



South Derbyshire District Council

Treasury Management Report Q4 2023/24

Introduction

The Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Council to approve treasury management semi-annual and annual outturn reports.

This report includes the requirement in the 2021 Code, mandatory from 1st April 2023, of reporting of the treasury management prudential indicators. The non-treasury prudential indicators are incorporated in a separate report.

The Council's treasury management strategy for 2023/24 was approved at a meeting on 22nd February 2023. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Council's treasury management strategy.

External Context

Economic background: UK inflation continued to decline from the 8.7% rate seen at the start of 2023/24. By the last quarter of the financial year headline consumer price inflation (CPI) had fallen to 3.4% in February but was still above the Bank of England's 2% target at the end of the period. The core measure of CPI, i.e. excluding food and energy, also slowed in February to 4.5% from 5.1% in January, a rate that had stubbornly persisted for three consecutive months.

The UK economy entered a technical recession in the second half of 2023, as growth rates of -0.1% and -0.3% respectively were recorded for Q3 and Q4. Over the 2023 calendar year GDP growth only expanded by 0.1% compared to 2022. Of the recent monthly data, the Office for National Statistics reported a rebound in activity with economy expanding 0.2% in January 2024. While the economy may somewhat recover in Q1 2024, the data suggests that prior increases in interest rates and higher price levels are depressing growth, which will continue to bear down on inflation throughout 2024.

Labour market data provided a mixed message for policymakers. Employment and vacancies declined, and unemployment rose to 4.3% (3mth/year) in July 2023. The same month saw the highest annual growth rate of 8.5% for total pay (i.e. including bonuses) and 7.8% for regular pay growth (i.e. excluding bonuses). Thereafter, unemployment began to decline, falling to 3.9% (3mth/year) in January and pay growth also edged lower to 5.6% for total pay and 6.1% for regular pay, but remained above the Bank of England's forecast.

Having begun the financial year at 4.25%, the Bank of England's Monetary Policy Committee (MPC) increased Bank Rate to 5.25% in August 2023 with a 3-way split in the Committee's voting as the UK economy appeared resilient in the face of the dual headwinds of higher inflation and interest rates. Bank Rate was maintained at 5.25% through to March 2024. The vote at the March was 8-1 in favour of maintaining rates at this level, with the single dissenter preferring to cut rates immediately by 0.25%. Although financial markets shifted their interest rate expectations downwards with expectations of a cut in June, the MPC's focus remained on assessing how long interest rates would need to be restrictive in order to control inflation over the medium term.

In the Bank's quarterly Monetary Policy Report (MPR) released in August 2023 the near-term projection for services price inflation was revised upwards, goods price inflation widespread across products, indicating stronger domestic inflationary pressure with second-round effects in domestic prices and wages likely taking longer to unwind than they did to emerge. In the February 2024 MPR the Bank's expectations for the UK economy were positive for the first half of 2024, with a recovery from the mild recession in calendar H2 2023 being gradual. Headline CPI was forecast to dip below the 2% target quicker than previously thought due to declining energy prices, these effects would hold inflation slightly above target for much of the forecast horizon.

Following this MPC meeting, Arlingclose, the authority's treasury adviser, maintained its central view that 5.25% remains the peak in Bank Rate and that interest rates will most likely start to be cut later in H2 2024. The risks in the short-term are deemed to be to the downside as a rate cut may come sooner than expected, but then more broadly balanced over the medium term.

The US Federal Reserve also pushed up rates over the period, reaching a peak range of between 5.25-5.50% in August 2023, where it has stayed since. US policymakers have maintained the relatively dovish stance from the December FOMC meeting and at the meeting in March, economic projections pointed to interest rates being cut by a total of 0.75% in 2024.

Following a similarly sharp upward trajectory, the European Central Bank hiked rates to historically high levels over period, pushing its main refinancing rate to 4.5% in September 2023, where it has remained. Economic growth in the region remains weak, with a potential recession on the cards, but inflation remains sticky and above the ECB's target, putting pressure on policymakers on how to balance these factors.

