AUDIT COMMITTEE/ EXECUTIVE / COUNCIL

Portfolio Area: Resources

Date: **8 November 2023 / 15 November 2023 / 20 December 2023**

2023/24 MID YEAR TREASURY MANAGEMENT REVIEW AND PRUDENTIAL INDICATORS

NON-KEY DECISION

Author – Rhona Bellis
Contributor – Belinda White / Reenu Keogh
Lead Officer – Brian Moldon
Contact Officer – Brian Moldon

1 PURPOSE

1.1 To update Members on the Treasury Management activities in 2023/24 and review effectiveness of the 2023/24 Treasury Management and Investment Strategy including the 2023/24 prudential and treasury indicators.

2 RECOMMENDATIONS

2.1 Audit Committee

That subject to any comments by the Audit Committee to the Executive, the 2023/24 Mid-Year Treasury Management Review and Prudential indicators reports is recommended to Council for approval.

2.2 Executive

That subject to any comments made by the Executive, in addition to those made by the Audit Committee, the 2023/24 Mid-Year Treasury Management Review and Prudential indicators report is recommended to Council for approval.

2.3 Council

That subject to any comments from the Audit Committee and the Executive, 2023/24 Mid-Year Treasury Management Review and Prudential indicators report be approved by Council.

3 BACKGROUND

3.1.1 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low-risk counterparties, providing adequate liquidity initially before considering optimising investment return.

3.1.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer-term cash may involve arranging long or short-term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly, treasury management is defined as:

"The management of the local authority's borrowing, investments and 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."

3.1.3 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2021). The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by the full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report, (stewardship report), covering activities during the previous year.
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Audit committee.

3.1.4 In December 2017, CIPFA revised the Code to require, all local authorities to report on:

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- an overview of how the associated risk is managed;
- the implications for future financial sustainability.

These elements are covered in the annual Capital Strategy reported to Council in February each year.

3.1.5 This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first half of the 2023/24 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the Council's investment portfolio for 2023/24;
- A review of the Council's borrowing strategy for 2023/24;
- A review of compliance with Treasury and Prudential Limits for 2023/24.

3.2 Economics and interest rates

3.2.1 **Economics update.**

3.2.2 The first half of 2023/24 saw:

- Interest rates rise by a further 100basis points, taking Bank Rate from 4.25% to 5.25%.
- Short, medium and long-dated gilts remain elevated as inflation continually surprised to the upside.
- A 0.5% month by month decline in real GDP in July.
- CPI inflation rose by 6.7% in the 12 months to September 2023, the same rate as in August, and down from a recent peak of 11.1% in October 2022.
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3.2.3 The yield on 10-year Gilts fell from a peak of 4.74% on 17th August to 4.44% on 29th September, mainly on the back of investors revising down their interest rate expectations. But even after their recent pullback, the rise in Gilt yields has exceeded the rise in most other Developed Market government yields since the start of the year. Looking forward, once inflation falls back, Gilt yields are set to reduce further. A (mild) recession over the next couple of quarters will support this outlook if it helps to loosen the labour market (higher unemployment/lower wage increases).

3.2.4 **Interest Rate Forecasts**

3.2.5 The Council has appointed Link Group as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. The PWLB rate forecasts below are based on the Certainty Rate* (the standard rate minus 20 bps, calculated as gilts plus 80bps) which has been accessible to most authorities since 1st November 2012.

3.2.6 The latest forecast on 25th September sets out a view that short, medium and long-dated interest rates will be elevated for some little while, as the Bank of England seeks to squeeze inflation out of the economy.

Chart 1

Link Group Interest Rate View	25.09.23												
	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26
BANK RATE	5.25	5.25	5.25	5.00	4.50	4.00	3.50	3.00	2.75	2.75	2.75	2.75	2.75
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.00	2.80	2.80	2.80	2.80	2.80
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.10	2.90	2.90	2.90	2.90	2.90
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.20	3.00	3.00	3.00	3.00	3.00
5 yr PWLB	5.10	5.00	4.90	4.70	4.40	4.20	4.00	3.90	3.70	3.70	3.60	3.60	3.50
10 yr PWLB	5.00	4.90	4.80	4.60	4.40	4.20	4.00	3.80	3.70	3.60	3.60	3.50	3.50
25 yr PWLB	5.40	5.20	5.10	4.90	4.70	4.40	4.30	4.10	4.00	3.90	3.80	3.80	3.80
50 yr PWLB	5.20	5.00	4.90	4.70	4.50	4.20	4.10	3.90	3.80	3.70	3.60	3.60	3.60

