Review of Treasury Management Activities 2023/24

Overview Select Committee

Date of Meeting: 31 July 2024

Lead director: Amy Oliver, Director of Finance

Useful information

- Ward(s) affected:
- Report author: Nick Booth, Treasury and Investments Manager
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- Report version number: 1

1. Summary

1.1 This report reviews how the Council conducted its borrowing and investments during 2023/24.

1.2 The year started with interest rates at a base rate of 4.25% and an expectation that they would continue to rise slightly to counter high inflation. Rates rose to 5.25% by August 2023 and remained at this level for the rest of the financial year. This rise in interest rates has benefitted the Council from a treasury management perspective (unlike many other authorities) because our loan debt is held at fixed rates for long periods, and we earn extra interest on our cash balances, although the effect is likely to be temporary as balances reduce.

1.3 Looking ahead, inflation is expected to fall to the Bank of England target of 2% (although with a possible temporary bounce back up after energy price falls have been fully reflected). Interest rates are expected to reduce gradually, although not to the earlier historically low levels.

2 Recommendations

2.1 Members of the Overview Select Committee are recommended to note the report and make comments to the Director of Finance and the Executive as they wish.

3. Background

3.1 Treasury management is the process by which our borrowing is managed, and our cash balances are invested. Whilst there are links to the budget approved annually by Council, the sums in this report do not themselves form part of the budget. Cash balances reported here cannot be used to finance expenditure. Rather, measures approved by Council such as drawing on managed reserves to help support the budget and incurring capital spending funded by prudential borrowing translate to a planned and approved call on cash balances.

3.2 The Council has incurred long term loan debt to pay for past capital expenditure.

3.3 The Council needs cash balances to meet day-to-day expenditure, such as to pay wages and suppliers when they are due. Substantial cash has however accumulated from funds set aside in the annual budget to repay the long-term loans. Because of Government rules regards repayment of loans from the Public Works Loans Board (PWLB), it has historically been prohibitively expensive to repay such debt early. This cash has therefore been invested, and more recently used as ‘internal borrowing’ for new capital spending not funded by grants, rather than taking out new loans (such as for new council housing). However, we were able to repay a loan to Barclays in April 2023, this being the first loan repayment for many years.

3.4 The report commences with an overview of treasury management, including loans and investments at key dates. It then reviews the credit worthiness of investments and implementation of our strategy, provides outcomes on key performance measures, and concludes by reviewing compliance against limits set by the Council.

3.5 Reports reviewing treasury management activities are submitted twice a year. The previous report was presented to this Committee on 14 December 2023.

4. **Overview of Treasury Management**

Main elements of Treasury Management

4.1 There are two main elements to treasury management. The first is managing our borrowings which were used to finance past capital expenditure. Most capital schemes have for some time been financed by capital grant, and only a limited number of recent schemes have been financed by prudential borrowing. These are generally those which pay for themselves, together with part-financing the acquisition and construction of new council housing in the Housing Revenue Account (HRA). In the past, the Government expected us to borrow but allowed for the cost of financing the borrowing in our annual revenue grant settlement, and we still have loan debt which was taken to meet this capital expenditure.

4.2 Whilst the Council has not borrowed long-term for more than 15 years, it is expected that we may do so again in the future as reserves are used to support the revenue budget and the capital programme progresses including the ongoing significant investment in new council housing. These are leading to on-going reductions in cash balances.

4.3 Historic debt can sometimes be restructured to save money (i.e. repaying one loan and replacing it with another) and this is always given active consideration. However, Government rules had previously made it prohibitively expensive to repay loans borrowed from the PWLB earlier than the maturity date. The rise in long term interest rates means that repaying loans has become a realistic proposition for the first time in several years. However, as the Council's cash balances are now reducing significantly, and capital spending funded by prudential borrowing is approved, any repayments would likely be as part of an overall longer-term debt refinancing and rescheduling exercise.

4.4 The revenue budget approved by the Council for each financial year includes provision for the interest payable on this borrowing. It also includes a provision for repaying the borrowing over a number of years (broadly speaking over the economic life of the assets acquired). As noted above, the actual loans have generally not been repaid, hence the funding set aside annually for repayment has contributed to cash balances.

4.5 The second element of treasury management is cash management which involves managing the Council's investments to ensure the optimum amount of money is in the bank account on a day-to-day basis – so that there is enough money in the account to cover the payments made on the day but no more (cash held in the bank account earns lower interest).

4.6 The Council has substantial (though falling) cash investments, but as noted above this is not of itself "spare cash". There are a number of key reasons for the level of cash:-

(a) As explained above, whilst the Government no longer supports capital spending with borrowing allocations, we are still required to provide money in the revenue budget each year to repay debt on past capital spending.

