Appendix 1

Mid-Year Monitoring Report 2023/24
Treasury Management and Prudential Indicators: 1 April 2023 to 30 September 2023

1. Introduction

1.1 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government in Scotland Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Scottish Ministers to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions have been made as yet during 2023/24).
- Statutory Instrument (SSI) 29 2004, requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities, and therefore to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services; and the treasury activity with regard to the CIPFA Code of Practice for Treasury Management in Local Authorities.
- Statutory Instrument (SSI) 123 2016, set out statutory arrangements for local authority borrowing and lending and the requirement to maintain a loans fund and replace the statutory arrangements set out in Schedule 3 of the Local Government (Scotland) Act 1975 (Schedule 3).

1.2 The regulatory framework of treasury management requires that the Council receive a mid-year treasury review, in addition to the forward looking annual treasury strategy and backward looking annual treasury report. This report meets that requirement and also incorporates the needs of the Prudential Code to ensure adequate monitoring of the capital expenditure plans and the Council's prudential indicators. The Treasury Strategy and Prudential Indicators were previously reported to Council on 29 March 2023. The current position is shown (where appropriate) and revisions to the 2023/24 estimate are provided where required.

1.3 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities require to prepare a Capital Strategy which provides the following:

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- an overview of how the associated risk is managed; and
- the implications for future financial sustainability

The Council's Capital Strategy was reported to and agreed by Council on 1 March 2023.

1.4 This report sets out:

- Key changes to the Council's capital activity (the prudential indicators);
- An economic update for the first part of the 2023/24 financial year;
- The actual and proposed treasury management activity (borrowing and investment); and
- The risk approach to treasury management (the treasury management indicators).

2. Key Prudential Indicators

2.1 This part of the report is structured to update:

- The Council's capital expenditure plans and how these plans are being financed;
- The impact of the changes in the capital expenditure plans on the PIs and the underlying need to borrow;
- Compliance with the limits in place for borrowing activity; and
- Policy on the statutory repayment of loans fund advances

2.2 **Capital Expenditure** – Table A shows the current position and revised estimates for capital expenditure for 2023/24 only.

Table A:

£000	2023/24 Original Estimate	Current Position	2023/24 Projected Outturn
General Services	79,916	7,698	50,320
HRA	66,277	16,308	46,070
Capital Expenditure	**146,193**	**24,006**	**96,390**
Financed by:			
Capital receipts	0	246	0
Capital grants	34,930	9,054	36,331
Revenue / other	909	0	288
Net financing need for the year	**110,354**	**14,706**	**59,771**

2.2.1 The anticipated spends and resources are regularly reported to Members through budgetary control reports.

2.3 **Impact of changes in Capital Expenditure Plans** – Table B shows the CFR, which is the underlying external need to borrow for a capital purpose while Table C shows the expected debt position over the period.

Table B:

£000	2023/24 Original Estimate	2023/24 Projected Outturn
Opening CFR (1 April 2023)	**706,242**	**742,283**
New Borrowing	99,308	59,226
LTL repayment in year	(3,138)	(3,370)
Closing CFR (31 March 2024)	**802,412**	**798,139**
movement in CFR	**96,170**	**55,856**
Net financing need for the year (Table A)	110,354	70,910
Loan repayments in year - excluding LTL (PPP)	(11,046)	(11,684)
New Borrowing - Movement in CFR (from previous year)	**99,308**	**59,226**

Table C:

£000	2023/24 Original Estimate	Current Position	2023/24 Projected Outturn
External Debt			
Estimated/Actual Debt at 1 April 2023	615,175	620,877	614,263
Maturing Debt	(150,485)	(212,000)	(314,677)
Movement in Borrowing			
New Borrowing - Maturing Debt	150,485	212,000	314,677
Borrowing adjustment in relation to over borrowing at year end	0	0	
New Borrowing – CFR (Table B)	99,308	7,000	48,077
Debt at 31 March (1)	**714,483**	**627,877**	**662,350**
Long Term Liabilities (LTL) at 1 April	89,115	90,122	90,122
LTL repayment in year (Table B)	(3,138)	(1,404)	(3,370)
LTL at 31 March (2)	**85,977**	**88,718**	**86,752**

Actual Debt at 31 March (1) + (2)	**800,460**	**716,595**	**749,102**
CFR from Table B	**802,412**	**n/a**	**787,000**
Under/(Over) Borrowing	**1,952**	**n/a**	**37,898**

2.3.1 The external debt figures included within Table C now includes both short term and long-term debt. This is due to the current strategy of using short-term borrowing to fund long-term capital investment enabling the Council to take advantage of lower interest rates. The reduction in the estimated external debt for 2023/24 is due to a reduction in the net capital financing need for the year.

2.3.2 The CFR is calculated on a year-end position based on the Council's balance sheet and therefore the current position is not shown. The CFR has decreased from the original estimate due to the decrease in the forecast level of capital expenditure in 2023/24. The Chief Officer - Resources can report that the Council is currently on target to meet the 2023/24 revised estimates for both indicators.

2.3.3 Table C highlights that the borrowing of the Council is forecasting a under-borrowed position against the CFR at 31 March 2024.

2.4 **Compliance with the limits in place for borrowing activity** – A key control over the treasury activity is a prudential indicator to ensure that over the medium term, gross borrowing will only be for a capital purpose.

Gross borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2023/24 and next two financial years. This allows some flexibility for limited early borrowing for future years.

The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent. The revised indicator is detailed in Table D and is illustrated by comparing the estimated gross debt as at 31 March 2023 with the CFR as at 31 March 2026. The Chief Officer - Resources reports that no difficulties are envisaged for the current year in complying with this prudential indicator.

Table D:

£000	**2023/24 Original Estimate**	**2023/24 Projected Outturn**
CFR at 31 March 2023		
Estimate/Actual (From Table B above)	**706,242**	**742,283**
Estimated movement in CFR		
2023/24 (From Table B above)	96,170	44,717
2024/25	80,411	95,020
2025/26	31,880	31,880
Anticipated CFR at 31 March 2025	**914,703**	**913,900**
Gross Debt at 31 March 2023 (From Table C above)	**800,460**	**749,102**

2.4.1 The Operational Boundary is detailed in Table E below and is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Table E:

£000	2023/24 Original Estimate	Current Position	2023/24 Projected Outturn
External Debt	880,506	716,595	824,012

2.4.2 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which is detailed in Table F and represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Table F:

£000	2023/24 Original Estimate	Current Position	2023/24 Projected Outturn
External Debt	960,552	716,595	898,992

3. Economic Outlook

3.1 UK

The Monetary Policy Commission (MPC) has kept the Bank Rate at 5.25% for the second time in a row (meeting Nov 2023).
The stickiness of UK inflation, still the highest in the G7 at 6.7%, is there for all to see - although it is about to fall significantly when the gas/electricity price cap reduction comes into the reckoning next month. CPI is expected to fall to 5% by the end of 2023.

Keeping a close eye on the housing market data releases, provides a good barometer of the strength or weakness of the overall economy. Only last week (Start of Nov) markets were surprised to learn that there was a 0.9% m/m rise in the Nationwide House Price index in October, which confounded the consensus forecast of a fall (-0.4% m/m) and was the largest increase since March 2022. This caused the annual rate of house price growth to rise from -5.3% in September to -3.3% in October. On the 7 November 2023, a similar picture emerged from the Halifax house price index, with prices rising 1.1% m/m (-3.2% y/y). Again, economists were caught on the hop, but with c2 million households due a mortgage rate reset (at a higher level) over the next 15 months it should only be a matter of time before we see further weakness in house prices and a general clamour for Bank Rate to be cut as soon as is practicable.

Furthermore, the UK domestic labour market is still having to contend with very low unemployment (4.2%) and the total number of job vacancies is only a smidgen below one million. Even if Labour takes over the governmental reins in the next year or so, it is unlikely that a fundamental overhaul of immigration policy, with a view to addressing staff shortages in various sectors of the economy, is going to be a priority, so keeping a lid on wages is going to be a tough challenge.

Furthermore, there is the small matter of a General Election coming into sight on the far horizon (late next year), so Government fiscal policy may potentially loosen at the same time as the Bank's monetary policy is still trying to take momentum out of the economy.

3.2 Scotland

- Total funding is forecast to increase in all years in nominal terms until in 2028-29, it is 13 per cent greater than in 2023-24. However inflation will erode that growth to 5 per cent.
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  Resource drives this growth with increases in all years. Nominal capital funding will remain 8 per cent below 2023-24 levels throughout the period. Income tax reconciliations take place three years after the Budget when the funding was originally set.

  In 2024-25 we still expect a large negative income tax reconciliation relating to 2021-22 revenues, which will exceed the fiscal framework borrowing limits. This will have a negative effect on resource funding

- High inflation sees real disposable incomes per person fall by 4 per cent by the end of 2023-24, Scotland's highest fall in living standards on record. Living standards will take until 2026-27 to recover to their 2021-22 level. In line with the latest Gross Domestic Product (GDP) data and the improved outlook for energy prices it is now forecast that the economy will remain broadly flat in 2023-24 rather than fall into a shallow recession.

- Since 2016-17, the Scottish higher rate threshold has largely been frozen. The number of higher rate taxpayers is expected to have increased by over 70 per cent in this time. The higher rate threshold freeze in the UK means the number of UK higher rate taxpayers is now also rising.

- Security spending is expected to increase from £5.3 bn in 2023-24 to £7.8 bn in 2028-29.

- Demand for disability payments across the UK has increased substantially since 2020. Disability payment forecasts have been revised up to reflect sustained demand at a higher-than-expected

3.3 **International update**

- What happens outside of the UK remains critical to movement in gilt yields as well. The European Central Bank has made it clear that policy tightening is at, or close to, the terminal rate (currently 4%), whilst the US FOMC (Federal Open Market Committee) has held its Bank Rate equivalent in the range of 5.25% - 5.5%.

3.4 Based upon the above information, the Council's treasury advisor, Link Asset Services, has provided the following interest rate forecast. As at September 2023:

Table G:

Link Group Interest Rate View	25.09.23												
	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26
BANK RATE	5.25	5.25	5.25	5.00	4.50	4.00	3.50	3.00	2.75	2.75	2.75	2.75	2.75
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.00	2.80	2.80	2.80	2.80	2.80
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.10	2.90	2.90	2.90	2.90	2.90
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.20	3.00	3.00	3.00	3.00	3.00
5 yr PWLB	5.10	5.00	4.90	4.70	4.40	4.20	4.00	3.90	3.70	3.70	3.60	3.60	3.50
10 yr PWLB	5.00	4.90	4.80	4.60	4.40	4.20	4.00	3.80	3.70	3.60	3.60	3.50	3.50
25 yr PWLB	5.40	5.20	5.10	4.90	4.70	4.40	4.30	4.10	4.00	3.90	3.80	3.80	3.80
50 yr PWLB	5.20	5.00	4.90	4.70	4.50	4.20	4.10	3.90	3.80	3.70	3.60	3.60	3.60

Source:Link Treasury Management Advisors

3.5 Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- **Labour and supply shortages** prove more enduring and disruptive and will depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, rising gilt yields).

- **The Bank of England** has increased bank rates too fast and too far over recent months, and subsequently brings about a deeper and a longer UK recession than what is anticipated.

- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.

- **Geopolitical risks,** for example in Ukraine/Russia, China/Taiwan/US, Iran, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows.

- **A re-emergence of banking sector fragilities**, which have been successfully addressed in the near-term by central banks and the market generally, but which may require further intervention if short-term interest rates stay elevated for longer than is anticipated.

3.6 Upside risks to current forecasts for UK gilt yields and PWLB rates are as

- The **Bank of England is too timid** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to remain elevated for a longer period within the UK economy, which then necessitates the Bank rate staying higher for longer than we currently expect.

- **The pound weakens** because of a lack in confidence in the UK Government's pre-election fiscal policies, resulting in investors pricing in a risk premium for holding sovereign debt.

- Longer term **US treasury yields** continue to rise strongly and pull gilt yields up even higher than currently forecast.

- **Projected gilt issuance**, inclusive of natural maturities and QT, could be too much for the markets to comfortably digest without higher yields compensating.

4. Treasury Management Activity

4.1 This part of the report is structured to update:

- The Council's expected borrowing need and details of under/(over) borrowing;
- Debt rescheduling and new borrowing;
- Debt charges; and
- Investments

4.2 **The Expected Borrowing Need** – This was set out in Table C (above) and demonstrates that at 30 September 2023 the Council is currently projecting and under-borrowed position to reduce risks in investments held and the cost of carry on investments. It should be noted that due to current economic climate the borrowing rates are significantly different than this time last year, with long term borrowing rates for periods greater than 25 years currently between 5.2% and 5.4%, depending on length of term for borrowing (as at 25 September 2023). This introduces an element of interest rate risk, as longer term borrowing rates may rise further; however, this position is being carefully monitored.

4.3 **Debt rescheduling and new borrowing** – The Council has not undertaken any debt rescheduling during the part of 2023/24 (to 30 September 2023). In the year to date naturally maturing debt of £224m has been repaid which has been mainly funded by loans from other local authorities.

4.4 **Debt Charges** – The revised estimate for debt charges for both the General Fund and the HRA is shown in Table H.

Table H:

£000	2023/24 Original Estimate	Current Position	2023/24 Revised Estimate
Borrowing	30,355	17,306	34,612
Other Long Term Liabilities	11,256	4,778	9,555
Total	**61,802**	**29,168**	**44,167**

4.5 **Investments** – The objectives of the Council's investment strategy are to ensure the re-payment of the principal and interest of its investments on time with the level of investment return being a secondary objective. Following on from the economic background above, the current investment climate has one over-riding risk consideration, which is the risk of default.

4.5.1 The Council held £8.370m of cash investments at 30 September 2023, and the constituent parts of the investment position are detailed in Table I:

Table I:

£000	Country	< 1 Year	1 – 2 Years	2 – 3 Years
Banks	UK	4,370	Nil	Nil
Money Market Fund	UK	4,000	Nil	Nil
Local Authorities	UK	0	Nil	Nil
Total	UK	8,370	Nil	Nil

4.5.2 Table J details the revised budget position for investment income. The original estimate has increased by £0.429m due to ongoing interest rates changes.

Table J:

£000	2023/24 Original Estimate	Current Position	2023/24 Revised Estimate
Investment Income	75	252	504

4.5.3 A regulatory development to address risk is the consideration and approval of benchmarks relating to investment security, liquidity and the level of return. Benchmarks are currently widely used to assess the level of return and investment performance, however the application of security and liquidity benchmarks are more subjective in nature.

- **Security** - The Council's maximum security risk benchmark for the current portfolio in relation to investment periods of up to one year (when compared to historic default tables) was set at 0.00% and the Chief Officer - Resources can report that there have been no defaults of principal sums invested in the year to date.

- **Creditworthiness -** Significant levels of downgrades to Short- and Long-Term credit ratings have not materialised since the crisis in March 2020.

- **Liquidity** – The Chief Officer - Resources can report that liquidity arrangements were adequate during the year to date and that the liquidity facilities and benchmarks set by the Council as noted below were maintained:

    - Bank overdraft - £1.000m; and
    - Liquid short term deposits of at least £5.000m available on an overnight basis.

- **Return on Investments** – The Chief Officer - Resources can report that the investment return to date average 3.61%. Table K illustrates how this average return compares with the local benchmarks.

Table K:

Benchmark	Benchmark Return	Average Return
Compound 12 month SONIA*	4.57%	3.76%
Council's Instant Access Account	4.75%	3.76%

* SONIA is Sterling Overnight Index Average and has replaced LIBOR & LIBID

5 Key Treasury Management Indicators

5.1 This part of the report is structured to update:

- Actual and estimates of the ratio of financing costs to net revenue stream;
- Upper limits on interest rate exposure:
- The maturity structure of borrowing; and
- Total principal sums invested.

5.2 **Actual and estimates of the ratio of financing costs to net revenue stream** – This indicator (as shown below in Table L) identifies the trend in the cost of capital against the net revenue stream.

Table L:

	2023/24 Original Estimate	2023/24 Revised Estimate
General Fund	8.51%	9.93%
HRA	35.55%	38.28%

5.3 **Upper Limits on Fixed and Variable Rate Exposure** – These indicators identify a maximum limit for fixed and variable interest rates based upon the debt position and were set at 100% and 50% respectively for 2023/24. The Chief Officer – Resources reports that the Council operates within these limits.

5.4 **Maturity Structures Of Borrowing** – These maximum limits are set to reduce the Council's exposure to large fixed rate loans (those instruments which carry a fixed interest rate for the duration of the instrument) which are due to naturally mature in any given period as detailed in Table M and show that the Council operates within limits set.

Table M:

Maturity Structure of Fixed Interest Rate Borrowing	2023/24 Original Limits	Current Position
Under 12 months	50%	45%
12 months to 2 years	50%	5%
2 years to 5 years	50%	10%
5 years to 10 years	50%	4%
10 years to 20 years	50%	3%
20 years to 30 years	50%	4%
30 years to 40 years	50%	3%
40 years to 50 years	100%	21%
50 years to 60 years	100%	5%
60 years to 70 years	100%	0%

5.5 **Total Principal Funds Invested** – These limits are set to reduce the need to temporarily borrow to cover any unexpected expenditure, and show limits to be placed on investments with final maturities beyond each year-end. The Council currently invests sums for periods greater than 365 days in Clydebank Property Company and hub West Scotland as detailed in Table N.

Table N:

	2023/24 Original Estimate	Current Position	2023/24 Revised Estimate
Principal sums invested > 365 days (maximum limit £7m)	£0.471m	£0.471m	£0.471m