Agenda Item No. 10

South Ayrshire Council

Report by Chief Financial Officer to Audit and Governance Panel of 26 June 2024

Subject: Treasury Management Annual Report 2023/24

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1. Purpose

1.1 The purpose of this report is to present, in line with the requirements of the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management, the annual report of treasury management activities for 2023/24 (as attached at Appendix 1) and seek Members' consideration of its contents.

2. Recommendation

2.1 It is recommended that the Panel:

2.1.1 considers the Annual Treasury Management Report 2023/24, as attached at Appendix 1; and

2.1.2 remits the Annual Treasury Management Report to Council on 10 October for approval.

3. Background

3.1 The Council is required through regulations issued under the Local Government in Scotland Act 2003 to produce an annual treasury report reviewing treasury management activities and prudential and treasury indicators. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

3.2 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

3.3 The Chief Financial Officer also confirms that the Council has complied with the requirements under the Code, to give prior scrutiny of treasury management reporting to the Council's Audit and Governance Panel prior to submitting the report to Council.

3.4 Treasury management in this context is defined as:

> ***'The management of the local authority's 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.***

4. Proposals

4.1 The Treasury Management Annual Report for 2023/24 is submitted to the Panel, as Audit and Governance Panel, in accordance with the requirements of the CIPFA Code of Practice on Treasury Management, for consideration and thereafter remit to the Council meeting on 10 October for approval.

4.2 ***Executive Summary***

During 2023/24, the Council complied with its legislative and regulatory requirements. The key prudential indicators detailing the impact of capital expenditure activities during the year, with previous year comparators, are shown below.

Actual Prudential and Treasury Indicators	***2022/23 Actual £'000***	***2023/24 Actual £'000***
Capital Expenditure	**119,064**	**99,362**
Total Capital Financing Requirement (including other long-term liabilities)	484,608	534,483
PPP and Finance Lease	(91,951)	(88,023)
Underlying Borrowing Requirement	**392,657**	**446,460**
Gross External Debt	355,385	387,659
Under (Over) Borrowed	37,272	58,801
Cash/Investments	(43,155)	(26,384)
Net External Debt	**312,230**	**361,275**

4.3 The table above shows that the Council has an under-borrowed position on 31 March 2024 of £58,801m, c13.17%. This means the Council has used internal borrowing from cash/reserves to fund an element of its current capital expenditure requirements. It does not indicate that borrowing for the capital programme has not been undertaken; only that internal cash resource has been used as funding, opposed to external borrowing.

4.4 Although this is a prudent position in the current interest rate environment given the cost of external borrowing compared with cash investment rates, the Council's under-borrowed position is 13.17% of its overall under-lying borrowing requirement and is therefore manageable within the current strategy. The strategy for 2024/25 is expected to maintain an under-borrowed position whilst closely monitoring longer term PWLB and market rates in considering new borrowing.

4.5 Other prudential and treasury indicators are included in [Appendix 1](#) to this report. The Chief Financial Officer also confirms that any borrowing was only undertaken for capital purpose and the statutory borrowing limit (the authorised limit) was not breached during 2023/24.

4.6 The financial year 2023/24 remained a challenging environment due to volatile interest rates with several rate increases in the first two quarters and then remained at a high level for the rest of the year.

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 Held*** – the Council originally budgeted to receive £0.965m in interest income (based on a return of 4.00%) to the General Fund in 2023/24. Interest rates for investment increased throughout 2023-24, with the strategy outperforming budget return resulting in an investment surplus.

Investment income to the General Fund out turned at £1.510m, a surplus of £0.546m. Interest was also received to the Council's Repairs and Renewals Fund and Capital Fund to the value of £0.056m.

