2 Midlothian

Audit Committee
Monday 24 June 2024
Item No 5.7

Annual Treasury Management Report 2023/24

Report by David Gladwin, Chief Financial Officer & Section 95 Officer

Report for Decision

1 Recommendations

The Audit Committee is invited to consider this report before the final report is presented to Council. Committee should note that the proposed recommendation to Council is that it note the Annual Treasury Management Report 2023/24.

2 Purpose of Report/Executive Summary

The purpose of the report is to inform members of the Audit Committee of the Treasury Management activity undertaken in 2023/24 and the year-end position.

Date: 10/06/2024
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3 Background

The main points arising from treasury activity in 2023/24 were:

- The pooled internal loans fund rate for General Fund and HRA was 2.08% in 2023/24, which is again expected to be one of the lowest when benchmarked against all mainland Authorities in Scotland;

- Were the pooled internal loans fund rate to have equated to the Scottish weighted average of 3.41%, this would have generated loan charges in 2023/24 of £22.3 million. The Council's actual 2023/24 loan charges for General Services and HRA were £17.3 million, representing a cash saving (compared to the Scotland weighted average) of £5.0 million in 2023/24;

- Total long term borrowing maturing in the year amounted to £0.882 million, comprising the following:-

  - £0.053 million of PWLB Annuities of various tenors and interest rates;
  - £0.664 million of Annuity and EIP, and £0.165 million of interest free loans.

- Total new long term borrowing taken in the year amounted to £20.000m, this being two £10.000 million maturity loans from PWLB drawn on 28 March 2024 with loan tenors of 3 and 4 years and at interest rates of 4.54% and 4.37% respectively, drawing down long term loan funding to de-risk the funding of the Council's 2023/24 capital plans in line with the Treasury Management and Investment Strategy approved by Council on 27 February 2024;

- The remainder of the 2023/24 borrowing requirement was funded through the utilisation of the Council's working capital balances;

- The Council were under-borrowed by £60.974 million (15% of the borrowing Capital Financing Requirement) at 31 March 2024. This means that the Council has funded the majority (85%) of its underlying borrowing requirement as at 31 March 2024. This position is prudent in the current economic climate (with PWLB rates forecast to drop from their prevailing rates, across the next 2 financial years), as it balances longer-term interest rate and refinancing risk with short-medium term budgetary implications;

- The average rate of interest paid on external debt was 3.00% in 2023/24, down marginally from 3.01% in 2022/23;

- Fixed Term Deposits were placed during the year in line with the Council's approved creditworthiness process as outlined in the "*Treasury Management and Investment Strategy 2023/24 & Prudential indicators*" (TMSS 23/24) report approved by Council on 21 February 2023. These fixed term deposits were placed with high credit worthy banks. The Council's deposit portfolio at 31 March 2024 is outlined in Table 2 below and in detail in Table 11 in Appendix 1;

- The average rate of return on deposits was 4.86% in 2023/24 (exceeding the benchmark[1] of 4.42% for the twentieth year in succession) with total interest earned on deposits totalling £4.590 million and reflecting the approved strategy of cash backing the Council's useable reserves;

- The majority (£56.618m) of the Council's useable reserves of £84.532 million at 31 March 2024[2] are fully cash backed.

- No debt rescheduling was undertaken during 2023/24.

A detailed report "*Annual Treasury Management Review 2023/24*" on the activity during 2023/24 is attached as Appendix 1.

The Treasury Portfolio at the start and end of the financial year is shown in Tables 1 and 2 below.

[1] 4.5 month backward uncompounded SONIA (Sterling Overnight Index Average) which reflects the weighted average duration of the Council's portfolio for the year
[2] Excluding Service Concessions

Table 1: Loan Portfolio at 1 April 2023 and 31 March 2024

Loan Type	Principal Outstanding 1 Apr 2023 £000's	Principal Outstanding 31 Mar 2024 £000's	Movement £000's
PWLB Annuity	505	452	-53
PWLB Maturity	284,128	304,128	+20,000
LOBO	20,000	20,000	0
Other Market Loans	16,885	16,221	-664
Salix Loans	235	70	-165
Total Loans	**321,753**	**340,871**	**+19,118**
CFR	**347,661**	**401,845**	**+54,184**
Over/(Under) Borrowed	**-25,908**	**-60,974**	**-35,066**

Table 2: Deposits at 1 April 2023 and 31 March 2024

Deposit Type	Principal Outstanding 1 Apr 2023 £000's	Principal Outstanding 31 Mar 2024 £000's	Movement £000's
Bank Call Accounts	2	1,518	+1,516
Money Market Funds	15,980	25,100	+9,120
Bank Fixed Term Deposit Accounts	96,000	30,000	-66,000
Other Local Authorities	2,000	0	-2,000
Total Deposits	**113,982**	**56,618**	**-57,364**
Useable Reserves	**90,582**	**84,532**	**-6,050**

Throughout 2023/24, all counterparties that the Council placed deposits with met their obligations in respect of the return of the deposited funds and interest receivable in full and on the required dates.

5 Report Implications (Resource, Digital and Risk)

5.1 Resource

Treasury Management activity during the year, in accordance with the approved strategy, has once again been effective in minimising loan charges through minimising the cost of borrowing and maximising the return on deposits within the parameters set by the strategy for the year.

Although benefits from Treasury Management activity continue to accrue there are no direct financial implications or other resource issues arising from this report.

