Annual Report 2022/23
Treasury Management and Actual Prudential Indicators

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), 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 were made in 2021/22);

- Statutory Instrument (SSI) 29 of 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; and

- Statutory Instrument (SI) 2016 No 123 requires the Council to document its policy on the prudent repayment of loans fund advances.

1.2 This Council has adopted both the CIPFA Code of Practice for Treasury Management in the Public Sector and the Prudential Code and operates its treasury management service and capital programme in compliance with these Codes and the above requirements. These require that the prime objective of the treasury management activity is the effective management of risk, and that its borrowing activities are undertaken in a prudent, affordable and sustainable basis.

In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued a revised Treasury Management Code and a revised Prudential Code.

A particular focus of these revised codes was how to deal with local authority investments which are not treasury type investments e.g. by investing in purchasing property in order to generate income for the Authority at a much higher level than can be attained by treasury investments. One recommendation was that local authorities should produce a new report to members to give a high level summary of the overall capital strategy and to enable members to see how the cash resources of the Authority have been apportioned between treasury and non-treasury investments. For 2022/23, a Capital Strategy was reported and approved by Council on 9 March 2022.

1.3 During 2022/23 the minimum reporting requirements were that the Council should receive the following reports:

- an annual treasury strategy in advance of the new financial year (Council 23 March 2022);
- a mid-year treasury update report (Council 26 October 2022); and
- an annual report following the financial year-end describing the activity compared to the strategy (this report).

1.4 This report sets out:

- A summary of the strategy agreed for 2022/23;
- The Council's treasury position at 31 March 2023;
- The main Prudential Indicators and compliance with limits;
- A summary of the economic factors affecting the strategy over 2022/23;
- The Treasury activity during 2022/23;
- Performance indicators set for 2022/23;
- Disclosure regarding the repayment of loan Fund advances for 2022/23; and
- Risk and Performance.

2. A Summary of the Strategy for 2022/23

2.1 **Borrowing** – It is forecast that the capital borrowing need (the Capital Financing Requirement) will be almost fully funded with external borrowing which is a mixture of short term and long term debt. Against this background and the risk within the economic forecast, caution will be adopted with the 2023/24 treasury operations. The Section 95 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

2.2 **Investments -** with the economic background at the time, the investment climate had one over-riding risk consideration - counterparty security risk. As a result of the underlying concerns, officers maintained an operational investment strategy which tightened the controls already in place in the approved investment strategy. The Council's investment strategy primary objectives are safeguarding the re-payment of the principal and interest of its investments on time first and ensuring adequate liquidity second – the investment return being a third objective.

2.3 Based on the above, the treasury strategy was to postpone borrowing (by not borrowing in advance of need) and in particular minimise longer term borrowing to avoid the cost of holding higher levels of investments at higher interest rates and to reduce counterparty risk.

3. The Council's Treasury Position at 31 March 2023

3.1 During 2022/23, the Chief Officer – Resources, in line with the Treasury Strategy, managed the debt position with the use of internal funds as well as a mix of short-term and long-term external borrowing, and the treasury position at 31 March 2023 compared with the previous year was:

Table 1

Treasury position – excluding PPP	**31 March 2023**		**31 March 2022**	
	Principal	**Average Rate**	**Principal**	**Average Rate**
Fixed Interest Rate Debt	£614.160m	3.19%	£574.570m	1.91%
Variable Interest Rate Debt	£0.000m	0.00%	£0.000m	0.00%
Total Debt	**£614.160m**	**3.19%**	**£574.570m**	**1.91%**
Total Investments	**£6.478m**	**4.00%**	**£11.440m**	**0.42%**
Net borrowing position	**£607.682m**		**£563.130m**	

3.2 From the above table, it can be seen that the average interest rate on the debt held as at 31 March has increased from 1.91% in 2022 to 3.19% as at 31 March 2023. At the same time the average interest rate has increased on the investments held as at 31 March from 0.42% in 2022 to 4.00% as at 31 March 2023.