6.1.2 ***Capital Financing Costs*** - the Council originally budgeted £15.583m for financing costs and expenses on debt for 2023/24. This budget consisted of £6.271m in loan principal, £9.128m in interest and £0.184m in expenses. During 2023/24, a pragmatic approach was taken when considering the borrowing requirements to fund capital expenditure. However, even with this the borrowing strategy during 2023/24 resulted in an overspend as under-noted:

	Budget £'000	Out-turn £'000	Variance £'000
Principal	6,271	6,261	10
Interest	9,128	11,179	(2,051)
Expenses	184	312	(128)
Capital Financing costs	**15,583**	**17,752**	**(2,169)**
Investment income	**(965)**	**(1,510)**	**545**
Total Debt charges	**14,618**	**16,242**	**(1,624)**

The borrowing strategy undertaken in 2023/24 resulted in an overall overspend to the General Services of £1.624m. This is due to the increase in interest rates throughout 2023/24 due to high inflation rates, cost of living crisis and war in Ukraine and the Middle East. This is discussed further in the Economic Commentary. The overall overspend was reduced due to the investment strategy overperforming.

6.2/

6.2 **Housing Revenue Account (HRA)**

6.2.1 ***Interest on HRA Revenue Balances Held*** – the HRA budgeted to receive investment income of £0.200m on its revenue balances in 2023/24 based on achieving an interest rate of 4.00%. Like the General Fund the investment strategy was able to out-perform both budget and benchmark resulting in a return of £0.386m in investment income a surplus of £0.186m.

6.2.2 ***Capital Financing Costs*** - the HRA budgeted £4,463m for financing costs on debt for 2023/24. This consisted of £1.674m in loan principal, £2.729m in interest and £0.066m in expenses.

	Budget £'000	Out-turn £'000	Variance £'000
Principal	1,674	1,674	0
Interest	2,729	3,177	(448)
Expenses	60	88	(28)
Capital Financing costs	**4,463**	**4,939**	**(476)**
Investment income	**(200)**	**(386)**	**186**
	4,263	**4,553**	**(290)**

The borrowing strategy undertaken in 2023/24 resulted in an overall overspend to the HRA of £0.290m.

6.3 In total, net debt financing costs were overspent by £2,646m, and when added to an over achievement in interest income of £0.732m resulted in an overall deficit of £1.914m which was reflected in the Council and HRA financial position at 2023/24.

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 If the recommendations are rejected, then the Council will be non-compliant with the requirements contained in both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

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 2.

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.

Background Papers	**CIPFA Code of Practice for Treasury Management in Local Authorities** **Report to South Ayrshire Council of 1 March 2023 - Treasury Management and Investment Strategy 2023-24** **Report to Cabinet of 16 January 2024 – Treasury Management and Investment Strategy Mid-year Report 2023-24**
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Date: 17 June 2024

Appendix 1

South Ayrshire Council

Treasury Management Annual Report 2022/23

Introduction

In accordance with the requirements of the CIPFA Code of Practice on Treasury Management in the Public Services, this report covers the following:

- Section 1 - The Council's Capital Expenditure and Financing 2023/24.
- Section 2 – The Council's overall borrowing need.
- Section 3 – Treasury Position as of 31 March 2024.
- Section 4 – The Strategy for 2023/24.
- Section 5 – The Economy and Interest Rates
- Section 6 – Borrowing Rates 2023/24
- Section 7 – Borrowing Outturn 2023/24
- Section 8 – Investment Outturn 2023/24
- Section 9 – Other Issues

Section 1 The Council's Capital Expenditure and Financing 2023/24

1.1 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 have no resultant impact on the Council's borrowing need; or

- if insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing requirement.

1.2 The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual expenditure, how this was financed and the resulting borrowing requirement.

Table 1

Item	***2022/23 Actual £'000***	***2023/24 Estimate per Strategy***	***2023/24 Actual***
General Fund capital expenditure	90,749	99,145	53,677
HRA capital expenditure	28,315	75,740	45,685
Total	**119,064**	**174,885**	**99,362**
Resourced by:			
Government Grant & Other	(22,818)	(27,917)	(23,910)
Other funding identified	(23,369)	(38,890)	(15,791)
Borrowing:	**72,877**	**108,078**	**59,661**

1.3 The reason for the movement between planned expenditure/funding and actual out-turns for 2023/24 can be found in the General Services and HRA 2023/24 capital monitoring reports presented to Leadership Panel throughout 2023/24. The largest examples (by value) of reprofiling of spend in to 2024/25 being:

- Troon Early Years – £1.75m
- Girvan P.S. - £1.5m
- Girvan PS and All-Weather Pitch - £1.75m
- Green Waste/Household Recycling - £0.750m
- Cemeteries/Crematoria - £0.775m
- Girvan Regeneration - £0.750m
- Hourstons Development - £2m
- Citadel Refurbishment – £1.2m
- Ayrshire Growth Deal - £23.6m
- Various Ward Projects - £1.97m
- Hangar Space - £2.7m
- End User Computing - £1m
- HRA Major component replacement programme - £8.5m
- HRA Structural & Environmental - £3.4m
- HRA New Builds – Various sites - £16.3m
- HRA Window Replacement Programme - £0.75m

Section 2 The Council's overall Borrowing Need

2.1 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR 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 (Table 1), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

2.2 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service manages the Council's cash position to ensure that sufficient cash is available to meet not only the capital plans but also to manage the daily cash flow requirements of funding its revenue commitments of payroll, suppliers, benefits etc.

2.3 This borrowing for capital expenditure may be sourced through external bodies such as the Government, through the Public Works Loan Board [PWLB] or the money markets) or utilising temporary cash resources within the Council (internal borrowing).

2.4 ***Reducing the CFR*** – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the scheduled debt amortisation as a loan repayment, to reduce the CFR. This is effectively a repayment of the borrowing need and differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge. The Council's 2023/24 prudent repayment policy, (as required by Scottish Government), was approved as part of the Treasury Management Strategy Report for 2023/24 on 4 March 2023.

2.5 The Council's CFR for the year is shown below and represents a key prudential indicator. It includes PFI and leasing schemes on the balance sheet, which increase the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

On 15 December 2022, the Council agreed a report on PPP Service Concession Arrangement Flexibilities.

Finance Circular 10/2022 (FC 10/2022) replaces the 2010 version that covered this area and permits the authority to apply a temporary flexibility for service concession arrangements entered prior to April 2022. The Circular sets out the accounting requirements and the options permitted for the recognition of repayments of the principal element of the lease component or the lease liability for the year and the temporary flexibility for SCAs entered prior to 1 April 2022.

The reprofiling of the debt liability repayments increased the Capital Financing Requirement (CFR) by £21.718m as at 1 April 2022. The Council made this adjustment in the financial year 2022/23. The increase in the CFR will continue to be reduced by the revised repayments after each SCA contract has expired until the end of the revised period. This has now been incorporated into the revised Prudential indicators as appropriate.

The undernoted table shows the Council's underlying borrowing requirement, inclusive of PPP and Finance lease arrangements, as of 31 March 2024.

Table 2

Capital Financing Requirement	**31 Mar 2023 £'000**	**31 Mar 2024 £'000**
Opening Balance	**399,006**	**484,608**
Add unfinanced capital expenditure	72,877	59,661
Add new OLTL obligations (PPP)	0	0
Retrospective PPP adjustment	21,718	0
Less loans fund repayment	(7,238)	(7,935)
Less PPP/ finance lease repayment	(1,755)	(1,851)
Closing Balance	**484,608**	**534,483**

The borrowing activity is constrained by prudential indicators for gross borrowing, CFR, and by the authorised limit. The increasing CFR position reflects the Council's capital programme expenditure in 2023/24 and the resulting borrowing requirements to fund this investment.

2.6 ***Gross Borrowing and the CFR*** - to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2023/24) plus the estimates of any additional capital financing requirement for the current (2024/25) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure.

This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs 2023/24. The table below highlights the Council's gross borrowing position against the CFR.

Table 3

Item	***31 March 2023 £'000***	***31 March 2024 £'000***
Capital Financing Requirement (CFR)	484,608	534,483
Gross External Borrowing Position (including PPP and finance Lease)	447,336	475,682
Net Under/ (Over) Borrowed Position	**37,272**	**58,801**

The table above shows the CFR in an under-borrowed position on 31 March 2024 of £58,801m. This means the Council has used internal borrowing from cash/ reserves to fund an element of its current capital expenditure requirements.

This is a prudent position in the current interest rate environment given the cost of external borrowing compared with cash investment rates. The current strategy for 2023/24 is expected to maintain this under-borrowed position whilst closely monitoring longer term PWLB and market rates and consideration of potentially re-financing some of the temporary loan debt with longer term.

2.7 ***Borrowing Prudential Indicators***

- **The Authorised Limit** – **Table 4** - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2022/23 the Council has maintained gross borrowing within its authorised limit.