The loan charges associated with Capital Expenditure and Treasury Management activity during 2023/24 are reported in the Financial Monitoring 2023/24 – General Fund Revenue report and HRA 2023/24 Outturn report elsewhere on the Council agenda for 25 June 2024.

5.2 Digital

None.

5.3 Risk

As the Council follows the requirements of the new CIPFA Code of Practice and the Prudential Code this minimises the risks involved in Treasury Management activities place. For those risks that do exist there are robust and effective controls in place to further mitigate the level of risks. These include full written Treasury Management Practices, which define the responsibilities of all staff involved, and which were updated during the 2023/24 financial year to reflect the provisions of the new Prudential and Treasury Management Codes and approved by Audit Committee.

5.4 Ensuring Equalities (if required a separate IIA must be completed)

This report does not recommend any change to policy or practice and therefore does not require an Equalities Impact Assessment.

5.5 Additional Report Implications

See Appendix A

Appendices:-

Appendix 1: Annual Treasury Management Review 2023/24

APPENDIX A – Report Implications

A.1 Key Priorities within the Single Midlothian Plan

Not applicable

A.2 Key Drivers for Change

Key drivers addressed in this report:

- ☐ Holistic Working
- ☐ Hub and Spoke
- ☐ Modern
- ☒ Sustainable
- ☒ Transformational
- ☐ Preventative
- ☐ Asset-based
- ☒ Continuous Improvement
- ☐ One size fits one
- ☐ None of the above

A.3 Key Delivery Streams

Key delivery streams addressed in this report:

- ☐ One Council Working with you, for you
- ☒ Preventative and Sustainable
- ☐ Efficient and Modern
- ☐ Innovative and Ambitious
- ☐ None of the above

A.4 Delivering Best Value

The report does not directly impact on Delivering Best Value.

A.5 Involving Communities and Other Stakeholders

Although no external consultation has taken place, cognisance has been taken of professional advice obtained from Link Asset Services, the Council's appointed Treasury Consultants.

A.6 Impact on Performance and Outcomes

The strategies adopted are an integral part of the corporate aim to achieve Best Value as they seek to minimise the cost of borrowing by exercising prudent debt management and placement of deposits. This in turn helps to ensure that the Council's capital expenditure is sustainable in revenue terms.

A.7 Adopting a Preventative Approach

Not applicable.

A.8 Supporting Sustainable Development

Not applicable.

Appendix 1

Annual Treasury Management Review 2023/24

Midlothian Council
June 2024

Contents

This Council is required by regulations issued under the Local Government in Scotland Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2023/24. This report meets the requirements of both the updated CIPFA Code of Practice on Treasury Management, (the Code), and the updated CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

During 2023/24 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 21 February 2023);
- a mid-year, (minimum), treasury update report (Council 19 December 2023);
- an annual review following the end of the year describing the activity compared to the strategy, (this report);

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit Committee before they are reported to the full Council.

1. The Council's Capital Expenditure and Financing 2023/24

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

Table 1: Capital Expenditure + Financing

	2022/23 Actual £000	2023/24 Budget £000	2023/24 Actual £000
General Fund			
Capital Expenditure	23,337	86,289	47,656
Available Funding	18,627	35,091	27,445
Borrowing Required	**4,710**	**51,198**	**20,211**
HRA			
Capital Expenditure	51,710	94,897	50,411
Available Funding	9,932	7,991	6,724
Borrowing Required	**41,778**	**86,906**	**43,687**
General Fund and HRA			
Capital Expenditure	75,047	181,186	98,067
Available Funding	28,559	43,082	34,169
Borrowing Required	**46,488**	**138,104**	**63,898**

2. The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend. It represents the 2023/24 unfinanced capital expenditure (see above table), plus prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

Reducing the CFR – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Scheduled Debt Amortisation (or loans repayment), to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the minimum loan repayment each year through an additional revenue charge.

The Council's CFR for the year is shown below, and represents a key prudential indicator.

Table 2: Council's Underlying Borrowing Requirement			
	31-Mar-23	2023/24	31-Mar-24
CFR:	**Actual**	**Budget**	**Actual**
	£000	**£000**	**£000**
Opening balance	**£ 307,247**	**£ 343,626**	**£ 347,661**
Add Borrowing Required	£ 46,488	£ 138,104	£ 63,898
Less scheduled debt amortisation	£ (6,074)	£ (9,068)	£ (9,714)
Closing balance	**£ 347,661**	**£ 472,662**	**£ 401,845**

Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2022/23) plus the estimates of any additional capital financing requirement for the current (2023/24) and next three 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 2023/24. The table below highlights the Council's gross borrowing position against the CFR (excluding PFI schemes). The Council has complied with this prudential indicator.