(b) We have working balances arising from our day-to-day business (e.g. council tax received before we have to pay wages and suppliers, and capital grants received in advance of the associated capital spending);

(c) We have reserves as shown in the annual budget report and the annual outturn report, which are essentially held in cash (or to underwrite 'internal borrowing' for new capital spending) until we need to spend them;

(d) We hold funds previously associated with our role as the accountable body to the former Leicester and Leicestershire Enterprise Partnership (LLEP). These are now held by the Council as the lead Upper Tier Local Authority for the post-LLEP arrangements.

(e) For some time, we have managed funds for the Combined Fire Authority.

4.7 There has been a very significant reduction in cash balances during the second half of the financial year as grants received for the capital programme have been spent, acquisitions of council housing have progressed and grant advances were repaid to Government. Balances have fallen by almost £100m, from £237m at September 2023 to £140m at March 2024 (balances at 31 March 2023 were £238m).

Treasury Management Policy and Monitoring

4.8 The activities to which this report relates were governed by the Treasury Strategy for 2023/24 which was approved by the Council on 22nd February 2023. This established an outline plan for borrowing and investment. The Treasury Strategy is drawn up in the light of the Council's expected borrowing requirements, its expected cash balances, the outlook for interest rates and the credit worthiness of the banks with whom the Council might invest its cash balances.

4.9 A twice-yearly report is submitted to this Committee reviewing the treasury activity undertaken in the year. This report is the second and final report for 2023/24.

Loans and Investments at Key Dates

4.10 Table 1 overleaf shows the loans (money borrowed by the Council) and investments (money invested by the Council) as at 30 September 2023 and at 31 March 2024. The rates shown are the averages paid and received during 2023/24.

4.11 The level of gross debt (total loans borrowed) remained the same during the second half of the year and no new long-term loans were borrowed during the year.

4.12 Our historic borrowing is predominantly from the Public Works Loans Board (PWLB), plus two historic bank loans. As discussed at para. 6.4 below, one of these was repaid in April 2023, shortly after the 2022/23 year-end. The other is a "LOBO" loan (Lender Option, Borrower Option). This is a £20m fixed rate loan but permits the lender to ask for a rate rise. We have the option to repay if they do. Members may be aware of some criticism of LOBOs nationally, principally in respect of authorities which have complex mechanisms for calculating interest rates; our LOBO is a simple scheme. The next option date (3 yearly) for this loan is January 2025 and unlike previous occasions it is possible that the lender may ask us for a rate rise. If a request is received, we would seriously consider repaying the loan.

4.13 Investments in the second half of the year have decreased significantly by £97m, from £237m at 30 September 2023 to £140m at 31 March 2024. This change reflects the usual pattern of balances declining towards the end of the financial year as grant income is spent. However, the decline during the second part of the financial year was somewhat greater than experienced in recent years. This was due at least in part to the repayment to Government of covid business grant advances, spending of capital grants and HRA expenditure on acquisition of council housing. By way of comparison to March 2023, balances at that time were £238m, essentially the same as at September 2023.

4.14 Since 2019/20, we have generally invested with other local authorities, rather than banks which have less protection for institutional investors. At the end of the 2023/24 financial year, the Council had no exposure to banks except to Barclays who act as our bankers. We may potentially in the future look to increase our deposits with banks if they can be secured by other assets.

4.15 The Council has continued to make use of money market funds which comprise a basket of short-dated loans to financial institutions. The funds that we use are very low risk and have very high credit ratings. We also use them because they are liquid (we can get money back when we need it). We have never lost any money in investing in these funds, but the downside of their safety is that returns are generally lower than some less secure alternatives.

Table 1- Loans & Investments

	Position at 30/09/2023 Principal £M	Position at 31/03/2024 Principal £M	Average Rate
Long Term Fixed Rate Loans			
Public Works Loan Board (PWLB)	134	134	4.2%
Bank Loans (repaid in April 2023)	NIL	NIL	
LOBO Loans			
Bank Loans	20	20	4.6%
Short Term (less than 6 months) Loans			
Local Authority Loans (repaid in April 2023)	NIL	NIL	
Gross Debt	**154**	**154**	**4.3%**
Treasury Investments			
Banks	0	0	
Other Local Authorities	162	98	
Money Market Funds	68	35	
Property Funds	7	7	
Total Treasury Investments	**237**	**140**	**3.37%**
NET INVESTMENTS	**83**	**(14)**	

4.16 The investments include £6.5m in two property unit trusts. These are unit trusts which invest in property, as opposed to more traditional unit trusts that invest in shares. The capital value has tended to be somewhat variable over the last few years and at March 2024 was £1.8m below their original purchase price of £8.3m in 2018. In practice, this has been offset by £1.7m of income over that period. Our strategy had been to hold the investments long term for income and short-term changes in capital values are not the prime focus of our investment.

4.17 The two funds are the Lothbury fund, where the valuation was £2.4m, £0.9m lower than the purchase price; and the Threadneedle Property fund, with a valuation of £4.1m which is also £0.9m lower than the original purchase price of £5m.

4.18 The Lothbury property fund was terminated on 30 May 2024. This means the fund is being wound up and as assets are sold the investors will receive repayment of their investment in instalments. The first repayment of £1.046m has been received in June 2024, which is approximately 43% of the termination valuation of the fund. The second repayment in July 2024 of £0.242m, brings the total repayment of investment to £1.288m. The sale of assets will continue, with fund managers anticipating that sales will conclude over the next year. Monies will be repaid each month to investors out of income and sale proceeds.

4.19 The dividends received on the units in the year totalled £327k (a return of 3.9% on the original investment).

4.20 The Treasury Strategy permits additional investments in property funds up to a total value of £30m, but no further such investments have been made during the last year. We do not expect to make any new property investments for the foreseeable future.

4.21 The Council's (Non-Treasury) Investment Strategy also allows the spending of capital or making of loans to a third party which are intended to (at least partly) achieve a return. Since 30 September 2023, the Council has not made any further loans to third parties. A summary of outstanding loans previously made under the Investment Strategy is shown in table 2 below.

<u>Table 2 - Loans under the Investment Strategy</u>

Loans	**Total loans outstanding At 31/03/2024 £m**	**Percentage Return 2023/2024**
<u>Loans</u>		
Ethically Sourced Products Ltd	1.0	4%
Leicestershire County Cricket Club Ltd	2.0	5%
Leicester Hockey Club CIC	0.4	5%
Leicester Community Sports Arena Ltd	1.3	5%
Total Loans	**4.7**	**4.8%**

4.22 The repayments of loans are in accordance with the agreements. It is expected that the loan to Ethically Sourced Products will be repaid in full by the end of 2025.

5. Credit Worthiness of Investments & Interest Rate Outlook

5.1 During 2023/24 we continued to see uncertainty in the economy. However, despite this, we did not see the financial system fail in the UK as in the financial crisis of 2008. This indicated that the corrective measures undertaken then to strengthen the banks have worked so far.

5.2 The governments of the largest world economies, including the UK, have implemented measures to make banks less likely to fail but also to reduce the impact on the financial system and on taxpayers if they do fail. The measures for dealing with a failing bank see investors who are not protected by the Financial Services Compensation scheme (which includes the Council) who have lent or deposited money, taking significant losses before there is any taxpayer support ("bail in"). These developments are reflected in the Council's approach to managing credit risk in its treasury strategies and the very low level of lending to banks.

5.3 The position is continually under review. One factor is that other regulatory developments are continuing to require or push banks towards greater financial robustness. Banks are now required to "ring fence" bank deposits from other riskier activities.

5.4 The Council has an indirect exposure to banks (including non-UK banks) through its investment in money market funds. Money market funds are like "unit trusts" but rather than investing in company shares these funds make interest bearing investments such as bank deposits. When we open such funds, they are vetted to ensure that they have strong investment and risk management processes, and we receive advice from our treasury advisor, Arlingclose.

6. Implementation of Borrowing & Investment Strategy

6.1 The strategy approved by Council for 2023/24 envisaged using cash balances to underpin new prudential borrowing and HRA council housing acquisitions and new build, instead of taking out new borrowing externally. This strategy has been adhered to. However, as revenue and capital reserves are called upon and with further substantial investment in the HRA planned, this strategy will have to change in the future, with new borrowing required.

6.2 Total investment income during 2023/24 was £7.9m. This was significantly greater than the £6.4m originally budgeted due to interest rates rising slightly higher and balances holding up better than anticipated. Most of this increase was reflected within the period 6 and period 9 revenue budget monitoring reports.

6.3 In April 2023 we repaid the Barclays loan of £25m with a fixed interest rate of 4.4% (£1.1m p.a.) which was due for repayment in the year 2077. This repayment also required an early repayment premium of £2.2m, which will be charged to the revenue budget at £40k p.a. through to 2077.

6.4 The repayment of the loan saves the fixed annual interest of £1.1m p.a. through to 2077, although that saving is offset to some extent by the loss of interest on the cash used for the repayment. The actual long-term effect on the Council's finances is of course impossible to predict over the next 53 years, though our advisors' model suggested potential savings of £6m using a discount rate of 3% (or even £18m applying no discount for inflation). However, a key reason for repaying the loan was to reduce risk if interest rates fell back again in the future (so, for example if interest rates fell to 3%, the Council would have continued to pay 4.4% interest on the loan, however, would have received only 3% on the retained cash).

7. **Key Performance Measures**

7.1 The most important performance measures are the rate of interest on the Council's borrowings, the timing of borrowing decisions, the timing of decisions to prematurely repay debt, the return on investments and the full repayment of the principal amounts invested.

7.2 The following (table 3) compares our performance against that of participating authorities at 31 March 2024 as compiled by our treasury advisor, Arlingclose.

Table 3 – Key Performance Data

Investment	**Leicester City Council**	**All Authorities**
Income return on short-term investments	3.32%	5.17 %
Income return on long-term strategic investments	4.34%	5.07%
Total Income return	3.37%	5.10%
Strategic funds capital gain/(loss)	(6.95)%	(1.27)%
Total Return	**2.99%**	**5.03%**
Percentage exposed to bail in of failed banks	13%	61%

7.3 The average rate of interest on all investments for participating authorities at 31 March 2024 is 5.10% whilst the Council's own rate was lower at 3.37%. This is mainly explained by differences on income from longer term investments, as the Council had a number of medium-term deposits with other local authorities which were made before the unexpectedly fast rise in interest rates and thus didn't benefit from those high rate rises. These medium-term deposits are coming to the end of their terms and will have a much smaller impact in future years.

7.4 The Council has no higher-risk investments in unsecured bank deposits and fewer longer dated strategic funds invested in more variable assets such as property and equities than many other authorities; and has a lower risk portfolio with a far smaller exposure to failed bank bail-in than most. Whilst this quite deliberately lowers our risk of capital losses, it also impacts our relative returns.

7.5 Members will be aware that some authorities have found themselves in major difficulties because they invested too much in riskier assets in anticipation of higher returns; and have since seen significant financial losses and in some cases Government intervention.

7.6 Higher investment returns are always available if higher risk is accepted. Risk can take the form of credit risk (money due is not paid) or market risk (the value of investments fall). However, the trade-off between risk and reward was considered when investment strategies were set for 2023/24 and in the current economic climate continues to be a most important consideration.

7.7 In practice, there is no such thing as a representative "average" authority. The benchmarking data reflects a division between the authorities that use longer term and more risky assets (about half of all authorities) and those adopting a more cautious approach. We fall much nearer to the cautious side of the two as we have only a small proportion of longer-term assets.

8. **Use of Treasury Advisors**

8.1 The Council is advised by Arlingclose Ltd. They advise on all aspects of treasury management, but their main focus is on providing advice on the following matters:

- the creditworthiness of banks
- the most cost-effective ways of borrowing
- appropriate responses to Government initiatives
- technical and accounting matters.

9. <u>Compliance with the Council's Treasury Strategy</u>

9.1 As required by the statutory borrowing framework, the Council is required to set a number of prudential limits and indicators. These limits are set annually and can be found within the budget and Treasury Strategy.

9.2 For the operational implementation of the Council's Treasury Management strategy, the most important limits and indicators that need to be monitored throughout the year are:

- The authorised limit – the maximum amount of borrowing that the Council permits itself to have outstanding at any one time.
- The operational limit – a lower limit to trigger management action if borrowing is higher than expected.
- The maximum proportion of debt that is fixed rate.
- The maximum proportion of debt that is variable rate.
- Limits on the proportion of debt maturing in a number of specified time bands.
- Limits on sums to be invested for more than 364 days.

9.3 These limits have been complied with.

9.4 Further details on the Prudential Indicators can be found in Appendix F to the Capital Budget Monitoring Outturn April-March 2023/24 report found elsewhere on your agenda.

10. Financial, legal, equalities, climate emergency and other implications

10.1 <u>Financial implications</u>

This report is solely concerned with financial issues.

10.2 <u>Legal implications</u>

There are no legal issues from this report - Kamal Adatia, City Barrister and Head of Standards, ext. 37 1401

10.3 <u>Equalities implications</u>

This report reviews how the Council conducted its borrowing and investments during 2023/24 and monitors compliance with the treasury management strategy. It has no direct equality impacts. - Surinder Singh, Equalities Officer, ext. 37 4148

10.4 <u>Climate Emergency implications</u>

There are limited climate emergency implications directly associated with this report. However, in general, the Council should consider opportunities to ensure that its investments are not contributing to negative climate and environmental impacts, as relevant and appropriate. - Aidan Davis, Sustainability Officer, ext. 37 2284

10.5 Other implications (You will need to have considered other implications in preparing this report. Please indicate which ones apply?)

None

11. **Background information and other papers:**

The Council's Treasury Management Strategy - "Treasury Strategy 2023/2024" - Council 22 February 2023
The Council's Treasury Policy Document – "Framework for Treasury Decisions" – Council 21 February 2024.
Mid-year review of Treasury Management activities - Overview Select Committee 14 December 2023.

12. **Summary of appendices:**

None

13. **Is this a private report (If so, please indicate the reasons and state why it is not in the public interest to be dealt with publicly)?**

No

14. **Is this a "key decision"? If so, why?**

No