Financial markets: Sentiment in financial markets remained uncertain and bond yields continued to be volatile over the year. During the first half of the year, yields rose as interest rates continued to be pushed up in response to rising inflation. From October they started declining again before falling sharply in December as falling inflation and dovish central bank attitudes caused financial markets to expect cuts in interest rates in 2024. When it emerged in January that inflation was stickier than expected and the BoE and the Federal Reserve were data dependent and not inclined to cut rates soon, yields rose once again, ending the period some 50+ bps higher than when it started.

Over the financial year, the 10-year UK benchmark gilt yield rose from 3.44% to peak at 4.75% in August, before then dropping to 3.44% in late December 2023 and rising again to 3.92% (28th March 2024). The Sterling Overnight Rate (SONIA) averaged 4.96% over the period to 31st March.

Credit review: In response to an improving outlook for credit markets, in January 2024 Arlingclose moved away from its previous temporary stance of a 35-day maximum duration and increased its advised recommended maximum unsecured duration limit on all banks on its counterparty list to 100 days.

Earlier in the period, S&P revised the UK sovereign outlook to stable and upgraded Barclays Bank to A+. Moody's also revised the UK outlook to stable, Handelsbanken's outlook to negative, downgraded five local authorities, and affirmed HSBC's outlook at stable while upgrading its Baseline Credit Assessment. Fitch revised UOB's and BMO's outlooks to stable.

In the final quarter of the financial year, Fitch revised the outlook on the UK sovereign rating to stable from negative based on their assessment that the risks to the UK's public finances had decreased since its previous review in October 2022, the time of the mini- budget.

Moody's, meanwhile, upgraded the long-term ratings of German lenders Helaba, Bayern LB and LBBW on better solvency and capital positions, despite challenges from a slowing German economy and exposure to the commercial real estate sector. Moody's also upgraded or placed on review for an upgrade, Australian banks including ANZ, CBA NAB and Westpac on the back of the introduction of a new bank resolution regime.

Credit default swap prices began the financial year at elevated levels following the fallout from Silicon Valley Bank and collapse/takeover of other lenders. From then the general trend was one of falling prices and UK lenders' CDS ended the period at similar levels to those seen in early 2023. Earlier in the year some Canadian lenders saw their CDS prices rise due to concerns over a slowing domestic economy and housing market, while some German lenders were impacted by similar economic concerns and exposure to commercial real estate towards the end of the period, with LBBW remaining the most elevated.

Heightened market volatility is expected to remain a feature, at least in the near term and, credit default swap levels will be monitored for signs of ongoing credit stress. As ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remain under constant review.

Local Context

On 31st March 2024, the Council had net investments of £16.092m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying resources available for investment. These factors are summarised in the table below.

Balance Sheet Summary

	31.3.23 Actual £'000	31.3.24 Actual £'000
General Fund CFR	6,860	6,607
HRA CFR	51,584	41,584
Total CFR	58,444	48,191
External borrowing	47,512	37,512
Internal borrowing	10,932	10,679
Less: Balance sheet resources	(76,438)	(64,283)
Net (investments)	(65,506)	(53,604)

The treasury management position at 31st March 2024 and the change over the year is shown in the table below.

Treasury Management Summary

	31.03.23 Balance £'000	Movement £m	31.03.24 Balance £'000	Average Rate %
Long-term borrowing:				
Fixed	47,423	(10,000)	37,423	3.31%
Variable	0	0	0	0.00%
Short-term borrowing	89	0	89	4.25%
Total borrowing	47,512	(10,000)	37,512	
Long-term investments	3,572	(138)	3,434	5.25%
Short-term investments	58,000	(12,500)	45,500	5.35%
Cash and cash equivalents	3,934	736	4,670	2.28%
Total investments	65,506	(11,902)	53,604	
Net investments	17,994	(1,902)	16,092	

Borrowing

CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement and so may lead to new borrowing, unless directly and primarily related to the functions of the Council. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield unless these loans are for refinancing purposes.