- **The Operational Boundary – Table 4** – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

- **Actual Financing Costs as a Proportion of Net Revenue Stream – Table 5 -** this indicator identifies the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream of the Council.

Table 4

Item	***2022/23 £'000***	***2023/24 £'000***
Authorised Borrowing Limit External Debt	**635,929**	**600,336**
Borrowing	355,385	387,659
Other Long-Term Liabilities	91,951	88,023
Total	**447,336**	**475,682**
Operational Boundary External Debt	**511,125**	**547,683**
Borrowing	355,385	387,659
Other Long-Term Liabilities	91,951	88,023
Total	**447,336**	**475,682**

Table 5

Ratio of Financing Costs to Net Revenue Stream	***Actual 2022/23***	***Estimated 2023/24***
General Services	5.44%	6.48%
HRA	10.97%	12.99%
Total	**6.04%**	**7.26%**

Section 3 Treasury Position as of 31st March 2024

3.1 The Council's treasury management debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices.

At the end of 2023/24 the Council's treasury, (excluding borrowing by PFI and finance leases), position was as follows:

Table 6/

Table 6

	Borrowing position as at 31 March 2023		***Borrowing position as at 31 March 2024***		***Change in year***
	£'000	***Average interest rate %***	***£'000***	***Average interest rate %***	***£'000***
Long Term Borrowing					
Public Works Loans Board	211,185	3.13	239,459	3.64	28,274
Market – Fixed	28,000	2.33	44,000	3.72	16,000
LOBO (Option Loans)	41,200	4.52	33,200	4.52	(8,000)
Total Long-Term Borrowing	**280,385**		**316,659**		**36,274**
Short Term Borrowing	75,000	2.36	71,000	4.92	(4,000)
Total External Borrowing	**355,385**	**3.09**	**387,659***	**3.96**	**32,274**
CFR (underlying borrowing need)	392,657		446,460		53,616
Over (Under) Borrowing	**(37,272)**		**(58,801)**		**21,342**
Investments	**(43,155)**	**1.35**	**(26,384)**	**5.37**	

* The carrying amount of loans on the Council's balance sheet as of 31 March 2024 is £388.472m. The difference between this figure and the external borrowing shown in Table 6 above is £0.813m of equivalent interest rate accounting adjustments required by the Code of Practice on local authority accounting.

3.2 **Table 7** below details the profile of the Council's loan maturity periods as of 31 March 2024.

Table 7

Maturity analysis of Debt Outstanding at 31 March 2024	***PWLB £'000***	***Market £'000***	***LOBO (Option) £'000***	***Temp Borrowing***	***Total £'000***
Maturing within 1 year	1,986	10,000	0	71,000	82,986
Maturing 1 to 2 years	2,419	29,000	0	0	31,419
Maturing 2 to 5 years	7,160	5,000	0	0	12,160
Maturing 5 to 10 years	33,587	0	3,000	0	36,587
Maturing 10 to 20 years	43,637	0	5,500	0	49,137
Maturing 20 to 30 years	44,004	0	10,000	0	54,004
Maturing 30 to 40 years	39,166	0	9,700	0	48,866
Maturing 40 to 50 years	67,500	0	0	0	67,500
Maturing > 50 years	0	0	5,000	0	5,000
Total	***239,459***	***44,000***	***33,200***	***71,000***	***387,659***

3.3 **Loans fund -** where a local authority has a Housing Revenue Account, the HRA should be reported separately from the General Fund. The reporting on the commitment to repay loans fund advances is for repayments only and does not include any interest costs. The Loans Fund balances are set out in Table 8 and Table 8(a) below:

Table 8 – Loans Fund Advances to General Fund

Loans Fund	31 March 2023 (£'000)	31 March 2024 (£'000)
Opening Balance	226,125	289,526
Add advances	69,290	31,501
Less repayments	(5,889)	(6,261)
Closing Balance	**289,526**	**314,766**

Table 8(a) – Loans Fund Advances to HRA

Loans Fund	31 March 2023 (£'000)	31 March 2024 (£'000)
Opening Balance	74,601	76,839
Add advances	3,587	28,160
Less repayments	(1,349)	(1,674)
Closing Balance	**76,839**	**103,325**

Section 4 Strategy for 2023/24

4.1 Investment returns picked up throughout the course of 2023/24 as central banks, including the Bank of England, continued to respond to inflationary pressures that were not transitory, and realised that tighter monetary policy was called for.

