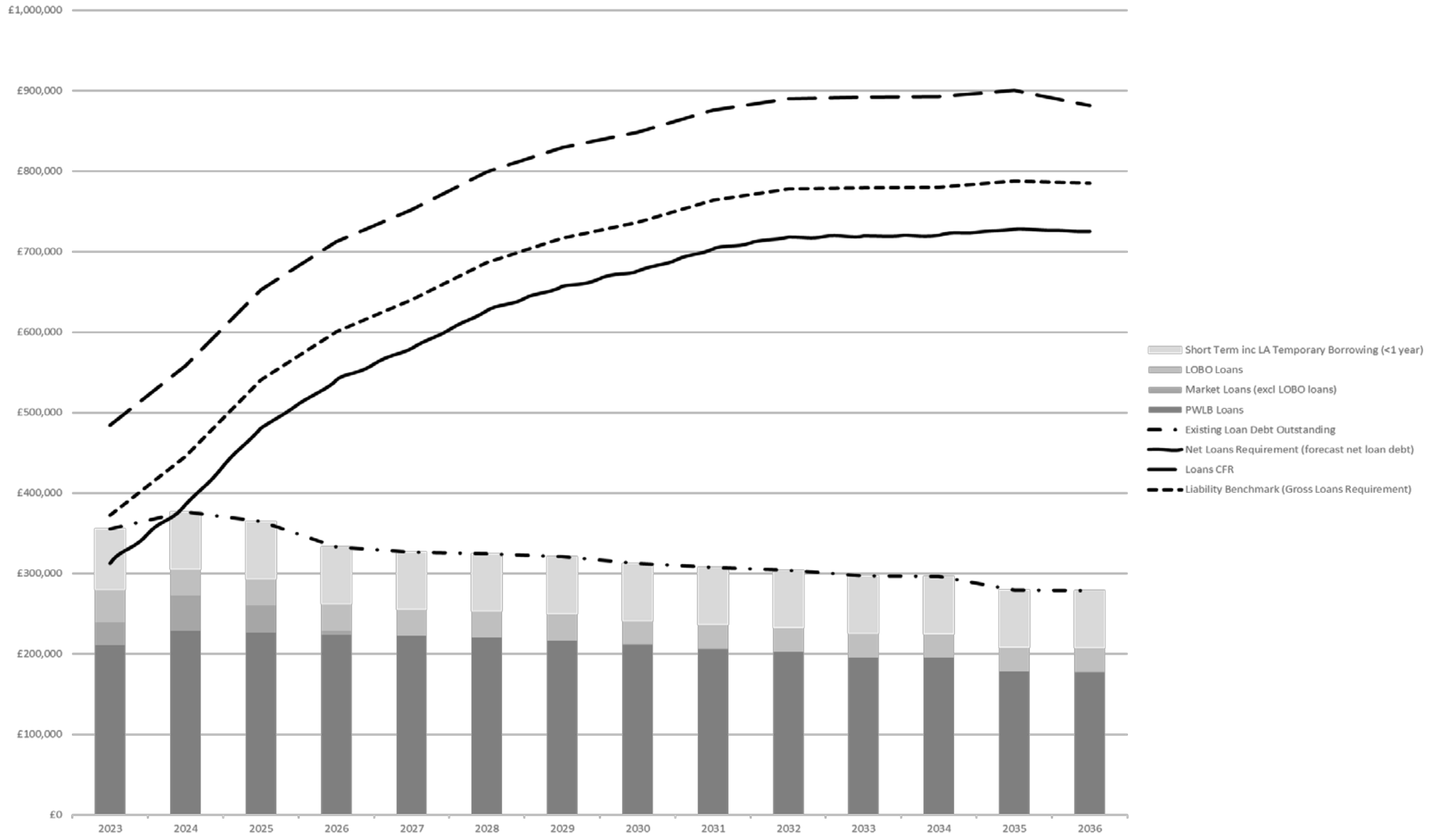
1. **Existing loan debt outstanding**: the Authority's existing loans that are still outstanding in future years.

2. **Loans CFR**: this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned Loans Fund advances/Loans Fund principal repayments. (Note only approved prudential borrowing is included).

3. **Net loans requirement**: this will show the Authority's gross loan debt less treasury management investments at the last financial year-end, projected into the future. and based on its approved prudential borrowing, planned Loans Fund principal. repayments and any other major cash flows forecast.

4. **Liability benchmark (or gross loans requirement)**: this equals net loans requirement plus short-term liquidity allowance.