The Council has not invested in assets primarily for financial return or that are not primarily related to the functions of the Council. It has no plans to do so in future.

Borrowing Strategy and Activity

As outlined in the treasury strategy, the Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective. The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

Interest rates have seen substantial rises over the last two years, although these rises have now begun to plateau. Gilt yields fell in late 2023, reaching April 2023 lows in December 2023 before rebounding to an extent in the first three months of 2024. Gilt yields have remained volatile, seeing upward pressure from perceived sticker inflation at times and downward pressure from falling inflation and a struggling economy at other times.

On 31st December, the PWLB certainty rates for maturity loans were 4.74% for 10-year loans, 5.18% for 20-year loans and 5.01% for 50-year loans. Their equivalents on 31st March 2023 were 4.33%, 4.70% and 4.41% respectively.

The cost of short term borrowing from other local authorities has generally risen with Base Rate over the year. Interest rates peaked at around 7% towards the later part of March 2024 as many authorities required cash at the same time. These rates are expected to fall back to more normal market levels in April 2024.

A new PWLB HRA borrowing rate which is 0.4% below the certainty rate was made available from 15th June 2023. This rate will now be available until to June 2025. The discounted rate is to support local authorities borrowing for the Housing Revenue Account and for refinancing existing HRA loans.

At 31st March 2024 the Council held £37.5m of loans, a decrease of £10m from 31st March 2023 due to the second instalment payment of the principle amount. These loans were taken out by the Council in 2011/12 for the purpose of HRA self-financing. The principal element of these loans is repayable in full on maturity, with interest being paid each March and September.

The short-term borrowing of £89k relates to deposits received from two Parish Councils within the District. These loans can be recalled on immediate notice. Interest is calculated at the Bank of England Base Rate, less 1%. Interest will be payable half yearly after the 30th September and the second after 31st March.

The following table shows the maturity dates of the loans and rate of interest payable.

Borrowing Position

Loan Profile	Type	Value £'000	Rate %	Maturity
Public Works Loan Board	Fixed	10,000	3.01	2026/27
Public Works Loan Board	Fixed	10,000	3.30	2031/32
Public Works Loan Board	Fixed	10,000	3.44	2036/72
Public Works Loan Board	Fixed	7,423	3.50	2041/42
Total Long-term borrowing		37,423		
Short-term Parish Council Loans		89	4.25	
Total borrowing		37,512		

The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

Treasury Investment Activity

The CIPFA Treasury Management Code now defines treasury management investments as those investments which arise from the Council's cash flows or treasury risk management

activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Council's investment balances ranged between £49.5m and £78.5m million due to timing differences between income and expenditure. The investment position is shown in the table below.

Treasury Investment Position

	31.03.23 Balance £'000	Q4 2024 Movement £'000	31.03.24 Balance £'000	31.03.24 Rate of Return %
Banks (unsecured)	3,934	736	4,670	2.28%
Local Authorities	42,000	(12,500)	29,500	5.36%
Money Market Funds	16,000	0	16,000	5.33%
CCLA Property Fund (Fair value)	3,572	(138)	3,434	5.25%
Total investments	65,506	(11,902)	53,604	

The main reason for the reduction to investments is primarily linked to the loan repayment of £10m on 31st March 2024.

Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

As demonstrated by the liability benchmark in this report, the Council expects to be a long-term borrower and new treasury investments are therefore primarily made to manage day-to-day cash flows using short-term low risk instruments. The existing portfolio of strategic pooled funds will be maintained to diversify risk into different asset classes and boost investment income.