Starting in April at 4.25%, Bank Rate moved up in stepped increases of either 0.25% or 0.5%, reaching 5.25% by August. By the end of the financial year, no further increases were anticipated. Indeed, the market is pricing in a first cut in Bank Rate in the summer of 2024.

The upward yield curve that continued throughout 2023/24 meant that local authorities continued to be faced with the challenge of proactive investment of surplus cash, while balancing this with the need to maintain cashflow for liquidity purposes.

With bond markets selling off, UK equity market valuations struggled to make progress, as did property funds, although there have been some market rallies from time to time including in November and December 2023. However, the more traditional investment options, such as specified investments (simple to understand, and less than a year in duration), have continued to be at the forefront of most local authority investment strategies, particularly given Money Market Funds have also provided decent returns close to Bank Rate for liquidity purposes. In the latter part of 2023/24, the local authority to local authority market lacked any meaningful measure of depth, forcing short-term investment rates above 7% in the last week of March.

While the Council has taken a prudent approach to investing surplus monies, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the Global Financial Crisis of 2008/09. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with a stressed market and economic conditions.

Section 5 Economy and Interest Rates

5.1 UK. Economy

Against a backdrop of 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.

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.

United Kingdom (UK), Euro-Zone (EZ) and United States (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)

The Bank of England made no changes in their March meeting, leaving interest rates at 5.25% for the fifth time in a row and, despite no Monetary Policy Commission (MPC) members no longer voting to raise interest rates, it retained its relatively cautious 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".

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 Gross Domestic Product (GDP) growth of -0.3% while y/y growth was also negative at -0.2%.

It is a recession with varied characteristics. Unemployment is currently sub 4%, against a backdrop of still over 900,000 of job vacancies, and annual wage inflation is running at above 5%. With gas and electricity price caps falling in April 2024, the Consumer Price Index (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 is awaiting upcoming inflation and employment releases before taking further decisions on interest rate decreases. It is noted that core CPI was still at 4.5% in February and, ideally, needs to fall further.

Consumer spending was reasonable despite 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.

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 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.

As for equity markets, the Financial Times Stock Exchange (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.

Despite its performance, the FTSE 100 is still lower than the Standard & Poor's 500 (S&P 500), which has been at an all-time high for several weeks.

USA Economy.

Despite the markets willing the Federal Open Market Committee (FOMC) to cut rates as soon as June 2024, the continued resilience of the economy, married to sticky inflation, is providing a significant headwind to a change in monetary policy. Markets currently anticipate three rate cuts this calendar year, but two or less would not be out of the question. Currently, policy remains flexible but primarily data driven.

In addition, the Federal Reserve (Fed) will want to reduce the $16 trillion balance sheet in the future. The $ is the world's foremost reserve currency (China owns over $1 trillion) but the US must deal with the budget deficit. The mix of inflation and significant treasury issuance is keeping treasury yields high. The 10 year stands at 4.4%.

As for inflation, it is currently a little above 3%. The market is not expecting a recession, but whether rates staying high for longer is uncertain, hence why the consensus is for rate cuts this year and into 2025.

EZ Economy.

Although the Euro-zone inflation rate has fallen to 2.4%, the European Central Bank (ECB) will still be mindful that it has further work to do to dampen inflation expectations. However, with growth moving slowly (GDP flatlined in 2023), a June rate cut from the current 4% looks probable.

Section 6 Borrowing Rates in 2023/24

6.1 *PWLB Borrowing Rates -*

HIGH/LOW/AVERAGE PWLB RATES FOR 2023/24

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	4.65%	4.13%	4.20%	4.58%	4.27%
Date	06/04/2023	27/12/2023	06/04/2023	06/04/2023	05/04/2023
High	6.36%	5.93%	5.53%	5.96%	5.74%
Date	06/07/2023	07/07/2023	23/10/2023	23/10/2023	23/10/2023
Average	5.54%	4.99%	4.97%	5.34%	5.08%
Spread	1.71%	1.80%	1.33%	1.38%	1.47%

PWLB rates are based on gilt (UK Government bonds) yields through HM Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields. Inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation and the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. Indeed, in recent years many bond yields up to 10 years in the Eurozone turned negative on expectations that the EU would struggle to get growth rates and inflation up from low levels. In addition, there has, at times, been an inversion of bond yields in the US whereby 10-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession.

However, since early 2022, yields have risen dramatically in all the major developed economies, first as economies opened post-Covid, then because of the inflationary impact of the war in Ukraine in respect of the supply side of many goods. In particular, rising cost pressures emanating from shortages of energy and some food categories have been central to inflation rising rapidly. Furthermore, at present the FOMC, ECB and Bank of England are all being challenged by levels of persistent inflation that are exacerbated by very tight labour markets and high wage increases relative to what central banks believe to be sustainable.

Regarding PWLB borrowing rates, the various margins attributed to their pricing are as follows: -

- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

Link Group Interest Rate View	24.05.23												
	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26
BANK RATE	4.75	5.00	5.00	4.75	4.50	4.00	3.50	3.25	2.75	2.50	2.50	2.50	2.50
3 month ave earnings	4.80	5.00	5.00	4.80	4.50	4.00	3.50	3.30	2.80	2.50	2.50	2.50	2.50
6 month ave earnings	5.10	5.20	5.10	4.90	4.50	3.90	3.40	3.20	2.90	2.60	2.60	2.60	2.60
12 month ave earnings	5.40	5.40	5.30	5.00	4.50	3.90	3.40	3.20	2.90	2.70	2.70	2.70	2.70
5 yr PWLB	5.00	5.00	5.00	4.80	4.50	4.10	3.70	3.50	3.30	3.20	3.20	3.10	3.10
10 yr PWLB	5.00	5.00	5.00	4.80	4.40	4.10	3.80	3.60	3.50	3.40	3.30	3.30	3.30
25 yr PWLB	5.30	5.30	5.20	5.10	4.80	4.50	4.20	4.00	3.80	3.70	3.60	3.60	3.60
50 yr PWLB	5.10	5.10	5.00	4.90	4.60	4.30	4.00	3.80	3.60	3.50	3.40	3.40	3.40

Link Group Interest Rate View	08.01.24												
	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	5.25	5.25	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	4.80	4.30	3.80	3.30	3.00	3.00	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.20	5.10	4.60	4.10	3.70	3.30	3.10	3.10	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.00	4.90	4.40	3.90	3.60	3.20	3.10	3.10	3.10	3.10	3.10	3.20	3.20
5 yr PWLB	4.50	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.60	3.50	3.50	3.50
10 yr PWLB	4.70	4.50	4.40	4.30	4.20	4.10	4.00	3.90	3.80	3.70	3.70	3.70	3.70
25 yr PWLB	5.20	5.10	4.90	4.80	4.60	4.40	4.30	4.20	4.20	4.10	4.10	4.10	4.10
50 yr PWLB	5.00	4.90	4.70	4.60	4.40	4.20	4.10	4.00	4.00	3.90	3.90	3.90	3.90

6.2 Borrowing strategy and control of interest rate risk

During 2023/24, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as although near-term investment rates were equal to, and sometimes higher than, long-term borrowing costs, the latter are expected to fall back through 2024 and 2025 as inflation concerns are dampened. The Council has sought to minimise the taking on of long-term borrowing at elevated levels (>4%) and has focused on a policy of internal and temporary borrowing, supplemented by short-dated borrowing (<5 years) as appropriate.

Interest rate forecasts initially suggested further gradual rises in short, medium and longer-term fixed borrowing rates during 2023/24. Bank Rate had initially been forecast to peak at 4.5% but it is now expected to have peaked at 5.25%.

By January it had become clear that inflation was moving down significantly from its 40-year double-digit highs, and the Bank of England signalled in March 2024 that the next move in Bank Rate would be down, so long as upcoming inflation and employment data underpinned that view. Currently the CPI measure of inflation stands at 3.4% but is expected to fall materially below 2% over the summer months and to stay there in 2025 and 2026. Nonetheless, there remains significant risks to that central forecast, mainly in the form of a very tight labour market putting upward pressure on wages and continuing geo-political inflationary risks emanating from the prevailing Middle East crisis and the Russian invasion of Ukraine.