* Certainty Rate reduction HRA – 0.6% is not included above

4 Treasury Management Strategy Statement and Annual Investment Strategy Update

4.1.1 The Treasury Management Strategy was approved by council on 23 February 2023.

There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

4.2 The Council's Capital Position (Prudential Indicators).

4.2.1 This part of the report is structured to update:

- The Council's capital expenditure plans and how these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

4.2.2 **Prudential Indicator for Capital Expenditure and changes to Financing of the Capital Programme.**

4.2.3 The table below shows the revised estimates for capital expenditure and financing and the changes since the capital programme was agreed at the Budget. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Table 1 Capital Expenditure and Financing			
	Original Capital Strategy (Council February 2023) £'000	**Revised Capital Strategy Q2 £'000**	***Movement*[1] £'000**
Capital Expenditure:			
General Fund Capital Expenditure	34,017	28,140	(5,877)
HRA Capital Expenditure	62,420	45,556	(16,864)
Total Capital Expenditure	96,437	73,696	(22,741)
Financed by:			
Capital Receipts	(22,090)	(22,249)	(159)
Capital Grants /Contributions	(20,212)	(13,314)	6,898
Capital Reserves	(1,733)	(20)	1,713
Revenue contributions	(592)	(937)	(345)
Major Repairs Reserve	(20,755)	(13,048)	7,707
Total Financing	(65,382)	(49,568)	15,814
Borrowing requirement	31,055	24,128	(6,927)

4.2.4 The General Fund net reduction of £5.877Million includes:

- Slippage of £10.456Million of the Housing Development budgets
- Budget increases of £4.578Million – including, £1.302Million in Regeneration, with Towns Fund slippage netted off by the addition of the SG1 Joint Venture.
- The Deferred Works Reserve budget was increased by £1.079Million to reflect the potential for significant costs arising such as from asbestos in the garage estate.
- The remaining increase is split across services, predominantly as a result of new grants that have been successfully bid for.

4.2.5 The HRA net reduction of £16.864Million is due to slippage of the Housing Development budgets.

4.3 Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational

4.3.1 The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary.

[1] This movement differs from that reported in the quarterly Capital Monitoring reports as that report uses the latest budget rather than the original as a comparator.

Part I
Release to Press

Prudential Indicator – Capital Financing Requirement and the Operational Boundary for external debt.

Table 2	2023/24 Original Estimate Council February 2023 £'000	Current Position £'000	2023/24 Revised Estimate Mid-Year £'000
CFR – non housing	55,035	45,850	52,769
CFR – housing	292,842	284,673	284,673
Total CFR	**347,877**	**330,523**	**337,442**
Net movement in CFR			**(10,435)**
Prudential Indicator – the Operational Boundary for external debt			
Borrowing	**292,121**	**248,118**	**269,118**
Other long-term liabilities[2]	**15,000**	**10,945**	**10,945**
Total debt (year-end position)	**307,121**	**259,063**	**280,063**

4.3.2 Details relating to changes in the capital strategy that are reflected in the net movement in CFR of £10Million, can be found in Quarters 1 and 2 Monitoring Report (Capital).

4.4 Limits to Borrowing Activity

4.4.1 The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2023/24 and next two financial years.

4.4.2 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

[2] Finance Leases

Table 3 Authorised limits	Operational Boundary [3] £'000	Authorised Limit £'000	Actual External Debt 30/09/2023 £'000
General Fund	55,035	56,035	14,886
Housing WOC	15,000	15,000	0
Finance Lease		15,000	10,945
Total General Fund	70,035	86,035	25,831
HRA	292,842	304,841	233,231
Total Debt	**362,876**	**390,876**	**259,062**
CFR (year-end position)			**337,442**

4.4.3 A temporary breach of the operational boundary is permissible for short term cash flow purposes however a breach of the authorised limit would require a report to Council. There have been no breaches of either limit in the period for 2023/24.