3.3 The external debt figure included within Table 1 includes both short term and long term debt.

3.4 There are four treasury prudential indicators which cover the activity of the treasury function. Complying with these indicators reduces the risk of an adverse movement in interest rates impacting negatively on the Council's overall position:

- Upper limits on variable rate exposure;
- Upper limits on fixed rate exposure;
- Maturity structures of borrowing; and
- Total principal funds invested for greater than 365 days

3.5 Table 2 shows the actual upper limits set per debt type and maturity as at 31 March 2023.

Table 2

	2022/23 Actual	**2022/23 Revised Indicator**	
Upper Limits on Fixed Interest Rates (Against maximum position)	100.00%	100.00%	
Upper Limits on Variable Interest Rates (Against maximum position)	0.00%	50.00%	
Maturity Structure Fixed Rate Borrowing (%)	Year End	Max	Min
Under 12 months	52.18%	50.00%	0%
12 months to 2 years	1.02%	50.00%	0%
2 years to 5 years	3.45%	50.00%	0%
5 years to 10 years	4.06%	50.00%	0%
10 years to 20 years	3.05%	50.00%	0%

20 years to 30 years	4.48%	50.00%	0%
30 years to 40 years	3.65%	50.00%	0%
40 years to 50 years	25.17%	100.00%	0%
50 years to 60 years	2.95%	100.00%	0%
60 years to 70 years	0.00%	100.00%	0%
Maximum Principal Funds Invested > 364 Days	£0.471m	£1m	Nil

4. The Main Prudential Indicators and Compliance with Limits

4.1 The Council is required by the Prudential Code to report the actual prudential indicators after the year end.

4.1.1 Capital Expenditure and its Financing

This indicator shows total capital expenditure for the year and how this was financed. The decrease in capital expenditure between revised estimate and actual as noted below in Table 3 is due to expenditure which has been reprofiled from 2022/23 into the 2023/24 capital programme, together with resources. The indicators for 2023/24 will be revised in line with this.

Table 3

	2022/23 Actual	**2022/23 Revised Estimate***
Capital expenditure:	£62.108m	£113.178m
Resourced by:		
Capital receipts and grants	£17.263m	£36.266m
Revenue	£2.911m	£0.288m
Capital expenditure - additional need to borrow for in-year capital spend	**£41.934m**	**£76.624m**

* From the mid-year report – Council 26 October 2022

4.1.2 Gross Borrowing and the Capital Financing Requirement (CFR)

In order to ensure that borrowing levels are prudent, over the medium term the Council's gross borrowing must only be used for capital purposes. Gross borrowing should not therefore, 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 in 2022/23.

4.1.3 The Chief Officer - Resources reports that the Council has complied with this indicator over the medium term (as can be seen by comparing the gross debt figure at 31 March 2023 with the anticipated CFR at 31 March 2026 as detailed in Table 4 below), and in the short term, the adjusted gross borrowing position also under the CFR as at 31 March 2023.

Table 4

	2022/23 Actual	2022/23 Revised Indicator*
Gross borrowing position per Table1	£614.160m	£641.712m
Long term liability	£90.122m	£89.115m
Adjusted gross borrowing position	**£704.282m**	**£720.857m**
Capital Financing Requirement	**£742,283m**	**£743.915m**

* From the mid-year Treasury Strategy – Council 22 December 2022

	(£m) 2022/23 Actual
CFR at 31 March 2023	
2022/23 Actual	**£742,283**
Estimated Movement in CFR*	
2023/24	£96.170
2024/25	£80.411
2025/26	£31.880
Anticipated CFR at 31 March 2026	**£923.751**
Gross Debt at 31 March 2023	**£664.643**

* Estimated movements from treasury Management Strategy 2023/24 – 29 March 2023

4.1.4 The Authorised Limit

The Authorised Limit is the “Affordable Borrowing Limit” required by Section 35 of the Local Government in Scotland Act 2003. The Council does not have the power to borrow above this level. The information in Table 5 demonstrates that during 2022/23 the Council has maintained gross borrowing within its Authorised Limit.

4.1.5 The Operational Boundary

The Operational Boundary is the borrowing position that the Council expects to work around during the year, and periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached. The information in Table 5 demonstrates that during 2022/23 the Council has maintained gross borrowing within its Operational Boundary.

4.1.6 Actual financing costs as a proportion of net revenue stream

This indicator shows the actual impact of capital expenditure in 2022/23 compared to the projected impact of the General Services Capital Plan Refresh and the HRA Capital Plan Update as approved by Members on 9 March 2022.The cost of capital is described as loan charges within the revenue budgets.

Table 5

	2022/23
Revised Indicator - Authorised Limit	£877.028m
Revised Indicator - Operational Boundary	£803.943m
Maximum gross borrowing position during 2022/23	£706.362m
Minimum gross borrowing position during 2022/23	£657.164m

	Estimated	Actual
Financing Costs as a proportion of net revenue stream		
General Fund	4.06%	3.97%
Housing (HRA)	27.08%	29.40%

* From treasury Management Strategy 2023/24 – 29 March 2023

5. Summary of the Economic Factors affecting the Strategy during 2022/23

5.1 The Economy and Interest Rates 2022/23 – to March 2023

UK / Scotland. 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, UK, EZ and US 10-year yields all rising by over 200bps(Basis Points) in 2022.