   This chart shows that South Ayrshire have a significant borrowing requirement over the coming years, as highlighted by the middle-dashed line, which is a risk. However, this borrowing is being monitored to determine timescales and interest rate risk factors and borrowing will only be taken if required.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2036
Short Term inc LA Temporary Borrowing (<1 year)
LOBO Loans
Market Loans (excl LOBO loans)
PWLB Loans
Existing Loan Debt Outstanding
Net Loans Requirement (forecast net loan debt)
Loans CFR
Liability Benchmark (Gross Loans Requirement)

Appendix 3

South Ayrshire Council
Equality Impact Assessment
Scoping Template

Equality Impact Assessment is a legal requirement under the Public Sector Duty to promote equality of the Equality Act 2010. Separate guidance has been developed on Equality Impact Assessment's which will guide you through the process and is available to view here: [Equality Impact Assessment including Fairer Scotland Duty]

Further guidance is available here: [Assessing impact and the Public Sector Equality Duty: a guide for public authorities (Scotland)]

The Fairer Scotland Duty ('the Duty'), Part 1 of the Equality Act 2010, came into force in Scotland from 1 April 2018. It places a legal responsibility on Councils to actively consider ('pay due regard to') how we can reduce inequalities of outcome caused by socio-economic disadvantage, when making strategic decisions. See information here: [Interim Guidance for Public Bodies] in respect of the Duty, was published by the Scottish Government in March 2018.

1. Policy details

Policy Title	Treasury Management and Investment Strategy Quarter 1 2023-24
Lead Officer (Name/Position/Email)	Kate Copland, Senior Finance Officer, Treasury/ Capital – kate.copland@south-ayrshire.gov.uk

2. Which communities, groups of people, employees or thematic groups do you think will be, or potentially could be, impacted upon by the implementation of this policy? Please indicate whether these would be positive or negative impacts

Community or Groups of People	Negative Impacts	Positive impacts
Age – men and women, girls & boys	-	-
Disability	-	-
Gender Reassignment (Trans/Transgender Identity)	-	-
Marriage or Civil Partnership	-	-
Pregnancy and Maternity	-	-
Race – people from different racial groups, (BME) ethnic minorities and Gypsy/Travellers	-	-
Religion or Belief (including lack of belief)	-	-
Sex – gender identity (issues specific to women & men or girls & boys)	-	-
Sexual Orientation – person's sexual orientation i.e. LGBT+, lesbian, gay, bi-sexual, heterosexual/straight	-	-
Thematic Groups: Health, Human Rights & Children's Rights	-	-

3. What likely impact will this policy have on people experiencing different kinds of social disadvantage? (Fairer Scotland Duty). Consideration must be given particularly to children and families.

Socio-Economic Disadvantage	Negative Impacts	Positive impacts
Low Income/Income Poverty – cannot afford to maintain regular payments such as bills, food, clothing	-	-

Socio-Economic Disadvantage	Negative Impacts	Positive impacts
Low and/or no wealth – enough money to meet Basic living costs and pay bills but have no savings to deal with any unexpected spends and no provision for the future	-	-
Material Deprivation – being unable to access basic goods and services i.e. financial products like life insurance, repair/replace broken electrical goods, warm home, leisure/hobbies	-	-
Area Deprivation – where you live (rural areas), where you work (accessibility of transport)	-	-
Socio-economic Background – social class i.e. parent's education, employment and income	-	-

4. Do you have evidence or reason to believe that the policy will support the Council to:

General Duty and other Equality Themes **Consider the 'Three Key Needs' of the Equality Duty**	**Level of Negative and/or Positive Impact (High, Medium or Low)**
Eliminate unlawful discrimination, harassment and victimisation	Low
Advance equality of opportunity between people who share a protected characteristic and those who do not	Low
Foster good relations between people who share a protected characteristic and those who do not. (Does it tackle prejudice and promote a better understanding of equality issues?)	Low
Increase participation of particular communities or groups in public life	Low
Improve the health and wellbeing of particular communities or groups	Low
Promote the human rights of particular communities or groups	Low
Tackle deprivation faced by particular communities or groups	Low

5. Summary Assessment

Is a full Equality Impact Assessment required? (A full Equality Impact Assessment must be carried out if impacts identified as **Medium and/or High**)	~~**YES**~~ **NO**

Rationale for decision:

The strategy outlines the approach to be taken in managing the Council's cash flow and capital funding arrangements and is a mechanism for ensuring that budget targets are achieved: a full EQIA is, therefore, not required

Signed : Tim Baulk **Head of Service**

Date: 29 January 2024