Agenda Item No. 6(e)

South Ayrshire Council

Report by Head of Finance, ICT and Procurement to Cabinet of 29 August 2023

Subject: Treasury Management Annual Report 2022/23

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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 2022/23 (as attached at Appendix 1) and seek Members' consideration of its contents.

2. Recommendation

2.1 It is recommended that the Cabinet approves the Annual Treasury Management Report 2022/23, as attached at Appendix 1.

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 Head of Finance, ICT and Procurement 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 Cabinet.

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.***

3.5 The Audit and Governance Panel of 28 June 2023 considered the Annual Treasury Management Report 2022/23 (attached at Appendix 1) and agreed that it be remitted to the Cabinet for approval.

4. Proposals

4.1 The Treasury Management Annual Report for 2022/23 is submitted to Cabinet for approval in accordance with the requirements of the CIPFA Code of Practice on Treasury Management.

4.2 ***Executive Summary***

During 2022/23, 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	***2021/22 Actual £'000***	***2022/23 Actual £'000***
Capital Expenditure	**89,463**	**119,064**
Total Capital Financing Requirement (including other long-term liabilities)	399,006	484,610
PPP and Finance Lease	(95,777)	(91,951)
Underlying Borrowing Requirement	**303,229**	**392,659**
Gross External Debt	289,434	355,385
Under (Over) Borrowed	13,795	37,274
Cash/Investments	(72,105)	(43,155)
Net External Debt	**217,329**	**312,230**

4.3 The table above shows that the Council has an under-borrowed position on 31 March 2023 of £37.274m, c 9.5%. This means the Council has used some 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 9.49% of its overall under-lying borrowing requirement and is therefore manageable within the current strategy. The strategy for 2023/24 is expected to maintain a marginal 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 Head of Finance, ICT and Procurement also confirms that any borrowing was only undertaken for capital purpose and the statutory borrowing limit (the authorised limit) was not breached during 2022/23.

4.6 The financial year 2022/23 remained a challenging environment due to volatile interest rates with several rate increases throughout 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 £0.114m in interest income (based on a return of 1.00%) to the General Fund in 2022/23. Interest rates for investment increased throughout 2022-23, with the strategy outperforming both budget and benchmark return resulting in an investment surplus.

Investment income to the General Fund out turned at £1.009m, a surplus of £0.895m. Interest was also received to the Council's Repairs and Renewals Fund, Insurance Fund and Capital Fund to the value of £0.082m.

6.1.2 **Capital Financing Costs** - the Council originally budgeted £12.747m for financing costs and expenses on debt for 2022/23. This budget consisted of £5.870m in loan principal, £6.699m in interest and £0.178m in expenses. During 2022/23, a pragmatic approach was taken when considering the borrowing requirements to fund capital expenditure. However, even with this the borrowing strategy during 2022/23 resulted in an overspend as under-noted:

	Budget £'000	**Out-turn £'000**	**Variance £'000**
Principal	5,870	5,889	(19)
Interest	6,699	8,033	(1,334)
Expenses	178	295	(117)
Capital Financing costs	**12,747**	**14,217**	**(1,470)**
Investment income	**(114)**	**(1,009)**	**895**
Total Debt charges	**12,633**	**13,208**	**(575)**

The borrowing strategy undertaken in 2022/23 resulted in an overall overspend to the General Services of £0.575m. This is due to the increase in interest rates throughout 2022-23 due to high inflation rates, cost of living crisis and war in Ukraine. This is discussed further in the Economic Commentary. The overall overspend was reduced due to the investment strategy overperforming.

6.2 *Housing Revenue Account (HRA)*

6.2.1 **Interest on HRA Revenue Balances Held** – the HRA budgeted to receive investment income of £0.050m on its revenue balances in 2022/23 based on achieving an interest rate of 1.00%. Like the General Fund the investment strategy was able to out-perform both budget and benchmark resulting in a return of £0.214m in investment income a surplus of £0.164m.

6.2.2 **Capital Financing Costs** - the HRA budgeted £3.918m for financing costs on debt for 2022/23. This consisted of £1.356m in loan principal, £2.496m in interest and £0.066m in expenses.