Table 3: Council's Gross Borrowing Position			
	31-Mar-23 Actual	2023/24 Budget	31-Mar-24 Actual
	£000	£000	£000
Gross Borrowing	£ 321,753	£472,662	£ 340,871
CFR	£ 347,661	£472,662	£ 401,845

The authorised limit – this Council has kept within its authorised external borrowing limit as shown by the table below. Once this has been set, the Council does not have the power to borrow above this level.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

Table 4: Gross Borrowing against Authorised Limit / Operational Boundary	
	2023/24
Authorised limit - borrowing	£ 534,105
Operational boundary - borrowing	£ 534,105
Maximum gross borrowing position	£ 340,871
Average gross borrowing position	£ 321,962

3. Treasury Position as at 31 March 2024

The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the Purpose section of this report, and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2023/24 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

Table 5: Treasury Position

	31 March 2023 Principal	Rate/ Return	Average Life (Yrs)	31 March 2024 Principal	Rate/ Return	Average Life (Yrs)
Debt						
Fixed Rate Debt						
PWLB	£ 284,633	2.92%	32.25	£ 304,580	3.02%	29.40
Market	£ 22,120	2.98%	28.89	£ 21,291	3.01%	28.34
Total Fixed Rate Debt	**£ 306,753**	**2.92%**	**32.01**	**£ 325,871**	**3.02%**	**29.33**
Variable Rate Debt						
PWLB	£ -	n/a	n/a	£ -	n/a	n/a
Market	£ 15,000	4.63%	27.71	£ 15,000	4.63%	26.71
Total Variable Rate Debt	**£ 15,000**	**4.63%**	**27.71**	**£ 15,000**	**4.63%**	**26.71**
Total debt/gross borrowing	**£ 321,753**	**3.00%**	**31.81**	**£ 340,871**	**3.09%**	**29.22**
CFR	**£ 347,661**			**£ 401,845**		
Over/ (under) borrowing	**£ (25,908)**			**£ (60,974)**		
Deposits						
Fixed Rate Deposits						
In House	£ 98,000	3.77%	0.31	£ 30,000	5.12%	0.83
With Managers	£ -	n/a	n/a	£ -	n/a	n/a
Total Fixed Rate Deposits	**£ 98,000**	**3.77%**	**0.31**	**£ 30,000**	**5.12%**	**0.83**
Variable Rate Deposits						
In House	£ 15,982	3.96%	0.01	£ 26,618	5.28%	0.01
With Managers	£ -	n/a	n/a	£ -	n/a	n/a
Total Variable Rate Deposits	**£ 15,982**	**3.96%**	**0.01**	**£ 26,618**	**5.28%**	**0.01**
Total Deposits	**£ 113,982**	**3.80%**	**0.27**	**£ 56,618**	**5.20%**	**0.45**

The maturity structure of the debt portfolio was as follows:

Table 6: Maturity Structure of Debt Portfolio					
	31-Mar-23		2023/24	31-Mar-24	
	Actual		Original Limits	Actual	
	£000	%	%	£000	%
Under 12 months	£ 812	0%	0% to 50%	£ 1,426	0%
12 months to 2 years	£ 1,496	0%	0% to 50%	£ 1,263	0%
2 years to 5 years	£ 2,795	1%	0% to 50%	£ 22,323	7%
5 years to 10 years	£ 45,136	14%	0% to 50%	£ 45,106	13%
10 years to 20 years	£ 32,239	10%	0% to 50%	£ 32,365	9%
20 years to 30 years	£ 39,691	12%	0% to 50%	£ 51,505	15%
30 years to 40 years	£ 84,584	26%	0% to 50%	£ 81,883	24%
40 years to 50 years	£ 110,000	34%	0% to 50%	£ 100,000	29%
50 years and above	£ 5,000	2%	0% to 50%	£ 5,000	1%
Total	**£ 321,753**	**100%**		**£ 340,871**	**100%**

The maturity structure of the Council's deposits was as follows:

Table 7: Maturity Structure of Deposit Portfolio		
	31-Mar-23	31-Mar-24
	£000	£000
Deposit		
Under 1 Year	£ 113,982	£ 56,618
Over 1 Year	£ -	£ -
Total	**£ 113,982**	**£ 56,618**

The exposure to fixed and variable interest rates on debt was as follows:-

Table 8: Fixed/Variable Interest Rate Exposure of Debt Portfolio					
	31-Mar-23		2022/23	31-Mar-24	
	Actual		Original Limits	Actual	
	£000	%	%	£000	%
Fixed Interest Rate Exposure	£ 306,753	95%	0% to 100%	£ 325,871	96%
Variable Interest Rate Exposure	£ 15,000	5%	0% to 30%	£ 15,000	4%
Total	**£ 321,753**	**100%**		**£ 340,871**	**100%**

4. The Strategy for 2023/24

At the outset of the financial year, the Council were under borrowed by £25.908 million and holding £156.367 million in instant access accounts and fixed term deposits.

Interest rate forecasts within the 2023/24 Treasury Management & Investment Strategy suggested that interest rates were expected to plateau before gradually falling in the 2nd half of the year and throughout the forthcoming 2 financial years.

Link Interest Rate forecasts at time of TMIS 2023/24 setting (February 2023)

Link Group Interest Rate View	07.02.23												
	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26
BANK RATE	4.25	4.50	4.50	4.25	4.00	3.75	3.25	3.00	2.75	2.75	2.50	2.50	2.50
3 month ave earnings	4.30	4.50	4.50	4.30	4.00	3.80	3.30	3.00	2.80	2.80	2.50	2.50	2.50
6 month ave earnings	4.40	4.50	4.40	4.20	3.90	3.70	3.20	2.90	2.80	2.80	2.60	2.60	2.60
12 month ave earnings	4.50	4.50	4.40	4.20	3.80	3.60	3.10	2.70	2.70	2.70	2.70	2.70	2.70
5 yr PWLB	4.00	4.00	3.90	3.80	3.70	3.60	3.50	3.40	3.30	3.20	3.10	3.10	3.10
10 yr PWLB	4.20	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.50	3.40	3.30	3.30	3.20
25 yr PWLB	4.60	4.60	4.40	4.30	4.20	4.10	3.90	3.80	3.70	3.60	3.50	3.40	3.40
50 yr PWLB	4.30	4.30	4.20	4.10	3.90	3.80	3.60	3.60	3.40	3.30	3.20	3.20	3.10

Link Interest Rate forecasts at end of 2023/24 Financial Year (March 2024)

Link Group Interest Rate View	25.03.24												
	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	5.25	5.25	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	4.80	4.30	3.80	3.30	3.00	3.00	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.20	5.10	4.60	4.10	3.70	3.30	3.10	3.10	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.00	4.90	4.40	3.90	3.60	3.20	3.10	3.10	3.10	3.10	3.10	3.20	3.20
5 yr PWLB	4.50	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.60	3.50	3.50	3.50
10 yr PWLB	4.70	4.50	4.40	4.30	4.20	4.10	4.00	3.90	3.80	3.70	3.70	3.70	3.70
25 yr PWLB	5.20	5.10	4.90	4.80	4.60	4.40	4.30	4.20	4.20	4.10	4.10	4.10	4.10
50 yr PWLB	5.00	4.90	4.70	4.60	4.40	4.20	4.10	4.00	4.00	3.90	3.90	3.90	3.90

With interest rates on new borrowing remaining elevated throughout much of 2023/24, borrowing was deferred until the final quarter of the year. Borrowing undertaken in March 2024 amounted to £20.000 million of PWLB maturities with short term tenors of 3 and 4 years to allow the Council to navigate past the expected hump in interest rates.

This position is prudent in the current economic climate (with PWLB rates forecast to drop from their prevailing rates, across the next 2 financial years), as it balances longer-term interest rate and refinancing risk with short-medium term budgetary implications.

At 31 March 2024, the Council was under-borrowed by £60.974 million. This means that the majority (85%) of the capital borrowing need, (the Capital Financing Requirement), is fully funded with loan debt.

The majority of useable reserves of £84.532 million at 31 March 2024 are fully cash backed.

5. The Economy and Interest Rates

UK Economy

Against a backdrop of stubborn inflationary pressures, the Russian invasion of Ukraine, and war in the Middle East, UK interest rates have continued to be volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2023/24.

Markets have sought an end to central banks' on-going phase of keeping restrictive monetary policy in place on at least one occasion during 2023/24 but to date only the Swiss National Bank has cut rates and that was at the end of March 2024.

UK, EZ and US 10-year yields have all stayed stubbornly high throughout 2023/24. The table below provides a snapshot of the conundrum facing central banks: inflation is easing, albeit gradually, but labour markets remain very tight by historical comparisons, making it an issue of fine judgment as to when rates can be cut.

	UK	Eurozone	US
Bank Rate	5.25%	4%	5.25%-5.5%
GDP	-0.3%q/q Q4 (-0.2%y/y)	+0.0%q/q Q4 (0.1%y/y)	2.0% Q1 Annualised
Inflation	3.4%y/y (Feb)	2.4%y/y (Mar)	3.2%y/y (Feb)
Unemployment Rate	3.9% (Jan)	6.4% (Feb)	3.9% (Feb)

The Bank of England sprung no surprises in their March meeting, leaving interest rates at 5.25% for the fifth time in a row and, despite no MPC members no longer voting to raise interest rates, it retained its relatively hawkish guidance.

The Bank's communications suggest the MPC is gaining confidence that inflation will fall sustainably back to the 2.0% target.

However, although the MPC noted that "the restrictive stance of monetary policy is weighing on activity in the real economy, is leading to a looser labour market and is bearing down on inflationary pressures", conversely it noted that key indicators of inflation persistence remain elevated and policy will be "restrictive for sufficiently long" and "restrictive for an extended period".

Of course, the UK economy has started to perform a little better in Q1 2024 but is still recovering from a shallow recession through the second half of 2023. Indeed, Q4 2023 saw negative GDP growth of -0.3% while y/y growth was also negative at -0.2%.

But it was a strange recession. Unemployment is currently sub 4%, against a backdrop of still over 900k of job vacancies, and annual wage inflation is running at above 5%. With gas and electricity price caps falling in April 2024, the CPI measure of inflation - which peaked at 11.1% in October 2022 – is now expected to continue to fall and to remain below that Bank of England benchmark for the next couple of years, according to Capital Economics; albeit the Bank of England still needs some convincing on that score. It is noted that core CPI was still a heady 4.5% in February and, ideally, needs to fall further.

Shoppers largely shrugged off the unusually wet weather in February, whilst rising real household incomes should support retail activity throughout 2024. Furthermore, the impact of higher interest rates on household interest payments is getting close to its peak, even though fixed rate mortgage rates on new loans have shifted up a little since falling close to 4.5% in early 2024.

From a fiscal perspective, the further cuts to national insurance tax (from April) announced in the March Budget will boost real household disposable income by 0.5 - 1.0%; although it remains to be seen how the General Election will impact this.

After real household disposable income rose by 1.9% in 2023, Capital Economics forecast it will rise by 1.7% in 2024 and by 2.4% in 2025. These rises in real household disposable income, combined with the earlier fading of the drag from previous rises in interest rates, means GDP growth of 0.5% is envisaged in 2024 and 1.5% in 2025. The Bank of England is less optimistic than that, seeing growth struggling to get near 1% over the next two to three years.

As for equity markets, the FTSE 100 has risen to nearly 8,000 and is now only 1% below the all-time high it reached in February 2023. The modest rise in UK equities in February was driven by strong performances in the cyclical industrials and consumer discretionary sectors, whilst communications and basic materials have fared poorly.

Despite its performance, the FTSE 100 is still lagging behind the S&P 500, which has been at an all-time high for several weeks.

USA Economy

Despite the markets willing the FOMC to cut rates as soon as June 2024, the continued resilience of the economy, married to sticky inflation, is providing a significant headwind to a change in monetary policy. Markets currently anticipate three rate cuts this calendar year, but two or less would not be out of the question. Currently, policy remains flexible but primarily data driven.

In addition, the Fed will want to shrink its swollen $16 trillion balance sheet at some point. Just because the $ is the world's foremost reserve currency (China owns over $1 trillion) does not mean the US can continually run a budget deficit. The mix of stubborn inflation and significant treasury issuance is keeping treasury yields high. The 10 year stands at 4.4%.

As for inflation, it is currently a little above 3%. The market is not expecting a recession, but whether rates staying high for longer is conducive to a soft landing for the economy is uncertain, hence why the consensus is for rate cuts this year and into 2025…but how many and when?

EZ Economy

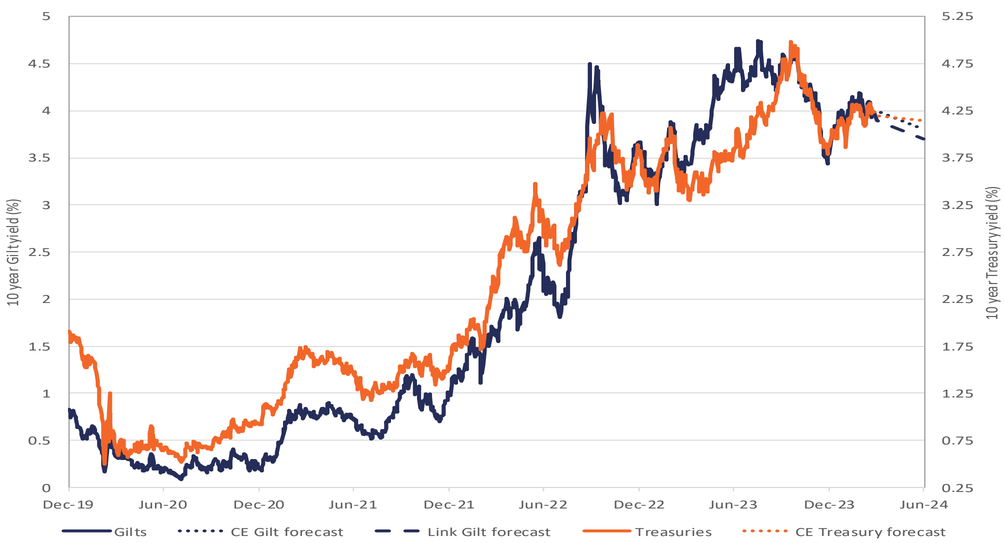
Although the Euro-zone inflation rate has fallen to 2.4%, the ECB will still be mindful that it has further work to do to dampen inflation expectations. However, with growth steadfastly in the slow lane (GDP flatlined in 2023), a June rate cut from the current 4% looks probable.

6. Borrowing Rates in 2023/24

PWLB rates are based on gilt (UK Government bonds) yields through HM Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields. Inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation and the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. Indeed, in recent years many bond yields up to 10 years in the Eurozone turned negative on expectations that the EU would struggle to get growth rates and inflation up from low levels. In addition, there has, at times, been an inversion of bond yields in the US whereby 10-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession.

However, since early 2022, yields have risen dramatically in all the major developed economies, first as economies opened post-Covid; then because of the inflationary impact of the war in Ukraine in respect of the supply side of many goods. In particular, rising cost pressures emanating from shortages of energy and some food categories have been central to inflation rising rapidly. Furthermore, at present the FOMC, ECB and Bank of England are all being challenged by levels of persistent inflation that are exacerbated by very tight labour markets and high wage increases relative to what central banks believe to be sustainable.

Graph of 10 year UK gilt yields v. US treasury yields



Gilt yields have generally been on a continual rise since the start of 2021, peaking in the autumn of 2023. Currently, yields are broadly range bound between 3.5% and 4.25%.

At the close of the day on 28 March 2024, all gilt yields from 1 to 50 years were between 3.81% and 4.56%, with the 1 year being the highest and 6-7 years being the lowest yield.

Regarding PWLB borrowing rates, the various margins attributed to their pricing are as follows: -

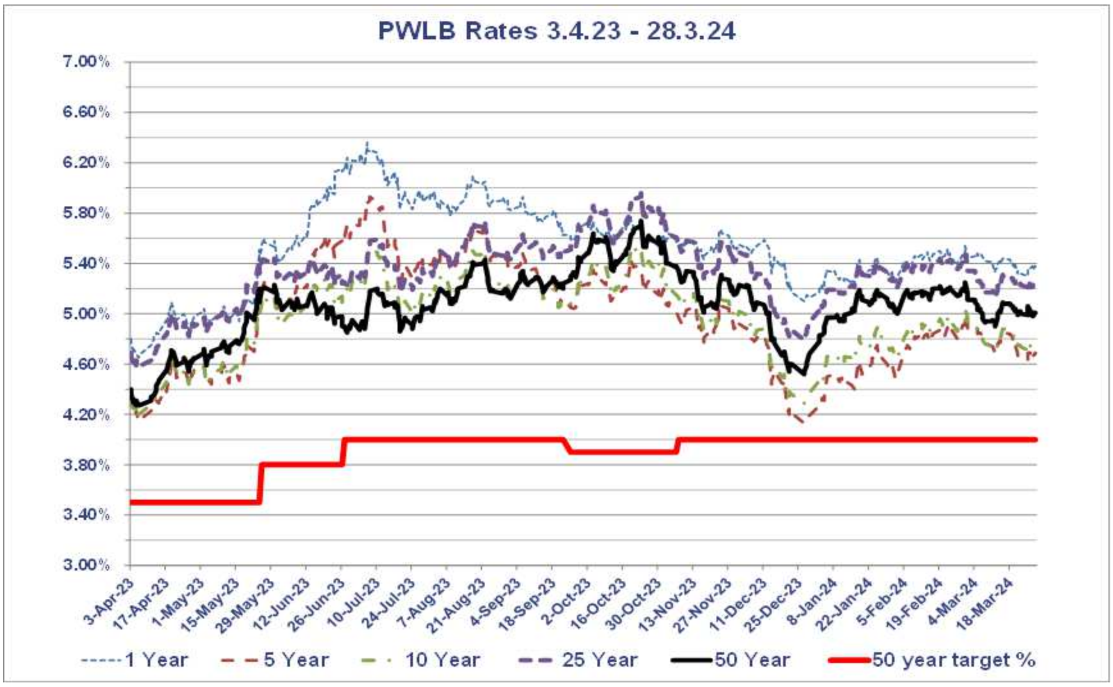
- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)
- **HRA Borrowing Rate** is gilt plus 40bps (G+40bps)

There is likely to be a fall in gilt yields and PWLB rates across the whole curve over the next one to two years as Bank Rate falls and inflation (on the Consumer Price Index measure) moves below the Bank of England's 2% target.

As a general rule, short-dated gilt yields will reflect expected movements in Bank Rate, whilst medium to long-dated yields are driven primarily by the inflation outlook.

The Bank of England is also embarking on a process of Quantitative Tightening. The Bank's original £895bn stock of gilt and corporate bonds will gradually be sold back into the market over several years. The impact this policy will have on the market pricing of gilts, while issuance is markedly increasing, and high in historic terms, is an unknown at the time of writing.

HIGH/LOW/AVERAGE PWLB RATES FOR 2023/24



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	4.65%	4.13%	4.20%	4.58%	4.27%
Low Date	06/04/2023	27/12/2023	06/04/2023	06/04/2023	05/04/2023

High	6.36%	5.93%	5.53%	5.96%	5.74%
High Date	06/07/2023	07/07/2023	23/10/2023	23/10/2023	23/10/2023
Average	5.54%	4.99%	4.97%	5.34%	5.08%
Spread	1.71%	1.80%	1.33%	1.38%	1.47%

7. Borrowing Outturn for 2023/24

New Treasury Borrowing:-

The following table gives details of new external treasury loans drawn during the year:-

Table 9: New Loans Taken in Financial Year 2023/24						
Lender	**Date Taken**	**Principal £000's**	**Interest Rate**	**Fixed/ Variable**	**Maturity Date**	**Term (Yrs)**
PWLB Maturity	28 Mar 2024	£ 10,000	4.54%	Fixed	28 Mar 2027	3.00
PWLB Maturity	28 Mar 2024	£ 10,000	4.37%	Fixed	28 Mar 2028	4.00
Total		**£ 20,000**				

Maturing Debt:-

The following table gives details of treasury debt maturing during the year:-

Table 10: Maturing Debt in Financial Year 2023/24						
Lender	**Date Repaid**	**Principal £000's**	**Interest Rate**	**Fixed/ Variable**	**Date Originally Taken**	**Original Term (Yrs)**
PWLB Annuities	Various	£ 53	7.75%-9.50%	Fixed	02 Aug 1968 to 15 May 1972	56-60 years
Salix	Various	£ 165	0.00%	Fixed	Various	7-8 years
Deutsche Pfandbriefbank	Various	£ 357	2.63%	Fixed	29 Jun 2017	28.00
Deutsche Pfandbriefbank	Various	£ 307	2.73%	Fixed	15 Nov 2018	25.50
Total		**£ 882**				

Rescheduling:-

No rescheduling was done during the year.

Summary of debt transactions:-

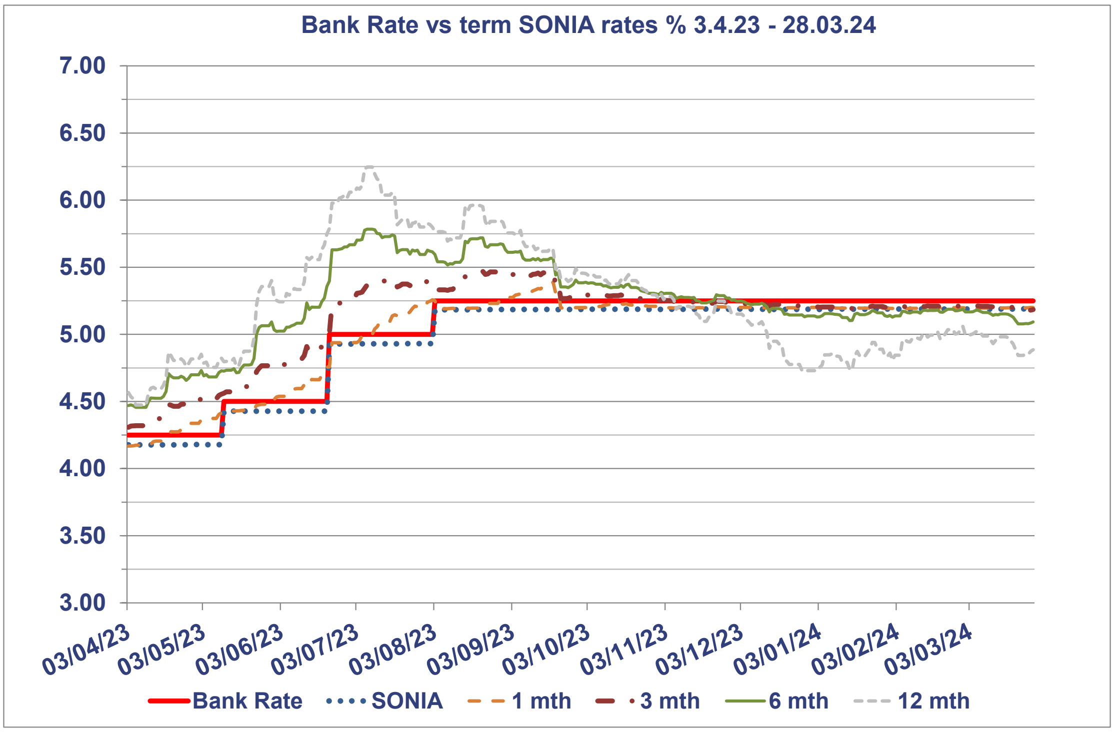
The average interest rate payable on external debt remained steady throughout the year, averaging 3.00% for the 2023/24 financial year (opening rate of 3.00% with closing rate of 3.09%). The average life of debt within the loan portfolio dropped from 31.81 years to 29.22 years.

8. Deposit Rates in 2023/24

Investment returns increased throughout the early part of 2023/24 to c. 5.25% before plateauing for the remainder of the year.

Money market fund rates started the year at 3.92-3.96%, increasing throughout the early part of the year in line with movements in Bank of England Base Rates, ending the year at 5.26-5.29%, with money market funds and instant access call accounts being utilised to manage the Council's day to day liquidity needs.

HIGH/LOW/AVERAGE BANK AND SONIA RATES FOR 2023/24



	Bank Rate	SONIA	1 mth	3 mth	6 mth	12 mth
Low	4.25%	4.18%	4.17%	4.31%	4.46%	4.47%
Low Date	03/04/2023	04/04/2023	03/04/2023	03/04/2023	06/04/2023	06/04/2023
High	5.25%	5.19%	5.39%	5.48%	5.78%	6.25%
High Date	03/08/2023	28/3/2024	19/09/2023	30/08/2023	07/07/2023	07/07/2023
Average	5.03%	4.96%	5.02%	5.13%	5.23%	5.2%
Spread	1.00%	1.01%	1.22%	1.17%	1.33%	1.77%

Investment returns picked up throughout the course of 2023/24 as central banks, including the Bank of England, continued to respond to inflationary pressures that were not transitory, and realised that tighter monetary policy was called for.

Starting April at 4.25%, Bank Rate moved up in stepped increases of either 0.25% or 0.5%, reaching 5.25% by August. By the end of the financial year, no further increases were anticipated.

The upward sloping yield curve that prevailed throughout 2023/24 meant that local authorities continued to be faced with the challenge of proactive investment of surplus cash, and this emphasised the need for a detailed working knowledge of cashflow projections so that the appropriate balance between maintaining cash for liquidity purposes, and “laddering” deposits on a rolling basis to lock in the increase in investment rates as duration was extended, became an on-going feature of the investment landscape.

With bond markets selling off, UK equity market valuations struggled to make progress, as did property funds, although there have been some spirited, if temporary, market rallies from time to time – including in November and December 2023. However, the more traditional investment options, such as specified investments (simple to understand, and less than a year in duration), have continued to be at the forefront of most local authority investment strategies, particularly given Money Market Funds have also provided decent returns in close proximity to Bank Rate for liquidity purposes.

While the Council has taken a prudent approach to investing surplus monies, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the Global Financial Crisis of 2008/09. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

9. Funds on Deposit Outturn for 2023/24

Deposit Policy:-

The Council's policy for placing deposits is governed by Scottish Government Investment Regulations, and the requirements of the CIPFA Prudential and Treasury Management Codes, which have been implemented in the annual investment strategy approved by the Council on 21 February 2023. This policy sets out the approach to the considerations when placing deposits, specifically security, liquidity and then yield (in that order) and sets out the approach for choosing counterparties based on their credit strength, and for financial institutions is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

The activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties. The position at 31 March 2024 was as follows:-