Bank Rate increased by 1% over the period, from 4.25% at the beginning of April 2023 to 5.25% by the end March 2024. Short term rates peaked at 5.7% for 3-month rates and 6.7% for 12-month rates during the period, although these rates subsequently began to decline towards the end of the period. Money Market Rates also rose and were between 5.26% and 5.38% by the end of March 2024.

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking below.

Investment Benchmarking – Treasury investments managed in-house (excludes CCLA)

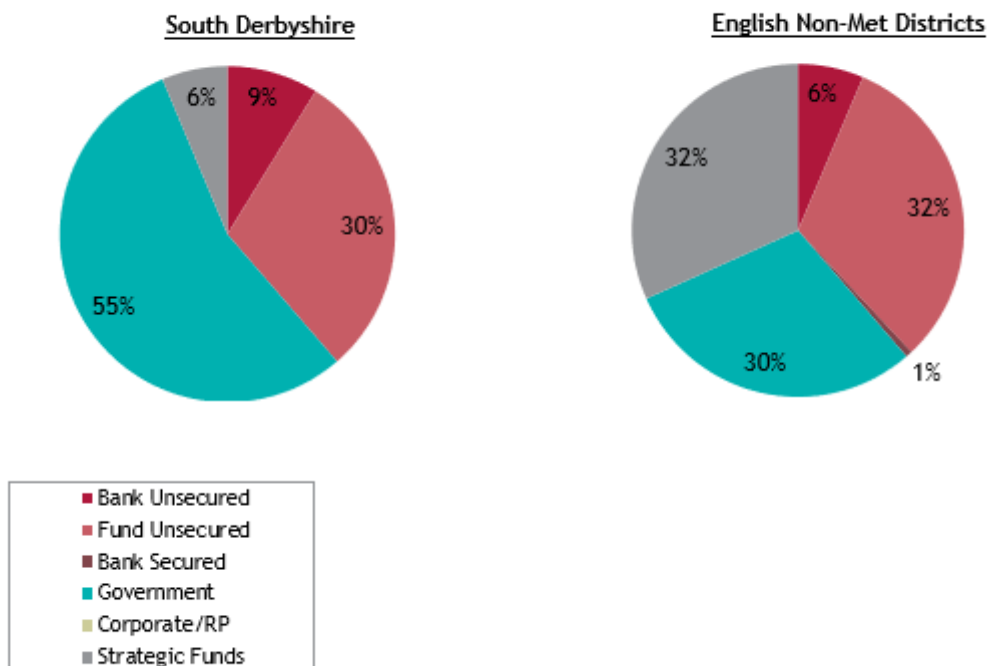
	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
31.03.2023	4.93	A+	32%	72	2.06
31.03.2024	4.85	A+	41%	75	4.67
Similar LAs	4.90	A+	61%	50	5.20
All LAs	4.82	A+	61%	9	5.03

Credit Score: This is a value weighted average score calculated by weighting the credit score of each investment by its value. A higher number indicates a higher risk.

Credit Rating: This is based on the long-term rating assigned to each institution in the portfolio, by ratings agencies Fitch, Moody’s and Standard & Poor’s. Ratings rang from AAA to D, and can be modified by +/-

Bail in Exposure: The adoption of a bail in regime for failed banks results in a potential increased risk of loss of funds for local authority should this need to be implemented. Therefore, a lower exposure to bail in investments reduces this risk.

Weighted Average Maturity: This is an indicator of the average duration of the internally managed investments. Similar authorities have a similar profile to South Derbyshire; other larger authorities tend to hold a greater proportion of fund in money markets than fixed term deposits with other LAs, due to their cash flow requirements.



This chart illustrates the type of investment funds held by the Council in comparison to other similar Local Authorities, this shows in greater detail, the comparisons in the bail in exposure and rate of return, on the above security benchmark table. The unsecured funds held by other Local Authorities is a slightly higher percentage of their investment portfolio, which will offer them a higher rate of return, however the bail in exposure risk to funds is 61% of their total portfolio. The Council have invested their funds in much safer secured investments (Government) which my produce a smaller yield but the risk to Council funds is lower at 41%.