	Budget £'000	**Out-turn £'000**	**Variance £'000**
Principal	1,356	1,349	7
Interest	2,496	2,376	120
Expenses	66	87	(21)
Capital Financing costs	**3,918**	**3,812**	**106**
Investment income	**(50)**	**(214)**	**164**
	3,868	**3,598**	**270**

The borrowing strategy undertaken in 2022/23 resulted in an overall saving to the HRA of £0.270m.

6.3 In total, net debt financing costs were overspent by £1,364m, and when added to an over achievement in interest income of £1,059m resulted in an overall deficit of £0.305m which was reflected in the Council and HRA financial position at 2022/23.

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.

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 Local Authorities**

Report to South Ayrshire Council of 3 March 2022 - Treasury Management and Investment Strategy 2022-23

Report to South Ayrshire Council of 17 January 2023 – Treasury Management and Investment Strategy Mid-year Report 2022-23

Report to Audit and Governance Panel of 28 June 2023 – Treasury Management Annual Report 2022/23

Person to Contact **Tim Baulk, Head of Finance, ICT and Procurement**
County Buildings, Wellington Square, Ayr, KA7 1DR
Phone 01292 612620
Email tim.baulk@south-ayrshire.gov.uk

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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 2022/23.
- Section 2 – The Council's overall borrowing need.
- Section 3 – Treasury Position as of 31 March 2023.
- Section 4 – The Strategy for 2022/23.
- Section 5 – The Economy and Interest Rates
- Section 6 – Borrowing Rates 22022/23
- Section 7 – Borrowing Outturn 2022/23
- Section 8 – Investment Outturn 2022/23
- Section 9 – Other Issues

Section 1 The Council's Capital Expenditure and Financing 2022/23

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	***2021/22 Actual £'000***	***2022/23 Estimate per Strategy***	***2022/23 Actual***
General Fund capital expenditure	66,230	128,120	90,749
HRA capital expenditure	23,233	64,208	28,315
Total	**89,463**	**192,328**	**119,064**
Resourced by:			
Government Grant & Other	(10,040)	(10,580)	(22,818)
Other funding identified	(20,339)	(19,128)	(23,369)
Borrowing:	**59,084**	**162,620**	**72,877**

1.3 The reason for the movement between planned expenditure/funding and actual out-turns for 2022/23 can be found in the General Services and HRA 2022/23 capital monitoring reports presented to Cabinet throughout 2022/23. The largest examples (by value) of reprofiling or reduction in spend being:

- ICT infrastructure and business systems projects - £2.5m
- Green Waste and Household Recycling Site – £1.7m
- Ayrshire Growth Deal - £3.8m
- Hangar Space - £1.75m
- Office and Welfare Building £1.25m
- Net Zero Projects - £0.5m
- HRA Major component replacement programme - £2.5m
- HRA External Fabric Upgrade project - £3m
- HRA New Build Housing - £18.6m
- New Leisure Centre - £21m

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 2022/23 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 2022/23 prudent repayment policy, (as required by Scottish Government), was approved as part of the Treasury Management Strategy Report for 2022/23 on 04/03/2022.

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 required against these schemes as a borrowing facility is included in the contract.

Full Council agreed a report in meeting of 15th December 2022 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 would increase the Capital Financing Requirement (CFR) by £21.720m as of 1 April 2022. The Council has made this adjustment in the current 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.

Based on above the Council has £91.951m of such schemes within the CFR as of 31 Mar 2023.

The undernoted table shows the Council's underlying borrowing requirement, inclusive of PPP and Finance lease arrangements, as of 31 March 2023.

Table 2

Capital Financing Requirement	**31 Mar 2022 £'000**	**31 Mar 2023 £'000**
Opening Balance	**350,157**	**399,006**
Add unfinanced capital expenditure	59,084	72,877
Add new OLTL obligations (PPP)	0	0
Retrospective PPP adjustment	0	21,720
PPP in year adjustment	0	2,071
Less loans fund repayment	(6,445)	(7,238)
Less PPP/ finance lease repayment	(3,790)	(3,826)
Closing Balance	**399,006**	**484,610**

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 2022/23 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 (2022/23) plus the estimates of any additional capital financing requirement for the current (2023/24) 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 2022/23.