4.5 Borrowing

4.5.1 The Council's capital financing requirement (CFR) for 2023/24 is £337Million. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing), or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. Table 3 shows the Council has borrowings of £259Million and has utilised £78Million of cash flow funds in lieu of borrowing (Current CFR less total current debt). This is a prudent and cost-effective approach in the current economic climate but will require ongoing monitoring in the event that any upside risk to gilt yields prevails.

4.5.2 capital programme is being kept under regular review due to the effects of inflationary pressures, shortages of materials and labour. The Council borrowing strategy will, therefore, also be regularly reviewed and then revised, if necessary, in order to achieve optimum value and risk exposure in the long-term.

4.5.3 External borrowing of £7.5Million from the PWLB was taken out 24 August 2023 for a period of 17 years at 5.3%. This funding replaced internal borrowing used to fund the HRA and did not increase the overall CFR for the HRA.

4.5.4 It is anticipated that further borrowing will be undertaken during the financial year in line with financing in table 1 above.

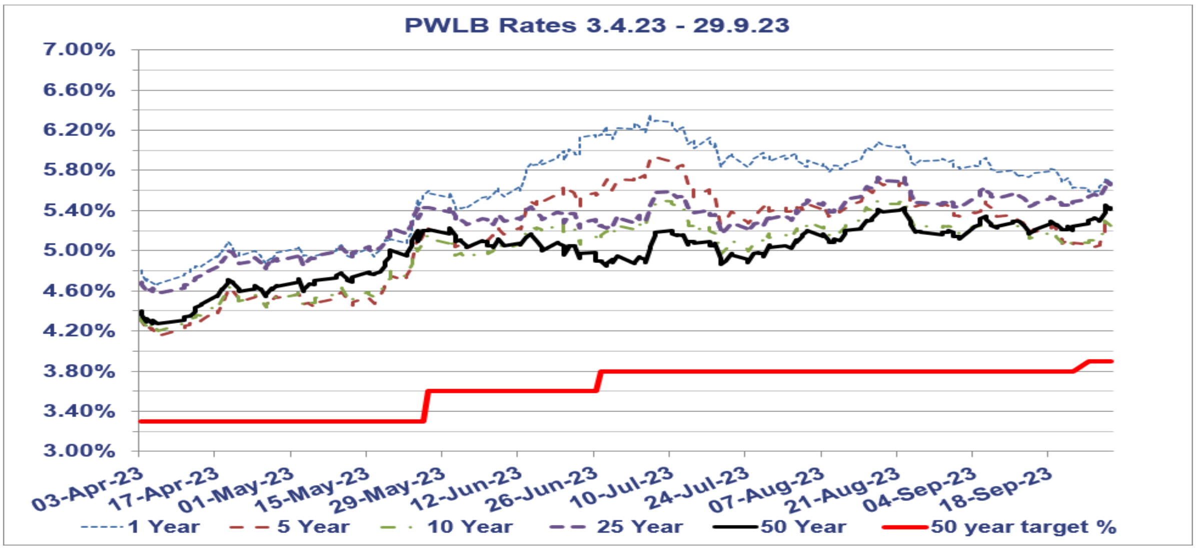
4.5.5 Gilt yields and PWLB certainty rates were on a generally rising trend throughout the first half of 2023/24. At the beginning of April, the 5-year rate was the cheapest part of the curve and touched 4.14% whilst the 25-year rate was relatively expensive at 4.58%.

[3] Operational Boundary = expected debt position

4.5.6 Rates are forecast to fall back over the next two to three years as inflation dampens. The CPI measure of inflation is expected to fall below 2% in the second half of 2024, and 50-year rates are expected to stand at 3.90% by the end of September 2025. However, there is considerable gilt issuance to be digested by the market over the next couple of years, as a minimum, so there is a high degree of uncertainty as to whether rates will fall that far.

4.5.7 The Chart below shows the volatility of the PWLB borrowing rates from 1 April 2023 to 29 September 2023.

Chart 2



4.6 COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS

4.6.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the half year ended 30 September 2023 the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2023/24. The Chief Finance Officer reports that no difficulties are envisaged for the current or future years in complying with these indicators.