CPI inflation picked up to what should be a peak reading of 11.1% in October, although hopes for significant falls from this level will very much rest 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 of February 2023, CPI was 10.4%.

The UK unemployment rate fell through 2022 to a 48-year low of 3.6%, and this 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 MPC will be concerned that wage inflation will prove just as sticky 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 MPC 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 ILO 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 £ 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 £'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. Markets are pricing in a further interest rate increases of 25-50bps, on top of the current interest rate range of 4.75% - 5%.

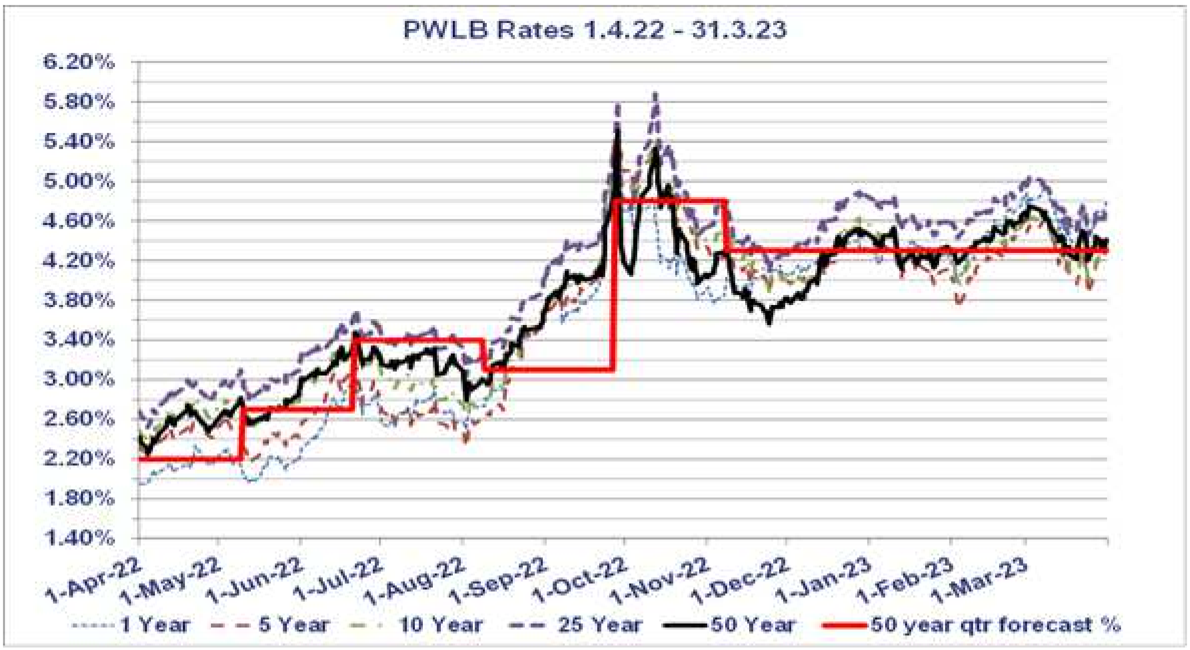
In addition, the Fed is expected to continue to run down its balance sheet once the on-going concerns about some elements of niche banking provision are in the rear-view mirror.

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.

5.2 Borrowing Rates in 2022/23

The graph for PWLB interest rates below shows that interest rates have continued to increase and most PWLB rates have been on a general upward trend since.



Source: Link Treasury Management Annual Report Template 2022/23 (Scotland)

6. Treasury Activity during 2022/23

6.1 **Borrowing** – The Council raised new new short term loans of £313.000m during 2022/23 for the replacement of naturally maturing debt and to finance the Council's capital programme.

6.2 **Rescheduling** – No debt rescheduling has taken place in 2022/23.

6.3 **Repayment** – The Council repaid naturally maturing debt of £279.186m.

6.4 **Summary of Debt Transactions** – The overall position of the debt activity resulted in the average annual interest rate paid throughout the year, year on year increasing from 1.91% (2021/22) to 3.19% to 3.19% (2022/23)

6.5 **Investment Policy –** The Scottish Government issued The Local Government Investments (Scotland) Regulations 2010 on 1 April 2010.

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

6.7 The Council's short term cash investments decreased from £11.440m at the beginning of the year to £6.478m at the end of the year with an average balance of £11.877m and received an average return of 0.063% over the year. In addition to the short term cash investments the Council also had 2 long term investments in Clydebank Property Company and Hub West Scotland with a total value of £0.471m as at 31 March 2023 as identified in table 2 above (investments over 364 days).