The table below highlights the Council's gross borrowing position against the CFR.

Table 3

Item	***31 March 2022 £'000***	***31 March 2023 £'000***
Capital Financing Requirement (CFR)	399,006	484,610
Gross External Borrowing Position (including PPP and finance Lease)	385,211	447,336
Net Under/ (Over) Borrowed Position	**13,795**	**37,274**

The table above shows the CFR in an under-borrowed position on 31 March 2023 of £37.274m. This means the Council has used some 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 2022/23 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/

Table 4

Item	*2021/22 £'000*	*2022/23 £'000*
Authorised Borrowing Limit External Debt	**474,726**	**635,929**
Borrowing	289,434	355,385
Other Long-Term Liabilities	95,777	91,951
Total	**385,211**	**447,336**
Operational Boundary External Debt	**425.211**	**487,336**
Borrowing	289,434	355,385
Other Long-Term Liabilities	95,777	91,951
Total	**385,211**	**447,336**

Table 5

Ratio of Financing Costs to Net Revenue Stream	*Actual 2021/22*	*Estimated 2022/23*
General Services	5.48%	6.06%
HRA	10.79%	10.96%
Total	**6.15%**	**6.69%**

Section 3 Treasury Position as of 31st March 2023

3.1 The Council's treasury management debt and investment position are organised by the treasury management service 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 2022/23 the Council 's treasury, (excluding borrowing by PFI and finance leases), position was as follows:

Table 6

	Borrowing position as of 31 March 2022		*Borrowing position as of 31 March 2023*		*Change in year*
	£'000	*Average interest rate %*	*£'000*	*Average interest rate %*	*£'000*
Long Term Borrowing					
Public Works Loans Board	178,233	3.51	211,185	3.13	32,952
Market – Fixed	8,000	0.52	28,000	2.33	20,000
LOBO (Option Loans)	41,200	4.52	41,200	4.52	0
Total Long-Term Borrowing	**227,433**		**280,385**		**52,952**
Short Term Borrowing	62,000	0.21	75,000	2.36	13,000
Total External Borrowing	**289,434***	**2.19**	**355,385***	**3.09**	**65,951**
CFR (underlying borrowing need)	303,229		368,868		65,639
Over (Under) Borrowing	**(13,795)**		**(13,483)**		**312**
Investments	**(72,105)**	**0.64**	**(43,155)**	**1.35**	**28,950**

* The carrying amount of loans on the Council's balance sheet as of 31 March 2023 is £356.207m. The difference between this figure and the external borrowing shown in Table 6 above is £0.823m 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 2023.

Table 7

Maturity analysis of Debt Outstanding on 31 March 2023	*PWLB £'000*	*Market £'000*	*LOBO (Option) £'000*	*Temp Borrowing*	*Total £'000*
Maturing within 1 year	2,588	3000	3000	75,000	83,588
Maturing 1 to 2 years	1,702	10,000	0	0	11,702
Maturing 2 to 5 years	4,900	15,000	0	0	19,900
Maturing 5 to 10 years	17,519	0	7,000	0	24,519
Maturing 10 to 20 years	31,800	0	1,500	0	33,300
Maturing 20 to 30 years	14,009	0	5,000	0	19,009
Maturing 30 to 40 years	61,166	0	5,000	0	66,166
Maturing 40 to 50 years	77,500	0	9,700	0	87,200
Maturing > 50 years	0	0	10,000	0	10,000
Total	***211,184***	***28,000***	***41,200***	***75,000***	***355,384***

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 2022 (£'000)**	**31 March 2023 (£'000)**
Opening Balance	179,292	226,125
Add advances	52,028	62,536
Less repayments	(5,196)	(5,889)
Closing Balance	**226,124**	**282,771**

Table 8(a) – Loans Fund Advances to HRA

Loans Fund	**31 March 2022 (£'000)**	**31 March 2023 (£'000)**
Opening Balance	68,794	74,601
Add advances	7,046	3,854
Less repayments	(1,249)	(1,349)
Closing Balance	**74,591**	**77,106**

Section 4 Strategy for 2022/23

4.1 Investment returns picked up throughout the course of 2022/23 as central banks, including the Bank of England, realised that inflationary pressures were not transitory, and that tighter monetary policy was called for.