4.6.2 All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

4.7 ANNUAL INVESTMENT STRATEGY

4.7.1 The Treasury Management Strategy Statement (TMSS) for 2023/24, which includes the Annual Investment Strategy, was approved by the Council on 23 February 2023. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite

4.7.2 There were no breaches to this policy in the year to 30 September 2023 with the investment activity conforming to the approved strategy. The Council had no liquidity difficulties and no funds have been placed with the Debt Management Office (DMO), demonstrating that counterparty limits and availability for placing funds approved in the TM Strategy were working effectively. It is possible that surplus funds that may be borrowed during 2023/24 will be placed in the DMO temporarily, if PWLB borrowing rates are advantageous and cash balances due to timing of taking out new loans would breach other counterparty limits.

4.7.3 The Specified and Non-Specified Investment Criteria (Appendix C) have been reviewed and updated in the Treasury Management Strategy 2023/24 which was agreed at Full Council in February 2023 and no further amendments are proposed at this stage.

4.7.4 In accordance with the Treasury Management Strategy, the Council invests its surplus cash balances that are committed for future approved spending. The policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data and counterparty limits dependant on level of cash balances held.

4.8 Investment performance year to date as of 30 September 2023

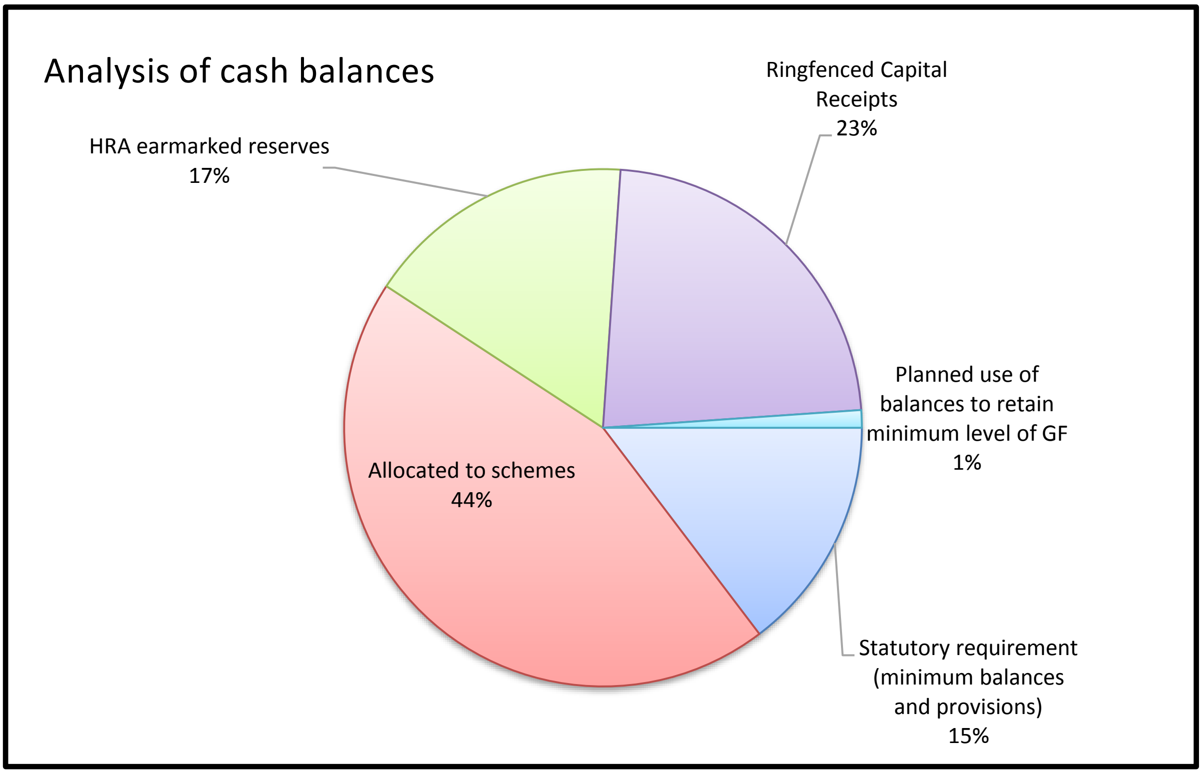
4.8.1 The Council's current investment portfolio consists of "conventional" cash investments: deposits with banks and building societies, Money Market Funds and loans to other Local Authorities. Currently no investments have been made with any of the other approved instruments within the Specified and Non-specified Investment Criteria (see Appendix C).

4.8.2 The average level of funds available for investment purposes during the first half of the financial year was £48.5Million, earning an average interest rate of 5.27%. Interest earned to 30 September 2023 was £1.6Million. Projected investment balances at 31 March 2024 are currently £38Million and forecast external interest receivable from investments is currently £2.6Million against a working budget of £1.404Million, contributing to General Fund (£379k) and Housing Revenue Account revenue income (£1.025Million).

4.8.3 The Council's balances are made up of cash reserves e.g. HRA and General Fund balances, restricted use receipts e.g. right to buy one for one receipts and balances held for provisions such as business rate appeals and debt repayment.

4.8.4 In considering the Council's level of cash balances, Members should note that the General Fund MTFS and Capital Strategy have a planned use of resources over a minimum of 5 years and the HRA Business Plan (HRA BP) a planned use of resources over a 30 year period, which means, while not committed in the current year; they are required in future years.

4.8.5 The following chart shows the planned use of cash balances as at 30 September 2023.



4.8.6 The restrictive use of a proportion of the cash balances set out above, plus the planned use of resources in line with the Council's capital and revenue strategies mean that the investment balance of £45Million as at 30 September 2023 is not available for new expenditure (for details see Appendix B).

5 IMPLICATIONS

5.1 Financial Implications

5.1.1 This report is of a financial nature and reviews the treasury management function for 2023/24 to date. Any consequential financial impacts identified in the Capital strategy and Revenue budget monitoring reports have been incorporated into this report.

5.1.2 During the financial year Officers operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury management practices.

5.2 Legal Implications

5.2.1 Approval of the Prudential Code Indicators and the Treasury Management Strategy are intended to ensure that the Council complies with relevant legislation and best practice.

5.2.2 There have been no changes to PWLB borrowing arrangements since the last Treasury report, however where there are changes to the Prudential and Treasury Management codes from 2023/24. Officers will ensure that any changes are reflected in treasury operations and reporting requirements**.**

5.3 Risk Implications

5.3.1 The current policy of minimising external borrowing only remains financially viable while cash balances are high and the differentials between investment income and borrowing rates remain. As these conditions change the Council may need to take borrowing at higher rates which would increase revenue costs.

5.3.2 There remains uncertainty on the long-term implications of exiting the EU on the UK economy and borrowing rates. Officers monitor interest rate forecasts to inform the timing of borrowing decisions.

5.3.3 The Council's Treasury Management Strategy is based on limits for counterparties to reduce risk of investing with only a small number of institutions.

5.3.4 The thresholds and time limits set for investments in the Strategy are based on the relative ratings of investment vehicles and counter parties. These are designed to take into account the relative risk of investments and also to preclude certain grades of investments and counterparties to prevent loss of income to the Council.

5.3.5 There is a risk to the HRA BP's ability to fund the approved 30 year spending plans if interest rates continue to rise. Mitigation is included in the revision to the BP (2023), including requiring higher levels of reserves to be maintained in the medium term to cover interest rate risks.

5.4 Equalities and Diversity Implications

5.4.1 This report is technical in nature and there are no implications associated with equalities and diversity within this report. In addition to remaining within agreed counterparty rules, the council retains the discretion not to invest in countries that meet the minimum rating but where there are concerns over human rights issues. Counterparty rules will also be overlaid by any other ethical considerations from time to time as appropriate.

5.4.2 The Treasury Management Policy does not have the potential to discriminate against people on grounds of age; disability; gender; ethnicity; sexual orientation; religion/belief; or by way of financial exclusion. As such a detailed Equality Impact Assessment has not been undertaken.

5.5 Climate Change Implications

5.5.1 The council's investment portfolio is sterling investments and not directly in companies. However the TM team continue to review the use of Money Market funds to ensure, where possible, money market funds that invest in environmentally sustainable companies are used. In this way the TM team aligns with the Councils ambition to attempt to be carbon neutral by 2030.

BACKGROUND PAPERS

- BD1 Treasury Management Strategy including Prudential Code Indicators 2023/24 (Council 23 February 2023)
- BD2 Quarters 1 and 2 Monitoring Report (Capital) (Executive 15 November 2023)

APPENDICES

- Appendix A - Prudential Indicators
- Appendix B - Investment Portfolio
- Appendix C - Counterparty List 30 September 2023