Section 7 Borrowing Outturn

7.1 During 2023/24 the Council funded part of the capital borrowing requirement in the short-term market, with temporary borrowing of £71.000m, in March 2024. However, additional long-term borrowing (PWLB) of £31.000m was also undertaken, taking advantage of lower interest rates and gaps in the borrowing maturity profile. The Council were in an under-borrowed position of £58,801m for 2023/24. The Council has not borrowed more than, or in advance of its needs, purely to profit from the investment of the extra sums borrowed.

7.2 During 2024/25 focus will be on monitoring longer term rates and looking to borrow longer term to meet the CFR when appropriate and at the same time consider some short-term borrowing where rates are suitable.

7.2 During 2023/24 the actual borrowing and repayments of external debt transacted are shown in Table 10 below. This shows temporary borrowing slightly decreased and mid-term borrowing has increased. Longer-term borrowing has been undertaken when rates have allowed, a prudent position in the current interest rate environment. The Council's policy is to ensure that not more than 25% of long-term loans are due to mature within any financial year. The indicator for maturing debt of 22% (within one year) is 3% below the maturity limit indicator.

Table 9

Loan Type	**Borrowed 2023/24 £'000**	**Repaid 2023/24 £'000**	**Net £'000**
PWLB	31,000	(725)	30,275
Market Loans	19,000	(3,000)	16,000
Temporary borrowing	71,000	(76,000)	(5,000)
	121,000	**(79,725)**	**41,275**

7.3 ***Debt Re-scheduling*** – no external debt was re-scheduled during 2023/24 as the average differential of 1% between PWLB new borrowing rates and premature redemption rates made early repayment of loans expensive and unviable due to the premiums that would be payable.

Section 8 Investment Out-turn, and Policy in 2023/24

8.1 The Council's investment policy is governed by Scottish Government investment regulations, which have been implemented in the annual investment strategy approved by the Council on 4 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.).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

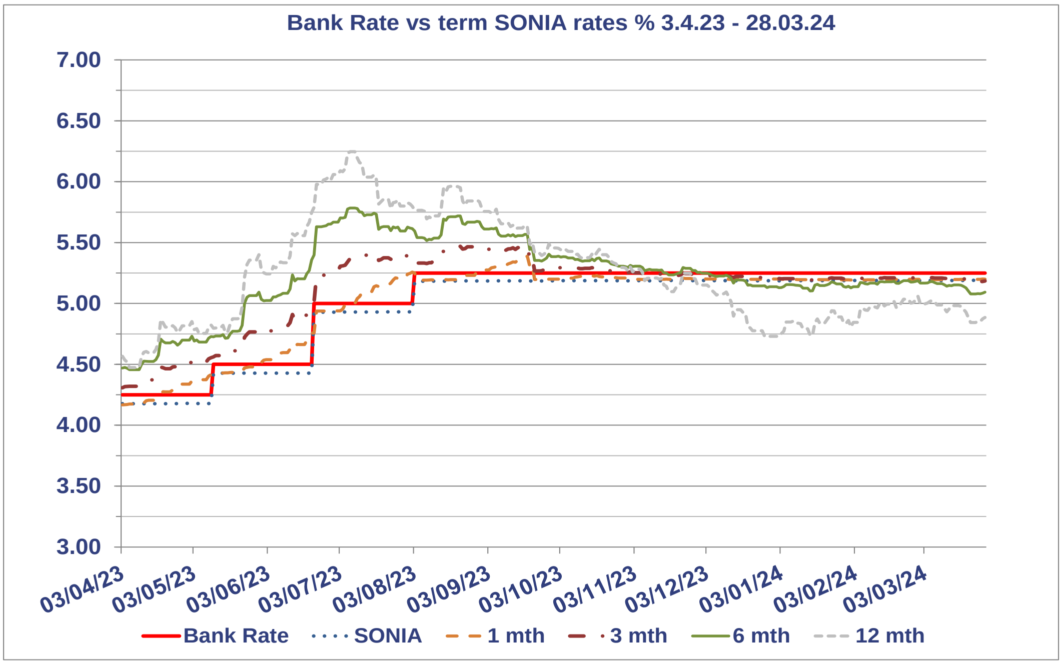
8.3 **Investment Out-turn –** the Council maintained an average balance of £51.506m of internally managed investment funds. The internally managed funds earned an average rate of return of 4.51%.

The comparable performance indicator is the 180d backward Sterling Overnight Index Average (SONIA) compounded rate which was 4.09%.

Table 10

	Average Value of Investments Held	***Rate of Return***	***Benchmark Return****
Investments	£51,506m	4.51%	4.09%

**The benchmark return used is the SONIA compounded rate of 4.09%.*



8.4 **Investment Policy** – the Council's investment policy is governed by Scottish Government investment regulations which have been implemented in the Annual Investment strategy approved by the Council on 4 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.).

The investment activity during the year met with the approved strategy, and the Council had no liquidity difficulties.

8.5 Current Council Investments held on 31 March 2024

Table 11

Class	Type	Start Date	Maturity Date	Counterparty	Profile	Rate	Principal £000
Deposit	Fixed	08/01/24	06/0125	Lancashire County Council	Maturity	5.75%	5,000
Fixed Total							**5,000**
Deposit	MMF	01/12/17	-	Federated Prime Rate Sterling Liquidity 3		5.29%	6,400
Deposit	MMF	30/06/20	-	Aberdeen Liquidity Fund - Sterling Fund Class L-1		5.27%	1,000
MMF Total							**7,400**
Deposit	VNAV	27/04/23	-	Federated Sterling Cash Plus Fund GBP 3 Acc		5.20%	29
VNAV Total							**29**
Deposit	Variable	10/05/2016	-	Bank of Scotland (Call A/c)	Variable	5.20%	13,955
Call Total							**13,955**
Overall Total							**26,384**

Section 9 Other Issues

9.1 **Sources of borrowing** - Although PWLB remains a low-risk source of long-term borrowing, due to recent rate changes and the ongoing consultation with local authorities on the future of PWLB borrowing other borrowing institutions may be looked at to remove the reliance on PWLB for long-term borrowing needs.

9.2 **Changes in risk appetite** - The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. South Ayrshire Council has a low-risk appetite and as such would look at all aspects before making any changes to the current strategy and members would be made fully aware of any such changes.

9.3 **IFRS 16** - The implementation of IFRS 16 bringing currently off-balance sheet leased assets onto the balance sheet is being implemented during 2024/25. Work has begun in this area in 2023/24 and will be progressing throughout 2024/25.

Appendix 2

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: https://www.south-ayrshire.gov.uk/equalities/impact-assessment.aspx

Further guidance is available here: https://www.equalityhumanrights.com/en/publication-download/assessing-impact-and-public-sector-equality-duty-guide-public-authorities/

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 Annual Report 2023/24**
Lead Officer (Name/Position/Email)	Tim Baulk, Chief Financial Officer Tim.Baulk@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	No	No
Disability	No	No
Gender Reassignment (Trans/Transgender Identity)	No	No
Marriage or Civil Partnership	No	No
Pregnancy and Maternity	No	No
Race – people from different racial groups, (BME) ethnic minorities and Gypsy/Travellers	No	No
Religion or Belief (including lack of belief)	No	No
Sex – gender identity (issues specific to women & men or girls & boys)	No	No
Sexual Orientation – person's sexual orientation i.e. LGBT+, lesbian, gay, bi-sexual, heterosexual/straight	No	No
Thematic Groups: Health, Human Rights & Children's Rights	No	No

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	No	No
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	No	No
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	No	No
Area Deprivation – where you live (rural areas), where you work (accessibility of transport)	No	No
Socio-economic Background – social class i.e. parent's education, employment and income	No	No

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 Impact
Advance equality of opportunity between people who share a protected characteristic and those who do not	Low Impact
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 Impact
Increase participation of particular communities or groups in public life	Low Impact
Improve the health and wellbeing of particular communities or groups	Low Impact
Promote the human rights of particular communities or groups	Low Impact
Tackle deprivation faced by particular communities or groups	Low Impact

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:

This report presents to the Panel the annual report of treasury management activities for 2023/24 Their decision on this has no specific equality implications.

Signed: Tim Baulk Chief Financial Officer

Date: 21 May 2024