Starting April at 0.75%, Bank Rate moved up in stepped increases of either 0.25% or 0.5%, reaching 4.25% by the end of the financial year, with the potential for a further one or two increases in 2023/24.

The change in investment rates meant local authorities were faced with the challenge of the investment of surplus cash for the first time in over a decade. It has increased the need for detailed cashflow projection to retain the appropriate balance between maintaining cash for liquidity purposes and taking advantage of improved investment rates.

With bond markets selling off, equity valuations struggling to make progress and, latterly, property funds enduring a difficult Q4 2022, the more traditional investment options, such as specified investments (simple to understand, and less than a year in duration) became more actively used in 2022-23.

Meantime, through the autumn, and then in March 2023, the Bank of England maintained various monetary policy easing measures as required to ensure specific markets, the banking system and the economy had appropriate levels of liquidity at times of stress.

Nonetheless, while the Council has taken a cautious approach to investing, 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 Great Financial Crisis of 2008/9. 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 extreme stressed market and economic conditions.

Section 5 Economy and Interest Rates

5.1 UK Economy

Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022/23.

Market commentators' misplaced optimism around inflation has been the root cause of the rout in the bond markets with, for example, United Kingdom (UK), Eurozone (EZ) and United Sates (US) 10-year yields all rising by over 200bps in 2022. The table below provides a snapshot of the conundrum facing central banks: inflation is elevated but labour markets are extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needs to tighten.

	UK	Eurozone	US
Bank Rate	4.25%	3%	4.75%-5%
GDP	0.1%q/q Q4 (4.1%y/y)	+0.1%q/q Q4 (1.9%y/y)	2.6% Q4 Annualised
Inflation	10.4%y/y (Feb)	6.9%y/y (Mar)	6.0%y/y (Feb)
Unemployment Rate	3.7% (Jan)	6.6% (Feb)	3.6% (Feb)

Q2 of 2022 saw UK Gross Domestic Product (GDP) deliver growth of +0.1% q/q, but this was quickly reversed in the third quarter, albeit some of the fall in GDP can be placed at the foot of the extra Bank Holiday in the wake of the Queen's passing. Q4 GDP was positive at 0.1% q/q. Most recently, January saw a 0.3% m/m increase in GDP as the number of strikes reduced compared to December. In addition, the resilience in activity at the end of 2022 was, in part, due to a 1.3% q/q rise in real household disposable incomes. A big part of that reflected the £5.7bn payments received by households from the government under the Energy Bills Support Scheme.

Nevertheless, Consumer Price Index inflation (CPI) picked up to what should be a peak reading of 11.1% in October, although hopes for significant falls from this level very much rested on the movements in the gas and electricity markets, as well as the supply-side factors impacting food prices. On balance, most commentators expect the CPI measure of inflation to drop back towards 4% by the end of 2023. As at February 2023, CPI was 10.4% and the most recent announcement on 24 May 2023 CPI reduced to 8.7% in April 2023.

The UK unemployment rate fell through 2022 to a 48-year low of 3.6%, and this was despite a net migration increase of c500k. The fact remains, however, that with many economic participants registered as long-term sick, the UK labour force shrunk by c500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at over 6% the Monetary Policy Committee (MPC) will be concerned that wage inflation will prove tricky as major supply-side shocks to food (up 18.3% y/y in February 2023) and energy that have endured since Russia's invasion of Ukraine on 22 February 2022.

Bank Rate increased steadily throughout 2022/23, starting at 0.75% and finishing at 4.25%.

In the interim, following a Conservative Party leadership contest, Liz Truss became Prime Minister for a tumultuous seven weeks that ran through September and October. Put simply, the markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and their reign lasted barely seven weeks before being replaced by Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Their Autumn Statement of the 17th of November gave rise to a net £55bn fiscal tightening, although much of the "heavy lifting" has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have reversed the increases seen under the previous tenants of No10/11 Downing Street, although they remain elevated in line with developed economies generally.