Table 11: Breakdown of Deposits by Counterparty at 31 March 2024

Counterparty	Principal Outstanding 31 Mar 2024 £000's	Security Long/Short Term Rating (Colour)	Liquidity		Yield	UK Local Authority Investment* £000's
Bank of Scotland	1,498	A+/F1 (Red)	Instant Access Call Account		5.14%	203,653
Royal Bank of Scotland	2	A+/F1 (Blue)	Instant Access Call Account		3.25%	21,857
Handelsbanken	19	AA/F1+ (Orange)	Instant Access Call Account		5.09%	209,263
MMF - Aberdeen Liquidity Fund	216	AAAmmf (Yellow)	Instant Access Money Market Fund		5.26%	689,417
MMF - Federated	10,548	AAAmmf (Yellow)	Instant Access Money Market Fund		5.29%	1,086,498
MMF - LGIM	14,335	AAAmmf (Yellow)	Instant Access Money Market Fund		5.29%	399,681
National Westminster Bank plc	20,000	A+/F1 (Blue)	27-Mar-24	27-Mar-25	5.06%	558,629
Handelsbanken	10,000	AA/F1+ (Orange)	27-Mar-24	27-Sep-24	5.25%	209,263
Total Deposits	**56,618**				**5.20%**	**2,943,488**

** As at 31 March 2024*

Deposits placed by the Council:-

The Council maintained an average balance of £94.298 million of instant access and fixed term deposits, earning an average rate of return of 4.86%. The comparable performance indicator[3] is 4.42%.

[3] 4.5 month backward uncompounded SONIA (Sterling Overnight Index Average) which reflects the weighted average duration of the Council's portfolio for the year

10. Performance Measurement

One of the key requirements in the Code is the formal introduction of performance measurement relating to investments, debt and capital financing activities.

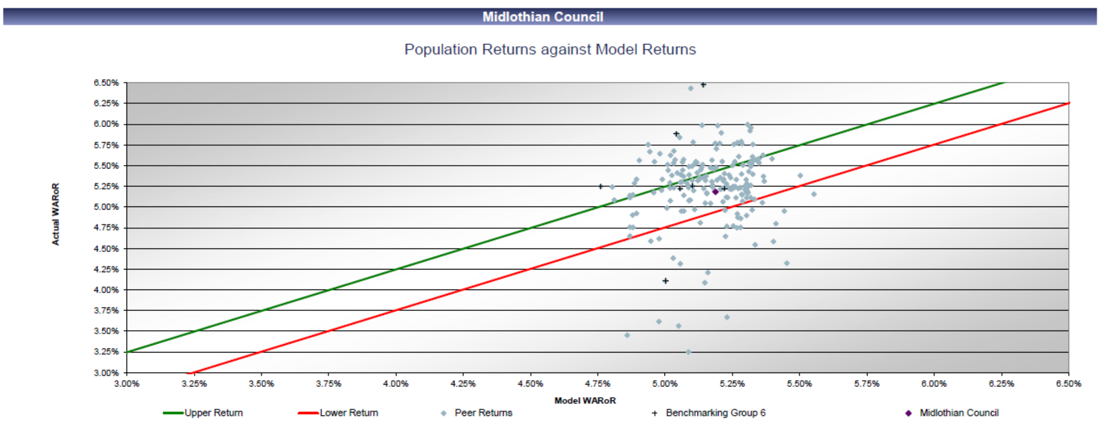
Loans Fund Rate

Combining the interest paid (earned) on external debt (deposits) with charges for premiums written off and internal interest allowed into an average Loans Fund Rate, Midlothian's result of 2.41% for 2022/23 was the lowest Loans Fund Rate amongst all mainland authorities in Scotland, as reported previously to Council.

The comparative Loans Fund Rate for 2023/24, of 2.08%, is once again expected to be one of the lowest when benchmarked against all mainland authorities in Scotland (note that at present, these benchmark figures are not yet available).

Deposit Benchmarking

The Council participates in the Scottish Investment Benchmarking Group set up by its Treasury Management Consultants, Link. This service provided by Link provides benchmarking data to authorities for reporting and monitoring purposes, by measuring the security, liquidity and yield within an individual authority portfolio. Based on the Council's funds on deposit as at 31 March 2024, the Weighted Average Rate of Return (WARoR) on deposits of 5.20% against other authorities is shown in the graph below:-



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
Midlothian Council	5.18%	5.19%	0.00%	4.94%	5.43%	Inline

As can be seen from the above graph, Midlothian is performing above the Link model benchmarks (red to green lines), and is achieving one of the highest Weighted Average Rates of Return (WARoR) for the Weighted Average Credit Risk held, not only amongst peer Councils within the Benchmarking Group but also amongst the population of authorities across the UK.

Debt Performance

Whilst deposit performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide. In this respect, the relevant figures for Midlothian are incorporated in the table in Section 3.

11. Conclusion

The Council's overall cost of borrowing continues to benefit significantly from the approved strategy and the proactive Treasury Management activity undertaken.

The cost of long term borrowing has been maintained throughout the year, with the benefit of long term borrowing in December 2021 allowing the Council to defer borrowing at higher than forecast rates during the 2023/24 financial year.

A better than average return on deposits has been achieved for the eighteenth consecutive year and Midlothian continues to perform above the Link model benchmarks and is achieving one of the highest Weighted Average Rates of Return (WARoR) for the Weighted Average Credit Risk held, not only amongst peer Councils within the Benchmarking Group but also amongst the population of authorities across the UK.

Overall Midlothian's Loans Fund Rate of 2.08% for the year is expected to be one of the lowest when benchmarked against all mainland Authorities in Scotland.