Appendix B

Annual Treasury Management Review 2022/23

Midlothian Council
June 2023

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 2022/23. 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 2022/23 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 15/02/2022);
- a mid-year, (minimum), treasury update report (Council 13/12/2022);
- 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 2022/23

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			
	2021/22 Actual £000	**2022/23 Budget £000**	**2022/23 Actual £000**
General Fund			
Capital Expenditure	22,969	68,240	23,322
Available Funding	17,115	32,796	18,627
Borrowing Required	**5,854**	**35,444**	**4,695**
HRA			
Capital Expenditure	39,477	124,894	51,710
Available Funding	33,058	7,240	9,932
Borrowing Required	**6,419**	**117,654**	**41,778**
General Fund and HRA			
Capital Expenditure	62,446	193,134	75,032
Available Funding	50,173	40,036	28,559
Borrowing Required	**12,273**	**153,098**	**46,473**

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 2022/23 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-22	**2022/23**	**31-Mar-23**
CFR:	**Actual**	**Budget**	**Actual**
	£000	**£000**	**£000**
Opening balance	**£ 302,758**	**£ 312,806**	**£ 307,247**
Add Borrowing Required	£ 12,273	£ 153,098	£ 46,473
Less scheduled debt amortisation	£ (7,784)	£ (5,843)	£ (6,059)
Closing balance	**£ 307,247**	**£ 460,061**	**£ 347,661**

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 (2021/22) plus the estimates of any additional capital financing requirement for the current (2022/23) 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 2022/23. 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-21	2021/22	31-Mar-22
	Actual	Budget	Actual
	£000	£000	£000
Gross Borrowing	£ 323,271	£ 363,996	£ 321,753
CFR	£ 307,247	£ 460,061	£ 347,661

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	
	2022/23
Authorised limit - borrowing	£ 472,662
Operational boundary - borrowing	£ 472,662
Maximum gross borrowing position	£ 323,271
Average gross borrowing position	£ 322,650

3. Treasury Position as at 31 March 2023

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 2022/23 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

Table 5: Treasury Position

	31 March 2022 Principal	Rate/ Return	Average Life (Yrs)	31 March 2023 Principal	Rate/ Return	Average Life (Yrs)
Debt						
Fixed Rate Debt						
PWLB	£ 285,328	2.94%	33.18	£ 284,633	2.92%	32.25
Market	£ 22,943	2.95%	29.49	£ 22,120	2.98%	28.89
Total Fixed Rate Debt	**£ 308,271**	**2.94%**	**32.91**	**£ 306,753**	**2.92%**	**32.01**
Variable Rate Debt						
PWLB	£ -	n/a	n/a	£ -	n/a	n/a
Market	£ 15,000	4.63%	28.71	£ 15,000	4.63%	27.71
Total Variable Rate Debt	**£ 15,000**	**4.63%**	**28.71**	**£ 15,000**	**4.63%**	**27.71**
Total debt/gross borrowing	**£ 323,271**	**3.02%**	**32.71**	**£ 321,753**	**3.00%**	**31.81**
CFR	**£ 307,247**			**£ 347,661**		
Over/ (under) borrowing	**£ 16,024**			**£ (25,908)**		
Deposits						
Fixed Rate Deposits						
In House	£ 80,000	1.06%	0.41	£ 98,000	3.77%	0.31
With Managers	£ -	n/a	n/a	£ -	n/a	n/a
Total Fixed Rate Deposits	**£ 80,000**	**1.06%**	**0.41**	**£ 98,000**	**3.77%**	**0.31**
Variable Rate Deposits						
In House	£ 76,367	0.61%	0.10	£ 15,982	3.96%	0.01
With Managers	£ -	n/a	n/a	£ -	n/a	n/a
Total Variable Rate Deposits	**£ 76,367**	**0.61%**	**0.10**	**£ 15,982**	**3.96%**	**0.01**
Total Deposits	**£ 156,367**	**0.84%**	**0.26**	**£ 113,982**	**3.80%**	**0.27**

The maturity structure of the debt portfolio was as follows:

Table 6: Maturity Structure of Debt Portfolio					
	31-Mar-22		2022/23	31-Mar-23	
	Actual		Original Limits	Actual	
	£000	%	%	£000	%
Under 12 months	£ 1,465	0%	0% to 50%	£ 812	0%
12 months to 2 years	£ 830	0%	0% to 50%	£ 1,496	0%
2 years to 5 years	£ 3,553	1%	0% to 50%	£ 2,795	1%
5 years to 10 years	£ 33,857	10%	0% to 50%	£ 45,136	14%
10 years to 20 years	£ 43,421	13%	0% to 50%	£ 32,239	10%
20 years to 30 years	£ 12,563	4%	0% to 50%	£ 39,691	12%
30 years to 40 years	£ 95,534	30%	0% to 50%	£ 84,584	26%
40 years to 50 years	£ 127,048	39%	0% to 50%	£ 110,000	34%
50 years and above	£ 5,000	2%	0% to 50%	£ 5,000	2%
Total	**£ 323,271**	**100%**		**£ 321,753**	**100%**

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

Table 7: Maturity Structure of Deposit Portfolio		
	31-Mar-22	31-Mar-23
	£000	£000
Deposit		
Under 1 Year	£ 154,367	£ 113,982
Over 1 Year	£ 2,000	£ -
Total	**£ 156,367**	**£ 113,982**

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-22		2022/23	31-Mar-23	
	Actual		Original Limits	Actual	
	£000	%	%	£000	%
Fixed Interest Rate Exposure	£ 308,271	95%	0% to 100%	£ 306,753	95%
Variable Interest Rate Exposure	£ 15,000	5%	0% to 30%	£ 15,000	5%
Total	**£ 323,271**	**100%**		**£ 321,753**	**100%**

4. The Strategy for 2022/23

At the outset of the financial year, the Council were over borrowed by £16.024 million – this being a result of prudent long-term borrowing of £50.000 million of PWLB long-term maturity loans at rates of between 1.26% and 1.36% in December 2021 when PWLB rates were at an all-time historically low level.

Also at the outset of the financial year, the Council were holding £156.367 million in instant access accounts and fixed term deposits; this level of deposits being higher than normal and reflective of (a) the Scottish Government providing upfront funding to local authorities to support a range of grant schemes, in particular schemes to support local businesses, (b) developer contribution receipts, (c) PWLB borrowing taken in advance, and (d) the impact on the Council's cashflow due to re-phasing of capital expenditure plans. The majority of the level of higher cash balances that are being held are fully committed to fund revenue and capital expenditure in the 2023/24 and forthcoming financial years.

Interest rate forecasts within the 2022/23 Treasury Management & Investment Strategy initially suggested only gradual rises in short, medium and longer-term fixed borrowing rates during 2022/23 (see first table below) but by August it had become clear that inflation was moving up towards 40-year highs, and the Bank of England engaged in monetary policy tightening at every Monetary Policy Committee meeting during 2022, and into 2023, either by increasing Bank Rate by 0.25% or 0.5% each time. Currently the CPI measure of inflation is still above 10% in the UK. Nonetheless, there remain significant risks to that central forecast. Interest rate forecasts at the end of the financial year are also shown in the second table below.

Link Group Interest Rate View	7.2.22											
	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
3 month ave earnings	1.00	1.00	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20
6 month ave earnings	1.10	1.20	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30
12 month ave earnings	1.50	1.60	1.70	1.70	1.60	1.60	1.50	1.40	1.40	1.40	1.40	1.40
5 yr PWLB	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30
10 yr PWLB	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40
25 yr PWLB	2.50	2.50	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60
50 yr PWLB	2.30	2.30	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40

Link Group Interest Rate View	27.03.23											
	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	4.50	4.50	4.25	4.00	3.50	3.25	3.00	2.75	2.75	2.50	2.50	2.50
3 month ave earnings	4.50	4.50	4.30	4.00	3.50	3.30	3.00	2.80	2.80	2.50	2.50	2.50
6 month ave earnings	4.50	4.40	4.20	3.90	3.40	3.20	2.90	2.80	2.80	2.60	2.60	2.60
12 month ave earnings	4.50	4.40	4.20	3.80	3.30	3.10	2.70	2.70	2.70	2.70	2.70	2.70
5 yr PWLB	4.10	4.10	3.90	3.80	3.70	3.60	3.50	3.40	3.30	3.20	3.20	3.10
10 yr PWLB	4.20	4.20	4.00	3.90	3.80	3.70	3.50	3.50	3.40	3.30	3.30	3.20
25 yr PWLB	4.60	4.50	4.40	4.20	4.10	4.00	3.80	3.70	3.60	3.50	3.50	3.40
50 yr PWLB	4.30	4.20	4.10	3.90	3.80	3.70	3.50	3.50	3.30	3.20	3.20	3.10

With interest rates on new borrowing higher than forecast during financial year 2022/23, and the Council holding both an over-borrowed position and significant levels of surplus cash, the opportunity existed throughout the financial year to defer any new long term borrowing and run down surplus cash balances, given that a cost of carry generally remained in place during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary further increase in cash balances; and this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns. This strategy was prudent as investment returns were initially low and minimising counterparty risk on placing investments also needed to be considered.

As a result, all new borrowing in 2022/23 was deferred.

At 31 March 2023, the Council was under-borrowed by £25.908 million. This means that the capital borrowing need, (the Capital Financing Requirement), is not fully funded with loan debt, with the Council's surplus cash and liquidity / working capital supporting this position.

Useable Reserves of £90.583 million at 31 March 2023 are fully cash backed.

5. The Economy and Interest Rates

UK. Economy.

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 in 2022. The table below provides a snapshot of the conundrum facing central banks: inflation is elevated but labour markets are extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needs to tighten.

	UK	Eurozone	US
Bank Rate	4.25%	3%	4.75%-5%
GDP	0.1%q/q Q4 (4.1%y/y)	+0.1%q/q Q4 (1.9%y/y)	2.6% Q4 Annualised
Inflation	10.4%y/y (Feb)	6.9%y/y (Mar)	6.0%y/y (Feb)
Unemployment Rate	3.7% (Jan)	6.6% (Feb)	3.6% (Feb)

Q2 of 2022 saw UK GDP deliver growth of +0.1% q/q, but this was quickly reversed in the third quarter, albeit some of the fall in GDP can be placed at the foot of the extra Bank Holiday in the wake of the Queen's passing. Q4 GDP was positive at 0.1% q/q. Most recently, January saw a 0.3% m/m increase in GDP as the number of strikes reduced compared to December. In addition, the resilience in activity at the end of 2022 was, in part, due to a 1.3% q/q rise in real household disposable incomes. A big part of that reflected the £5.7bn payments received by households from the government under the Energy Bills Support Scheme.

Nevertheless, 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. The flurry of comments from Fed officials over recent months suggest there is still an underlying hawkish theme to their outlook for interest rates. 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.

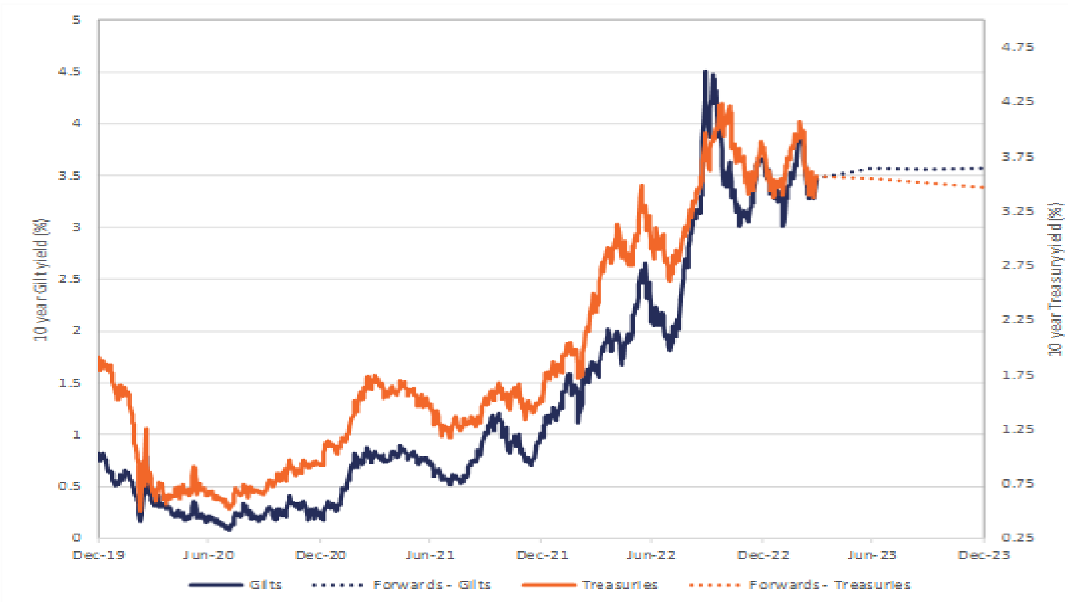
EU. Although the Euro-zone inflation rate has fallen below 7%, the ECB will still be mindful that it has further work to do to dampen inflation expectations and it seems destined to raise rates to 4% in order to do so. Like the UK, growth has remained more robust than anticipated but a recession in 2023 is still seen as likely by most commentators.

6. Borrowing Rates in 2022/23

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 persistent inflation that is exacerbated by very tight labour markets and high wage increases relative to what central banks believe to be sustainable.

Graph of UK gilt yields v. US treasury yields



Gilt yields have been on a continual rise since the start of 2021, peaking in the autumn of 2022. At the close of the day on 31 March 2023, all gilt yields from

1 to 50 years were between 3.64% and 4.18%, with the 1 year being the highest and 6-7.5 years being the lowest yield.

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

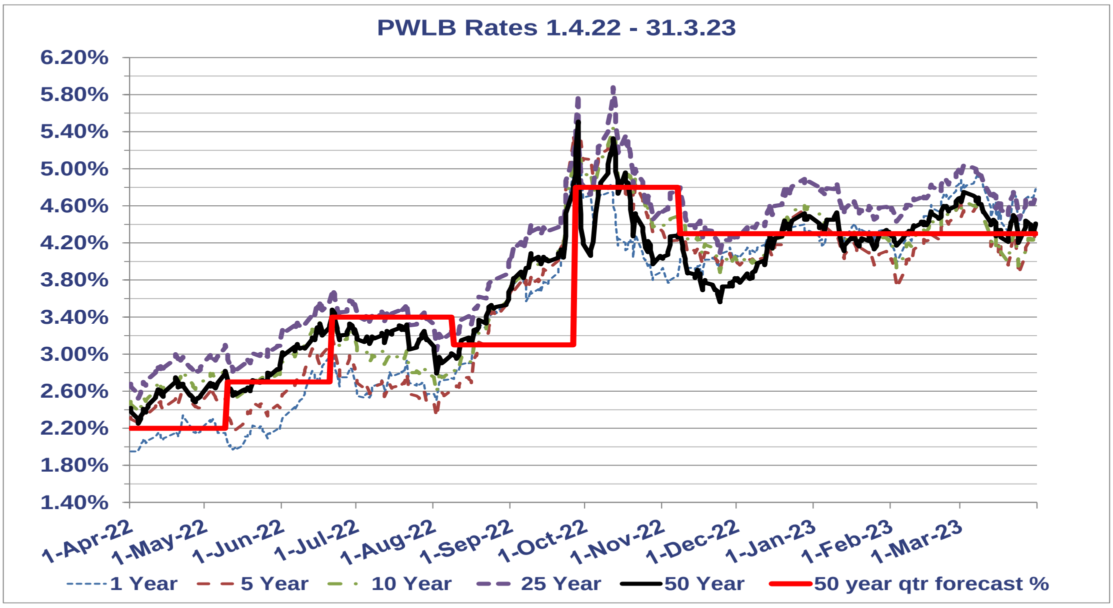
- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

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 first rises to dampen inflationary pressures and a tight labour market, and is then cut as the economy slows, unemployment rises, and inflation (on the Consumer Price Index measure) moves closer to 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, but the scale and pace of this has already been affected by the Truss/Kwarteng government in the autumn of 2022 and more recently by the financial market unease with some US (e.g., Silicon Valley Bank) and European banks (e.g., Credit Suisse). The gradual reduction of the Bank's original £895bn stock of gilt and corporate bonds will 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, is an unknown at the time of writing.

HIGH/LOW/AVERAGE PWLB RATES FOR 2022/23



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.95%	2.18%	2.36%	2.52%	2.25%

Date	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
High	5.11%	5.44%	5.45%	5.88%	5.51%
Date	28/09/2022	28/09/2022	12/10/2022	12/10/2022	28/09/2022
Average	3.57%	3.62%	3.76%	4.07%	3.74%
Spread	3.16%	3.26%	3.09%	3.36%	3.26%

7. Borrowing Outturn for 2022/23

New Treasury Borrowing:-

No new loans were drawn in 2022/23.

Maturing Debt:-

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

Table 10: Maturing Debt in Financial Year 2022/23

Lender	Date Repaid	Principal £000's	Interest Rate	Fixed/ Variable	Date Originally Taken	Original Term (Yrs)
PWLB	03 Feb 2023	£ 648	8.63%	Fixed	16 Feb 1995	28.00
PWLB Annuities	Various	£ 48	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	£ 300	2.73%	Fixed	15 Nov 2018	25.50
Total		**£ 1,518**				

Rescheduling:-

No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Summary of debt transactions:-

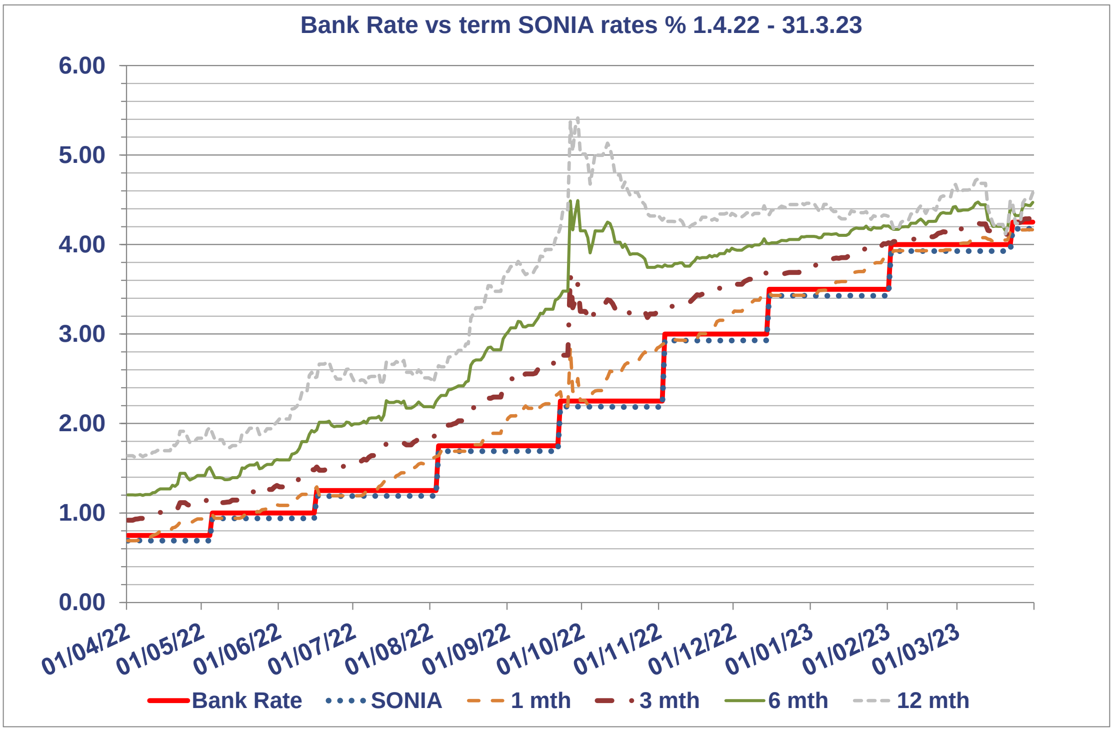
The average interest rate payable on external debt remained steady throughout the year, from an opening rate of 3.02% falling marginally to an end of year rate of 3.00%. The average life of debt within the loan portfolio dropped from 32.71 years to 31.81 years.

8. Deposit Rates in 2022/23

Investment returns picked up throughout the course of 2022/23 as central banks, including the Bank of England, realised that inflationary pressures were not transitory, and that tighter monetary policy was called for.

Starting in April at 0.75%, Bank Rate moved up in stepped increases of either 0.25% or 0.5%, reaching 4.25% by the end of the financial year.

Money market fund rates started the year at 0.51-0.53%, increasing throughout the year in line with movements in Bank of England Base Rates, ending the year at 3.92-3.96%, with money market funds and instant access call accounts being utilised to manage the Council’s day to day liquidity needs.



The sea-change in fixed term investment rates meant local authorities were faced with the challenge of balancing the maintenance of cash for liquidity purposes, and “laddering” deposits on a rolling basis to lock in the increase in investment rates as duration was extended, which became an on-going feature of the investment landscape.

With bond markets selling off, equity valuations struggling to make progress and, latterly, property funds enduring a difficult Q4 2022, the more traditional deposit options, such as vanilla fixed term deposits (simple to understand, and less than a year in duration) became more actively used by local authorities across the UK.

Meantime, through the autumn, and then in March 2023, the Bank of England maintained various monetary policy easing measures as required to ensure specific markets, the banking system and the economy had appropriate levels of liquidity at times of stress.

9. Funds on Deposit Outturn for 2022/23

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 15 February 2022. 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 2023 was as follows:-

Table 11: Breakdown of Deposits by Counterparty at 31 March 2023

Counterparty	Principal Outstanding 31 Mar 2023 £000's	Security Long/Short Term Rating (Colour)	Liquidity		Yield	UK Local Authority Investment*** £000's
MMF - Aberdeen Liquidity Fund	2,342	AAAmmf (Yellow)	Instant Access Money Market Fund		3.93%	943,280
MMF - Federated	14	AAAmmf (Yellow)	Instant Access Money Market Fund		3.92%	540,049
MMF - LGIM	13,624	AAAmmf (Yellow)	Instant Access Money Market Fund		3.96%	327,840
Handelsbanken	2	AA/F1+ (Orange)	Instant Access Call Account		3.80%	258,821
Stoke on Trent City Council	2,000	Quasi-UK Government (AA- / Yellow)	06-Apr-20	06-Apr-23	1.60%	3,354,054
Lloyds Bank Corporate Markets plc	30,000	A+/F1 (Red)	30-Nov-22	30-May-23	4.25%	216,902
Standard Chartered Bank	10,000	A+/F1 (Red)	30-Nov-22	30-May-23	4.06%	702,000
National Westminster Bank plc	15,000	A+/F1 (Blue)	31-May-22	31-May-23	2.00%	830,477
SMBC Bank International plc	11,000	A-/F1 (Red)	02-Feb-23	02-Jun-23	4.13%	125,000
Toronto Dominion Bank	10,000	AA-/F1+ (Orange)	16-Jun-22	15-Jun-23	2.85%	433,405
Landesbank Hessen-Thueringen Girozentrale	5,000	A+/F1+ (Orange)	30-Nov-22	29-Nov-23	4.47%	220,000
National Westminster Bank plc	15,000	A+/F1 (Blue)	08-Mar-23	08-Mar-24	4.80%	830,477
Total Deposits	**113,982**				**3.80%**	**8,782,305**

Deposits placed by the Council:-

The Council maintained an average balance of £159.870 million of instant access and fixed term deposits, earning an average rate of return of 2.03%. The comparable performance indicator[1] is 1.42%.

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[1] 6 month 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.

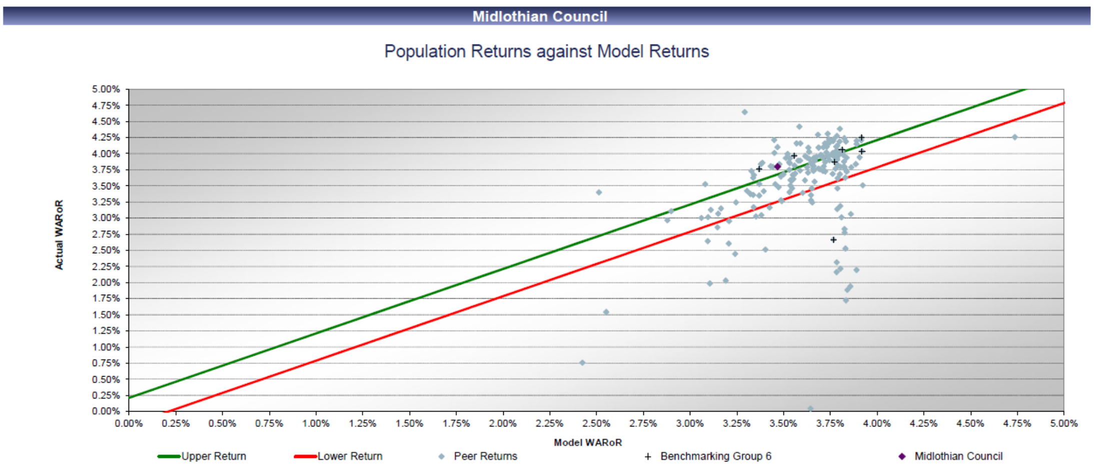
Loans Fund Rate

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 2.98% for 2021/22 was the fifth lowest Loans Fund Rate amongst all mainland authorities in Scotland, as reported previously to Council.

The comparative Loans Fund Rate for 2022/23, of 2.41%, 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 2023, the Weighted Average Rate of Return (WARoR) on deposits of 3.60% against other authorities is shown in the graph below:-



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
Midlothian Council	3.80%	3.47%	0.33%	3.26%	3.68%	Above

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 2022/23 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 2.41% for the year is expected to be one of the lowest when benchmarked against all mainland Authorities in Scotland.