As noted above, GDP has been tepid throughout 2022/23, although the most recent composite Purchasing Manager Indices for the UK, US, EZ and China have all surprised to the upside, registering survey scores just above 50 (below suggests economies are contracting, and above suggests expansion). Whether that means a shallow recession, or worse, will be avoided is still unclear. Ultimately, the Monetary Policy Committee will want to see material evidence of a reduction in inflationary pressures and a loosening in labour markets. Realistically, that is an unlikely outcome without unemployment rising and wage settlements falling from their current levels. At present, the bigger rise in employment kept the International Labour Organization unemployment rate unchanged at 3.7% in January. Also, while the number of job vacancies fell for the ninth consecutive month in February, they remained around 40% above pre-pandemic levels.

Our economic analysts, Capital Economics, expect real GDP to contract by around 0.2% q/q in Q1 and forecast a recession this year involving a 1.0% peak-to-trough fall in real GDP.

The pound has remained resilient of late, recovering from a record low of $1.035, on the Monday following the Truss government's "fiscal event", to $1.23. Notwithstanding the pound's better run of late, 2023 is likely to see a housing correction of some magnitude as fixed-rate mortgages have moved above 4.5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.

As for equity markets, the FTSE 100 started 2023 strongly, rising to a record high of 8,014 on 20th February, as resilient data and falling inflation boosted earnings. But global equities fell sharply after concerns over the health of the global banking system emerged early in March. The fall in the FTSE 100 was bigger than the drop in the US S&P 500. Indeed, at around 7,600 now, the FTSE is 5.2% below its record high on 20th February, while the S&P 500 is only 1.9% lower over the same period. That's despite UK banks having been less exposed and equity prices in the UK's financial sector not falling as far. It may be due to the smaller decline in UK interest rate expectations and bond yields, which raise the discounted value of future earnings, compared to the US.

USA. The main comments from Federal Reserve (Fed) officials over recent months suggest there is still an underlying combative theme to their outlook for interest rates. Markets are pricing in a further interest rate increases of 25-50bps, on top of the current interest rate range of 4.75% - 5%.

In addition, the Fed is expected to continue to run down its balance sheet once the on-going concerns about some elements of niche banking provision are in the rear-view mirror.

As for inflation, it is currently at c6% but with the economy expected to weaken during 2023, and wage data already falling back, there is the prospect that should the economy slide into a recession of any kind there will be scope for rates to be cut at the backend of 2023 or shortly after.

EU. Although the Euro-zone inflation rate has fallen below 7%, the European Central Bank (ECB) will still be mindful that it has further work to do to dampen inflation expectations and it seems destined to raise rates to 4% in order to do so. Like the UK, growth has remained more robust than anticipated but a recession in 2023 is still seen as likely by most commentators.

Section 6 Borrowing Rates in 2022/23

6.1 ***PWLB Borrowing Rates -***

HIGH/LOW/AVERAGE PWLB RATES FOR 2022/23

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.95%	2.18%	2.36%	2.52%	2.25%
Date	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
High	5.11%	5.44%	5.45%	5.88%	5.51%
Date	28/09/2022	28/09/2022	12/10/2022	12/10/2022	28/09/2022
Average	3.57%	3.62%	3.76%	4.07%	3.74%
Spread	3.16%	3.26%	3.09%	3.36%	3.26%

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 persistent inflation that is 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 20.12.21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.20	0.30	0.50	0.50	0.60	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
10 yr PWLB	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
25 yr PWLB	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50
50 yr PWLB	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30

Link Group Interest Rate View 27.03.23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26
BANK RATE	4.50	4.50	4.25	4.00	3.50	3.25	3.00	2.75	2.75	2.50	2.50	2.50
3 month ave earnings	4.50	4.50	4.30	4.00	3.50	3.30	3.00	2.80	2.80	2.50	2.50	2.50
6 month ave earnings	4.50	4.40	4.20	3.90	3.40	3.20	2.90	2.80	2.80	2.60	2.60	2.60
12 month ave earnings	4.50	4.40	4.20	3.80	3.30	3.10	2.70	2.70	2.70	2.70	2.70	2.70
5 yr PWLB	4.10	4.10	3.90	3.80	3.70	3.60	3.50	3.40	3.30	3.20	3.20	3.10
10 yr PWLB	4.20	4.20	4.00	3.90	3.80	3.70	3.50	3.50	3.40	3.30	3.30	3.20
25 yr PWLB	4.60	4.50	4.40	4.20	4.10	4.00	3.80	3.70	3.60	3.50	3.50	3.40
50 yr PWLB	4.30	4.20	4.10	3.90	3.80	3.70	3.50	3.50	3.30	3.20	3.20	3.10

6.2 Borrowing strategy and control of interest rate risk

During 2022/23, 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 investment returns were initially low and minimising counterparty risk on placing investments also needed to be considered.

A cost of carry generally remained in place during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns. As the cost of carry dissipated, the Council sought to avoid taking on long-term borrowing at elevated levels (>4%) and has focused on a policy of internal and temporary borrowing, supplemented by short-dated borrowing (<3 years) as appropriate.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Head of Finance, ICT and Procurement therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks. Due to the increase in borrowing rates in the last two quarters of 22/23 there has been a move to more short-term borrowing. Interest rates are forecast to fall towards the end of 2024 when longer term borrowing rates may be more advantageous.

Interest rate forecasts were initially suggesting only gradual rises in short, medium and longer-term fixed borrowing rates during 2022/23 but by August it had become clear that inflation was moving up towards 40-year highs, and the Bank of England engaged in monetary policy tightening at every Monetary Policy Committee meeting during 2022, and into 2023, either by increasing Bank Rate by 0.25% or 0.5% each time. Currently the CPI measure of inflation is still above 10% in the UK but is expected to fall back towards 4% by year end. Nonetheless, there remain significant risks to that central forecast.

7. Borrowing Outturn

7.1 During 2022/23 the Council funded part of the capital borrowing requirement in the short-term market, increasing temporary borrowing to £75.000m, in March 2023. However, additional long-term borrowing (PWLB) of £35.000m was also undertaken, taking advantage of low interest rates and gaps in the borrowing maturity profile. The Council were in an under-borrowed position of £13,795m for 2022/23. 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 2023/24 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.

7.3 During 2022/23 the actual borrowing and repayments of external debt transacted are shown in Table 10 below. This shows temporary borrowing being increased and longer-term borrowing being undertaken, a prudent position in the current interest rate environment. The Council's policy is to ensure that no 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 2022/23 £'000**	**Repaid 2022/23 £'000**	**Net £'000**
PWLB	35,000	(2,049)	32,951
Market Loans	0	0	0
Temporary borrowing	94,000	(81,000)	13,000
	129,000	**(83,049)**	**45,951**

7.4 ***Debt Re-scheduling*** – no external debt was re-scheduled during 202/23 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 2022/23

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 3rd March 2023. 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.