Externally Managed Pooled Funds

£4m of the Council’s investments is invested in externally managed strategic pooled property funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds generated an £178k (5.25%) income return which is used to support services in year, and £138k (4.06%) of unrealised capital loss.

The market background for commercial property improved marginally in 2023 and was more stable, in contrast to the very challenging backdrop of 2022. Low transactional volumes were a constraint on valuations and made prospective sellers and buyers more cautious. Although many sectors lacked momentum, there was growing confidence in the longer-term outlook as occupier demand and rental markets held up. Industrial and retail warehousing sectors remained strong, but the retail and offices sectors remained weak, the latter continuing to be hindered by low occupancy from hybrid working practices.

Income returns remained broadly consistent. The Council has budgeted £136,000 income from these investments in 2023/24. Income received up to 31st March 2024 was £133,017, whilst a further £45,019 has been declared and is due to be paid by April.

Because the Council’s externally managed funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council’s investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates.

Statutory override: In April 2023 the Department for Levelling Up, Housing and Communities (DLUHC) published the full outcome of the consultation on the extension of the statutory override on accounting for gains and losses on pooled investment funds. The override has been extended until 31st March 2025, but no other changes have been made; whether the override will be extended beyond this date is unknown but commentary to the consultation outcome suggests it will not. The Authority will discuss with Arlingclose the implications for the investment strategy and what action may need to be taken.

CCLA Property Fund Performance

		2022/23	2023/24
		Q4	Q4
Dividend Received	£	38,409	45,019

Annual Equivalent Interest Rate	%	4.35%	5.31%
Bid (Selling) Price	pence/unit	283.80	272.73

The mid-market value of the fund as at the 31st March 2024 is £3,447,739 and the bid market value is £3,394,299. The quarters market and bid values have decreased from March 23 by 3.90%. This reinforces the notion that the Fund should only be considered for long-term investments.

The Council's investment in the CCLA fund remained stable throughout 23/24 with performance continuing to yield positive dividends.

Non-Treasury Investments

The definition of investments in the Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).

Investment Guidance issued by DLUHC and Welsh Government also broadens the definition of investments to include all such assets held partially or wholly for financial return.

The Council held £8.87m of investments made for commercial purposes. This consisted entirely of directly owned property and land. A full list of the Council's non-treasury investments is available in the Investment Strategy document.

These investments generated 0.675m of investment income for the Council after taking account of direct costs of £0.097m.

All commercial investments are located within the district.

Performance

Average 7-Day Money Market Rate

The main indicator the Council uses to measure its return on short-term investments to average over the year, is the Average 7-Day Money Market Rate. This is a standard measure of performance. Performance for the second quarter is shown below.

	As at 31.03.23	As at 31.03.24
Average 7-Day Money Market Rate (Target)	3.89%	5.24%
Average Interest Rate Achieved on Short Term Deposits	3.43%	5.35%

Cost of Debt

This indicator shows how much the costs of borrowing impact upon each household (at Band D Council Tax rate) in the District. The impact on Council Tax is positive as the General Fund

has no actual debt. The performance for the first quarter is shown below using the current interest received and the estimated annual interest based on current returns. This is compared to the actual annual interest received last year.

General Fund Impact per Council Tax Payer	Actual 31.03.2023	Actual 31.03.2024
	£	£
Net Interest Received - General Fund	-£751,544	-£1,900,080
Band D Properties	36,702	37,663
Cost per Band D Property	-£20.48	-£50.45

The cost of debt on each council tenant (HRA) is shown below. The performance for the first quarter is the actual costs compared to the estimated costs for the year.

HRA Debt Interest per Dwelling	31.03.2023 Actual	31.03.2024 Actual
HRA Interest Payable	1,504,805	1,504,805
Dwellings	2,945	2,947
Annual Cost per Dwelling	£510.96	£510.62

Consultations

In December DLUHC published two consultations: a “final” consultation on proposed changes to regulations and statutory guidance on MRP closing on 16th February 2024 and a “call for views” on capital measures to improve sector stability and efficiency closing on 31st January 2024.

Draft regulations and draft statutory guidance are included in the MRP consultation. The proposals remain broadly the same as those in June 2022 – to limit the scope for authorities to (a) make no MRP on parts of the capital financing requirement (CFR) and (b) to use capital receipts in lieu of a revenue charge for MRP.

In its call for views on capital measures, government wishes to engage with councils to identify and develop options for the use of capital resources and borrowing to support and encourage ‘invest-to-save’ activity and to manage budget pressures without seeking exceptional financial support. Whilst Government has identified some options including allowing authorities to capitalise general cost pressures and meet these with capital receipts, there is no commitment to take any of the options forward.

The Council will not look to take these options forward as there is no requirement to do so.

Compliance

The Chief Finance Officer reports that all treasury management activities undertaken during the quarter complied fully with the principles in the Treasury Management Code and the Council's approved Treasury Management Strategy.

Compliance with specific investment limits is demonstrated in the table below:

Investment limits

Sector	Maximum Investment Q4 2024	Counterparty Limit	Time Limit	Sector Limit	Complied
The UK Government	£22.5m	£25m	364 days	n/a	✓
Local authorities & other government entities	£37m	£5m	364 days	Unlimited	✓
Banks (unsecured)*	£2.8m	£3m	35 days	Unlimited	✓
Building societies (unsecured)*	£2m	£2m	35 days	£5m	✓
Money Market Funds*	£16m	£2m	60 days	£16m	✓
Strategic Pooled Funds	£4m	£4m	n/a	£4m	✓
Other Investments*	0	£1m	35 days	Unlimited	✓

Treasury Management Prudential Indicators

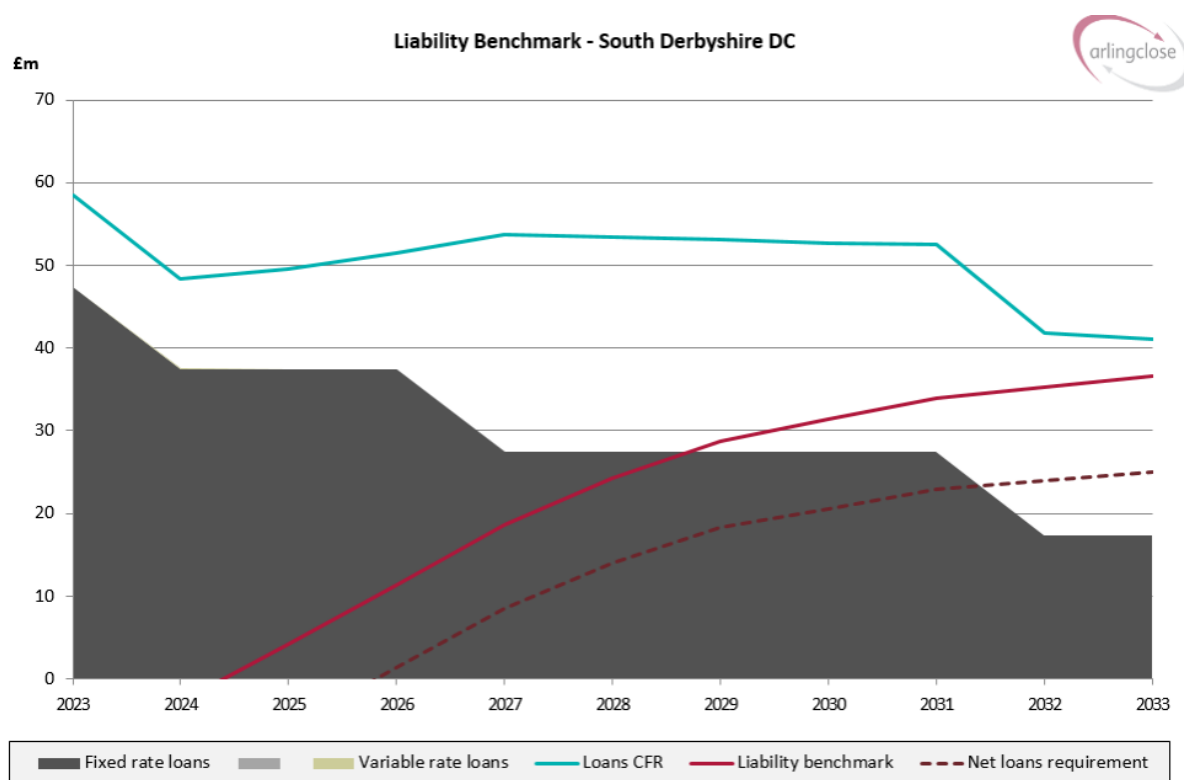
As required by the 2021 CIPFA Treasury Management Code, the Council monitors and measures the following treasury management prudential indicators.

Liability Benchmark:

This new indicator compares the Council's actual existing borrowing against a liability benchmark that has been calculated to show the lowest risk level of borrowing. The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. It represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level of £10m required to manage day-to-day cash flow.

	31.3.23 Actual	31.3.24 Actual	31.3.25 Forecast	31.3.26 Forecast
Loans CFR	58,444	48,191	49,493	51,532
Less: Balance sheet resources	(76,438)	(64,283)	(55,373)	(50,186)
Net loan requirement	(17,994)	(16,092)	(5,880)	1,346
Plus: Liquidity allowance	10,000	10,000	10,000	10,000
Liability benchmark	(7,994)	(6,092)	4,120	11,346
Existing borrowing	47,423	37,423	37,423	37,423

Following on from the medium-term forecast above, the long-term liability benchmark assumes capital expenditure funded by borrowing per the capital programme, minimum revenue provision on new capital expenditure based on the useful life of the asset and reserves continue to reduce year on year to fund future year expenditure.



The above graph shows that actual borrowing decreases over time as debt is repaid. The liability benchmark increases due to planned capital expenditure and utilisation of reserves. This graph demonstrates that the Council may need to borrow in the medium term.

Maturity Structure of Borrowing:

This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	Upper Limit	Lower Limit	31.03.2024 Actual	Complied?
Under 12 months	70%	0%	0%	✓

12 months and within 24 months	30%	0%	0%	✓
24 months and within 5 years	30%	0%	27%	✓
5 years and within 10 years	30%	0%	27%	✓
10 years and above	90%	0%	46%	✓

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Long-term Treasury Management Investments:

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury management limits are:

	2023/24	2024/25	2025/26	No fixed date
Limit on principal invested beyond year end	£0m	£0m	£0m	£4m
Actual principal invested beyond year end	£0m	£0m	£0m	£4m
Complied?	✓	✓	✓	✓

Long-term investments with no fixed maturity date include strategic pooled funds, real estate investment trusts and directly held equity but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

Interest Rate Exposures:

This indicator is set to control the Council's exposure to interest rate risk. Bank Rate rose by 1.25% from 4.25% on 1st April to 5.25% by 31st December.

For context, the changes in interest rates during the quarter were:

	31/3/23	31/3/24
Bank Rate	4.25%	5.25%
1-year PWLB certainty rate, maturity loans	4.78%	5.36%
5-year PWLB certainty rate, maturity loans	4.31%	4.68%
10-year PWLB certainty rate, maturity loans	4.33%	4.74%
20-year PWLB certainty rate, maturity loans	4.70%	5.18%
50-year PWLB certainty rate, maturity loans	4.41%	5.01%

The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at new market rates.