7. Performance Indicators set for 2022/23

7.1 The treasury strategy defined a set of performance indicators covering the following areas:

7.1.1 **Security** - In the context of benchmarking, assessing security is a very subjective area. Security is currently evidenced by the application of minimum quality criteria to financial institutions that the Council may choose to invest in, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody's and Standard & Poors). The Council has benchmarked security risk by assessing the historical likelihood of default for investments placed with any institution with a long term credit rating of A- (this is the minimum long term credit rating used in the Council's investment strategy). The Council's maximum security risk is that 0.05% of investments placed with financial institutions could theoretically default based on global historical data. During the year all investments within the Council's portfolio were repaid on their due dates with no defaults of the principal sums recorded.

7.1.2 **Liquidity** – As required by the CIPFA Treasury Management Code of Practice the Council has stated that it will "ensure that it has adequate, though not excessive, cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives". In respect to liquidity as defined above the liquidity arrangements during the year were maintained in line with the facilities and benchmarks previously set by the Council as follows:

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

7.1.3 **Return** – For the financial year the investment return averaged 1.984% which is an increase of 1.921% from the previous year. Table 6 illustrates that the Council's average return identified of 1.984% was less than the average return from the Council's bankers investment account (2.21%) and less than the Money Market Funds rate (noted in table 6) which are the local measures of return investment benchmarks approved in March 2012.

The Council's bankers (and therefore the bank with which the investment account is held) are currently Virgin money (formerly Clydesdale Bank plc) which falls within the Category 3 Investment Category approved in the investment strategy approved in February 2017. Due to the credit rating of this bank this category specified a maximum limit £5million which may be held on an overnight basis only thus limiting the ability to attract interest on this account.

Table 6

Benchmark	Benchmark Return	Average Return
Compound 12 month SONIA*	3.45%	1.984%

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

8. Disclosure regarding the repayment of loans fund advances for 2022/23

8.1 The policy on the prudent repayment of loans fund advances was detailed in the Mid-Year Monitoring Report 2022/23 - Treasury Management and Prudential Indicators reported to Council on 26 October 2022.

8.2 Table 7 shows the movement in the level of loan fund advances between 1 April 2022 and 31 March 2023 (excluding PPP).

Table 7

	General Fund	Housing
Opening Balance at 1 April 2022	**£339.474m**	**£244.436m**
New Advances in 2022/23	£17.833m	£26.328m
Repayments in 2022/23	(£2.988m)	(£6.510m)
Closing Balance at 31 March 2023	**£354.319m**	**£264.254m**

8.3 Table 8 details the anticipated repayment profile of the balance on the internal loans fund advances (excluding PPP) for both General Services and Housing held at 31 March 2023 (note, this is not external debt).

Table 8

Future Repayment Profile at 31 March 2023	General Fund	Housing	Total
	£m	£m	£m
Under 12 months	4.023	6.836	10.859
2 years to 5 years	16.888	27.080	43.968
6 years to 10 years	23.520	38.567	62.088
11 years to 15 years	27.967	30.964	58.930
16 years to 20 years	25.956	38.527	64.483
21 years to 25 years	18.217	42.462	60.680
26 years to 30 years	12.574	25.349	37.923
31 years to 35 years	9.941	5.304	15.245
36 years to 40 years	11.526	3.250	14.775
41 years to 45 years	12.257	3.378	15.635
46 years to 50 years	14.057	4.785	18.842
51 years to 55 years	18.900	7.114	26.013
56 years to 60 years	24.414	8.395	32.809
61 year +	134.080	22.244	156.324
Total	**354.319**	**264.254**	**618.573**

9. Risk and Performance

9.1 The Council has complied with all relevant statutory and regulatory requirements which require the Council to identify and, where possible, quantify the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach. Ongoing consideration of future affordability and sustainability are reported and considered by Members each year when setting the Council's General Fund and HRA capital and revenue budgets.

9.2 The Council is aware of the risks of passive management of the treasury portfolio and, with the support of the Council's treasury advisers, has proactively managed its treasury position within the current economic climate taking advantage of lower interest rates where it is deemed appropriate. The Council has complied with its internal and external procedural requirements. There is little risk of volatility of costs in the current debt portfolio as the interest rates are predominantly fixed, with the majority of debt comprised of long-term loans.

9.3 Shorter-term rates and likely future movements in these rates predominantly determine the Council's investment return. These returns can therefore be volatile and, whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult.