APPENDIX 1

FLINTSHIRE COUNTY COUNCIL

TREASURY MANAGEMENT

ANNUAL REPORT 2023/24

1.00 INTRODUCTION

The Council approved the Treasury Management Strategy 2023/24 (the Strategy) including key indicators, limits and an annual investment strategy on 23rd February 2023.

The Strategy was produced based on the 2021 edition of the *CIPFA Treasury Management in the Public Services: Code of Practice*.

This report includes the requirement in the 2021 Code, mandatory from 1st April 2023, of reporting of the treasury management prudential indicators.

The purpose of this report is to review the outcomes from 2023/24 treasury management operations and compare these with the Strategy.

Treasury management comprises the management of the local authority's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

2.00 ECONOMIC & INTEREST RATE REVIEW 2023/24

This is provided by Arlingclose Ltd, the Council's treasury management advisors.

2.01 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 Council'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.

2.02 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.

3.00 BORROWING REQUIREMENTS AND DEBT MANAGEMENT

3.01 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.

3.02 PWLB (Public Works Loans Board) Certainty Rate

The Council qualified for the PWLB Certainty Rate, allowing the Council to borrow at a reduction of 20 basis points on the Standard Rate for a further 12 months from April 2023.

3.03 Borrowing Activity in 2023/24.

The total long-term borrowing outstanding, brought forward into 2023/24 was £295.2 million.

	Balance 01/04/2023 £m	Debt Maturing £m	New Debt £m	Balance 31/03/2024 £m
Capital Financing Requirement	**355.3**	(6.6)	6.2	**354.9**
Short Term Borrowing	12.0	(12.0)	30.0	30.0
Long Term Borrowing	295.2	(5)	12.1	302.3
TOTAL BORROWING	**307.2**	**(17)**	**42.1**	**332.3**
Other Long-Term Liabilities	2.7	(0.3)	0.00	2.4
TOTAL EXTERNAL DEBT	**309.9**	**(17.3)**	**42.1**	**334.7**
Increase/(Decrease) in Borrowing (£m)	-	-	25.1	

The Council's Capital Programme is financed by a combination of capital receipts and grants, capital expenditure charged to the revenue account (CERA) and borrowing. The borrowing strategy in recent years, in accordance with advice received from the Council's treasury management advisors, Arlingclose, has been to use existing cash balances and short-term borrowing to confirm the long-term borrowing requirement. This is to ensure that the Council does not commit to long-term borrowing too early and borrow unnecessarily, which will be costly. This is balanced against securing low interest costs and achieving cost certainty over the period for which the funds are required so as not to compromise the long-term stability of the portfolio.

Short term borrowing continued to be available throughout the year and was utilised as far as possible without exposing the Council to excessive refinancing risk. The total short term (temporary) borrowing as at 31st March 2024 was £30m with an average rate of 6.08%.

The relative costs and benefits of internal / short-term borrowing and long-term borrowing were monitored closely, in conjunction with Arlingclose, throughout the year. Although Arlingclose's advice was to keep borrowing short, the Council continued to have a long-term borrowing requirement. In December, short to medium term loans were taken to support its strategy of fixing a portion of its long-term borrowing requirement. After discussing with Arlingclose, the following loans were taken out:

Start Date	Maturity Date	Amount	Rate	Loan Type
12 Dec 2023	12 Dec 2035	£5.0m	4.41%	EIP
28 Dec 2023	28 Dec 2036	£7.0m	3.98%	EIP

On 31st March 2024, £279.0m of the Council's loans were in the form of fixed rate with the PWLB, £18.95m were variable rate in the form of LOBOs (Lender Option Borrower Option) and £4.3m were interest free loans from the Government, available for specific schemes. The Council's average rate for long term borrowing was 4.49%.

The Council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) as at 31st March 2024 was £354.9m. The Council's total external debt was £334.7m.

3.04 Lender Option Borrower Option loans (LOBOs)

The Council holds £18.95m of LOBOs, loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost.

As market interest rates rose, there was increased probability of call options on the LOBOs being exercised by lenders. These LOBO loans had semi-annual call option dates during the year to 31st March 2024, however, none of them were called.

The LOBO loans also have call dates within the next 12 months. The Council has liaised with treasury management advisors Arlingclose over the likelihood of the options being exercised. If the option is exercised and an increased rate proposed, the Council plans to repay the loan at no additional cost as accepting the revised terms would mean it would still have refinancing risk in later years. If required, the Council will repay the LOBO loans with available cash or by borrowing from other local authorities or the PWLB.

3.05 Debt Rescheduling

Options for debt rescheduling were explored in conjunction with the Council's treasury management advisors. The premium charged for early repayment of PWLB debt remained relatively expensive for the loans in the Council's portfolio and therefore unattractive for debt rescheduling activity. As a consequence, no rescheduling activity was undertaken.

The Corporate Finance Manager, in conjunction with the Council's treasury management advisors, will continue to review any potential opportunities for restructuring the Council's debt in order to take advantage of potential savings as interest rates change and to enhance the balance of the long-term portfolio (amend the maturity profile and/or the balance of volatility).

4.00 INVESTMENT ACTIVITY

4.01 Guidance

The Welsh Government's Investment Guidance gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

4.02 Investment Activity in 2023/24

Summary of investments as at 31st March 2024.

Country	Total	<1 month	1 –12 months	>12 months
	£m	£m	£m	£m
UK BANKS	3.0	3.0		
UK BUILDING SOCIETIES				
OVERSEAS				
MMF's	30.4	30.4		
LOCAL AUTHORITIES				
DMO	5.0		5.0	
TOTAL	**38.4**	**33.4**	**5.0**	

The investment for £5m was classified as a short-term investment in the Council's Balance Sheet. The remainder of the investments had maturities of less than 3 months, so were classified as cash.

Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Strategy for 2023/24. Investments during the year included:

- Deposits with the Debt Management Office
- Deposits with other local authorities
- Investments in AAA-rated Low Volatility Net Asset Value (LVNAV) money market funds
- Call accounts and deposits with banks and building societies

4.03 Credit Risk

The Council assessed and monitored counterparty credit quality with reference to credit ratings, credit default swaps, GDP of the country in which the institution operate, the country's net debt as a percentage of GDP, and share price. The minimum long-term counterparty credit rating determined by the Council for the 2023/24 treasury strategy was A-/A-/A3 across rating agencies Fitch, S&P and Moody's.

4.04 Counterparty Update

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 Council's counterparty list recommended by Arlingclose remain under constant review.

4.05 Liquidity

In keeping with the WG's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of money market funds and call accounts.

4.06 Yield

Due to the increases in the UK bank rate, the short-term money market rates have been higher than expected. The Council's budgeted investment income for the year had been prudently estimated at £1.2m, based on an average rate of 3.9%. The average investment balance was £44.3m during the period and interest earned was £2.177m, at an average interest rate of 4.87%.

4.07 Loans to NEW Homes

The loans to NEW Homes do not meet the definition of an investment and are not therefore included in the Council's investment figures. They are classed as capital expenditure.

4.08 ESG Policy

When investing in banks and funds, the Council prioritised banks and other institutions that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code.

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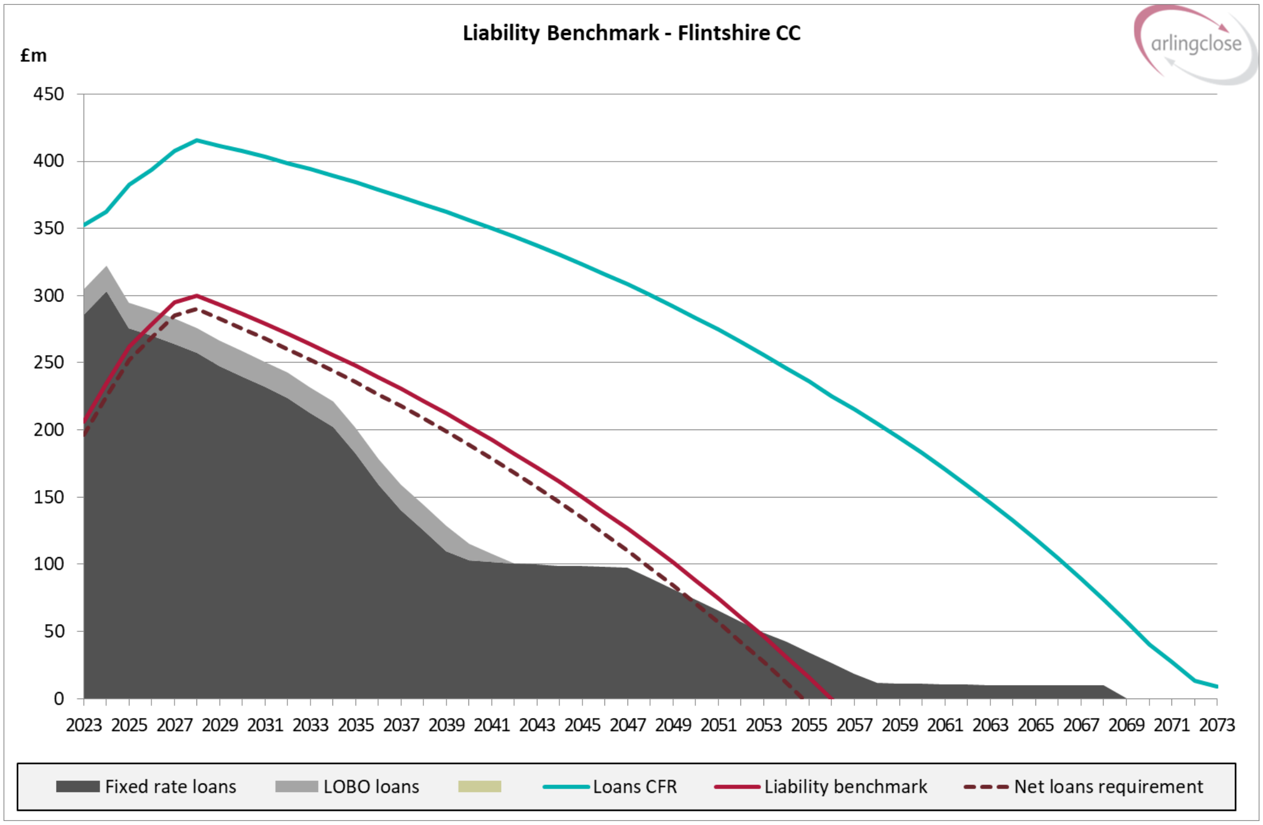
5.00 TREASURY MANAGEMENT PRUDENTIAL INDICATORS

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

5.01 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 required to manage day-to-day cash flow.



5.02 Interest Rate Exposures

This indicator is set to control the Council's exposure to interest rate risk.

Interest rate risk indicator	31.12.23 £'000	31.03.24 £'000
Upper limit on one-year revenue impact of a 1% rise in interest rates	(274)	(198)
Upper limit on one-year revenue impact of a 1% fall in interest rates	421	344

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

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

5.03 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 fixed rate borrowing will be:

	Lower	Upper	Actual as at 31.03.24
Under 12 months	0%	20%	2.63%
12 months and within 24 months	0%	20%	2.13%
24 months and within five years	0%	30%	7.29%
Five years and within 10 years	0%	50%	14.80%
10 years and above	0%	100%	73.15%

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.

5.04 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 investments will be:

Price risk indicator	2023/24 Limit	31.03.24 Actual
Limit on total principal invested beyond year end	£5m	£0m

Any long-term investments carried forward from previous years will be included in each year's limit.

5.05 Borrowing Limits

These limits are reported as part of the quarterly monitoring of the capital programme, however, they are repeated here for completeness.

	2023/24 Limit	31.03.24 Actual
Operational Boundary	£403m	£334.7m
Authorised Limit	£438m	£334.7m

6.00 COMPLIANCE

The Council can confirm that it has complied with its Prudential Indicators for 2023/24. These were approved by Council as part of the Treasury Management Strategy on 23rd February 2023.

In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during 2023/24. None of the Prudential Indicators have been breached and a prudent approach has been taking in relation to investment activity with priority being given to security and liquidity over yield.

The treasury function operated within the limits detailed in the Treasury Management Policy and Strategy Statement 2023/24.

7.00 OTHER ITEMS

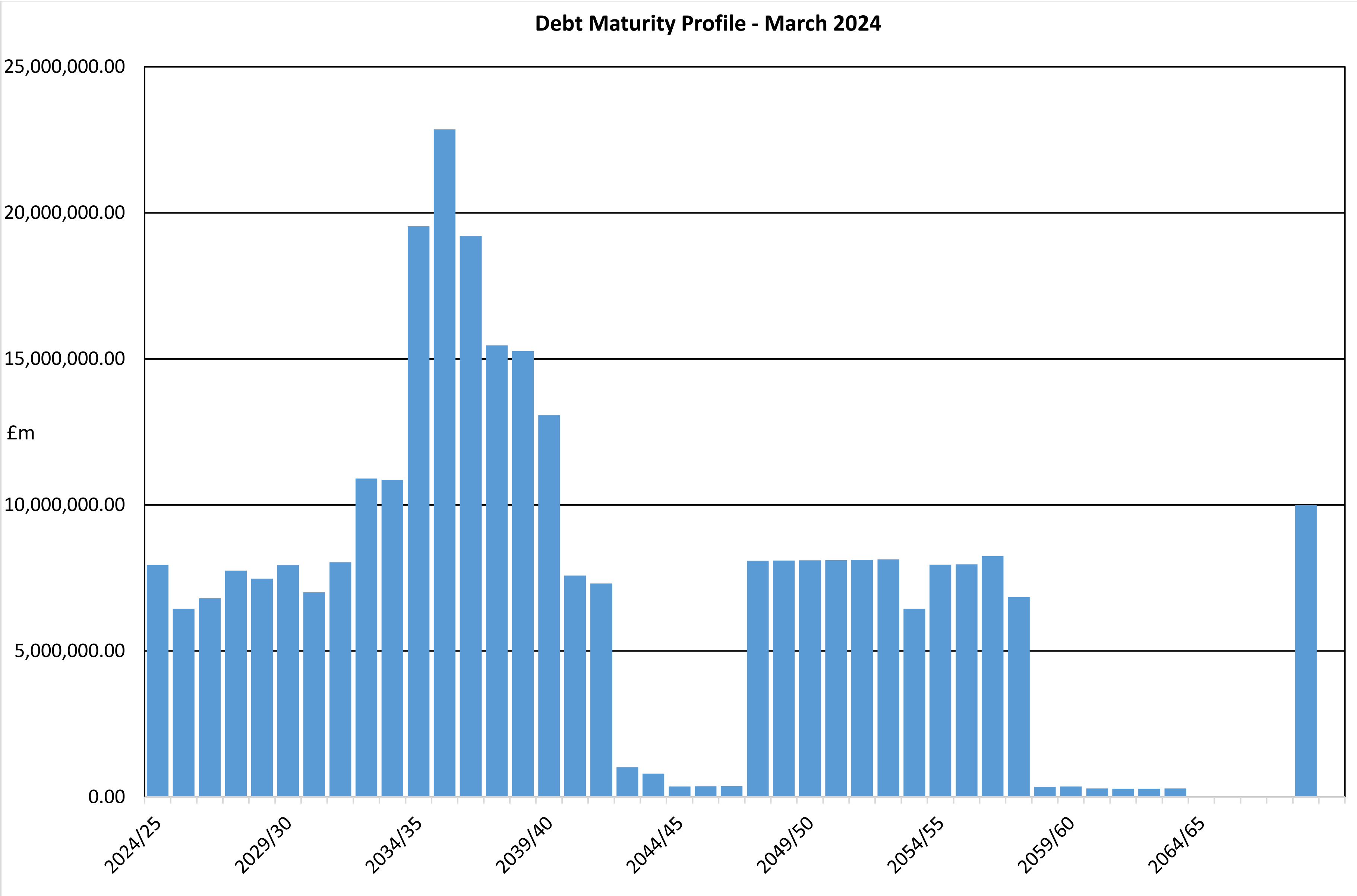
The following were the main treasury activities during 2023/24:

- The Council's Governance and Audit Committee received a Mid-Year Report on 22nd November 2023.
- Quarterly update reports were presented to the Governance and Audit Committee.
- The 2024/25 Investment Strategy Statement was approved by Council on 20th February 2024.
- The Council's cash flow was managed on a daily basis. During the year the Council acted both as a borrower and as a lender and was a net borrower over the year in question. The maximum investments the Council had on deposit at any one time were £62.0m and the maximum long-term borrowing at any one time was £302.5m.

8.00 CONCLUSION

The treasury management function has operated within the statutory and local limits detailed in the 2023/24 Treasury Management Strategy.

The Treasury Management Policy was implemented in a pro-active manner with security and liquidity as the primary focus.



Debt Maturity Profile - March 2024
25,000,000.00
20,000,000.00
15,000,000.00
£m
10,000,000.00
5,000,000.00
0.00
2024/25
2029/30
2034/35
2039/40
2044/45
2049/50
2054/55
2059/60
2064/65

APPENDIX A NON-TREASURY INVESTMENTS

1.01 The definition of investments in the Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council 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 the Welsh Government also includes within the definition of investments all such assets held partially or wholly for financial return.

The Council has given loans to wholly owned companies for service purposes and has historical non-financial investments in property defined as Investment Properties within the Council's Statement of Accounts. The Council considers both to be non-treasury investments.

1.02 Wholly Owned Companies

The Council's investments in the form of loans to wholly owned companies contribute to its service delivery objectives and/or to promote wellbeing as follows:

- The Council has embarked on an ambitious house building programme as part of its Strategic Housing and Regeneration Programme (SHARP). Over a 5-year period 500 new homes will be built at a range of sites across the county, a mixture of new council houses and affordable homes, alongside commissioning a range of linked regeneration initiatives and community benefits.

- Affordable homes are being developed through the Council's wholly owned subsidiary North East Wales Homes Limited (NEW Homes) in partnership with the Council. Affordable homes for rent are built or purchased by NEW Homes funded by loans from the Council. New affordable homes for rent have been built in Flint, Penyffordd (Holywell), Dobshill, Bryn-y-Baal, Northop and Saltney.

The Council considers that its financial exposure to loans to wholly owned companies is proportionate and has set the limits in the table below. The Council's loan book is currently within these self-assessed limits.

Borrower	**Cash Limit**
Wholly owned companies	£40m
Treasury management investments meeting the definition of a loan	Unlimited

Yield (net profit)

The loans generate a small income for the Council as there is a margin of approx. 0.25% charged to NEW Homes on the Council's borrowing rate from the PWLB. The income makes a very small contribution to achieving a balanced revenue budget.

1.03 Investment Properties

The Welsh Government guidance includes an investment category covering non-financial assets held primarily or partially to generate a profit, primarily investment property. Proper accounting practice defines an investment property as those that are held solely to earn rent and / or for capital appreciation.

The Council has a portfolio of investment properties, in the form of agricultural property and industrial units. Although these are classified as investment properties, they are legacy assets, and the Council is managing down its agricultural portfolio and is reviewing its position regarding industrial units.

Fair Value of Investment Properties

	31.03.2024 £m	31.03.2023 £m	31.3.2022 £m	31.3.2021 £m	31.3.2020 £m
Fair Value Inv. Properties	29.3	29.0	27.6	25.2	25.0

Yield (net profit)

The profit generated by investment activity makes a small contribution to achieving a balanced revenue budget. The table below details the extent to which funding expenditure to meet the service delivery objectives and or promote wellbeing in the Council is dependent on achieving the expected yield over the life cycle of the Medium-Term Financial Plan.

Proportionality of Investment Properties

	2023/24 Actual £m	2024/25 Budget £m	2025/26 Budget £m
Net Revenue Budget	352.121	368.106	368.106
Net Investment income	1.71	1.67	1.67
Proportion	0.48%	0.45%	0.45%