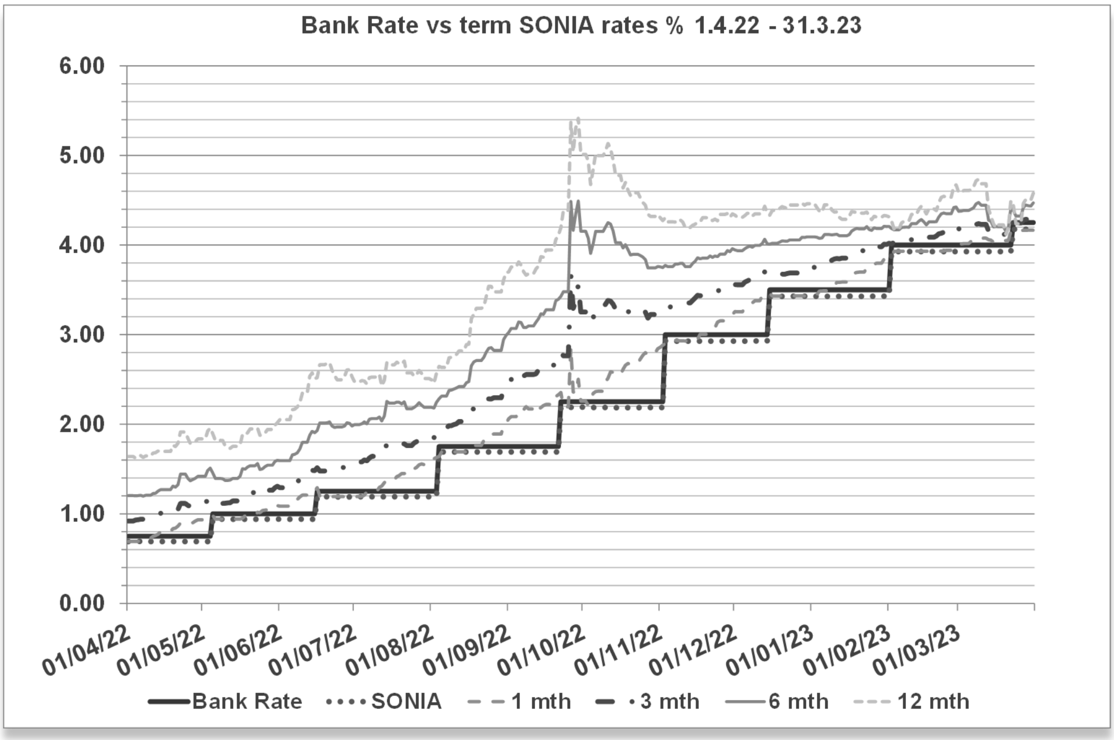
8.3 **Investment Out-turn –** the Council maintained an average balance of £74.7 of internally managed investment funds. The internally managed funds earned an average rate of return of 1.35%.

The comparable performance indicator is the average 90 day SONIA compounded rate which was 1.38%.

Table 10

	Average Value of Investments Held	***Rate of Return***	***Benchmark Return****
Investments	£74.669	1.35%	1.38%

**The benchmark return used is the 90-day SONIA compounded rate of 1.3804%.*



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 3 March 2023. 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 2023**

Table 11

Class	Type	Start Date	Maturity Date	Counterparty	Profile	Rate	Principal £000
Deposit	Fixed	15/08/22	14/08/23	Slough Borough Council	Maturity	2.20%	5,000,000
Deposit	Fixed	30/08/22	29/08/23	Slough Borough Council	Maturity	2.25%	5,000,000
Deposit	Fixed	05/09/22	04/09/23	London Borough Of Croydon	Maturity	2.30%	5,000,000
Deposit	Fixed	30/09/22	29/09/23	London Borough Of Croydon	Maturity	2.30%	5,000,000
Deposit	Fixed	06/02/23	05/02/24	Blackpool Borough Council	Maturity	4.10%	5,000,000
Deposit	Fixed	09/01/23	08/01/24	Eastleigh Borough Council	Maturity	4.75%	5,000,000
Fixed Total							**30,000**
Deposit	Variable	10/05/2016	-	Bank of Scotland (Call A/c)	Variable	4.25	13,155,000
Call Total							**13,155**
Overall Total							**43,155**

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 has had an additional delay and not now due to be implemented till 2024/25. Work will be progressing in this area throughout 2023/24 which should make future requirements easier to implement.

Appendix 2

South Ayrshire Council
Comhairle Siorrachd Àir a Deas
Making a Difference Every Day

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. FSD Guidance for Public Bodies in respect of the Duty, was published by the Scottish Government in March 2018 and revised in October 2021. See information here: https://www.gov.scot/publications/fairer-scotland-duty-guidance-public-bodies/

1. Policy details

Policy Title	Treasury Management Annual Report 2022/23
Lead Officer (Name/Position/Email)	Tim Baulk, Head of Finance, ICT and Procurement – 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	-	-
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 – (issues specific to women & men or girls & boys)	-	-

Community or Groups of People	Negative Impacts	Positive impacts
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 i.e. The Fairer Scotland Duty (This section to be completed for any Strategic Decisions). 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	-	-
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: **This report presents to the Cabinet the annual report of treasury management activities for 2022/23 Their decision on this has no specific equality implications**	
Signed : Tim Baulk **Head of Service** **Date:** 11 July 2023	