AUDIT COMMITTEE	AGENDA ITEM No. 8
28 NOVEMBER 2022	PUBLIC REPORT

Report of:	Cecilie Booth, Executive Director, Corporate Services	
Cabinet Member(s) responsible:	Cllr Coles, Cabinet Member for Finance and Corporate Governance	
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TREASURY MANAGEMENT MID YEAR UPDATE

R E C O M M E N D A T I O N S	
FROM: Cecilie Booth, Executive Director of Corporate Services and S151 Officer	**Deadline date:** Full Council 7 December 2022
It is recommended that Audit Committee: 1. Review the Treasury Management Strategy Statement (TMSS) Mid-year position and performance against the Prudential Indicators. 2. Review and recommend to Full Council approval to add additional non-specified investments detailed within Appendix C (Property Funds, Bond Funds and other pooled funds) to the Treasury Management Strategy.	

1. ORIGIN OF REPORT

1.1 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), which recommends that Members receive reports on its treasury management policies, practices and activities, including an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close.

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.

The second main function of the treasury management service is the funding of the Council's capital plans. The Capital Plans identify the borrowing need of the Council and the longer-term cash flow planning to ensure the Council can meet its capital spending requirements. Cashflow management may involve long or short-term loans and investments, using longer term cash flow surpluses for investment purposes, and / or restructuring of the Council's debt portfolio.

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."

1.2 This mid-year report covers the following:

- An update on interest rate forecasts;

- A review of the Treasury Management Strategy Statement;
- A review of compliance with Treasury and Prudential Limits for 2022/23;
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the Council's borrowing strategy for 2022/23;
- A review of the Council's investment portfolio for 2022/23.

1.3 **Interest rate Forecasts**

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.

Link Groups latest forecast on 8th November 2022 now has a lower forecast peak in Bank Rate of 4.5% (compared to 5% previously), but which runs through to the end of 2023. By Q3 2025 they see Bank Rate falling to 2.5%. In addition, PWLB rates are expected to trend gently downwards, across the curve, from Q1 2023 through to Q4 2025.

Link Group Interest Rate View 08.11.22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
BANK RATE	3.50	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
3 month ave earnings	3.60	4.30	4.50	4.50	4.50	4.00	3.80	3.30	3.00	3.00	2.80	2.50	2.50
6 month ave earnings	4.20	4.50	4.60	4.50	4.20	4.10	3.90	3.40	3.10	3.00	2.90	2.60	2.60
12 month ave earnings	4.70	4.70	4.70	4.50	4.30	4.20	4.00	3.50	3.20	3.10	3.00	2.70	2.70
5 yr PWLB	4.30	4.30	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.20	3.10
10 yr PWLB	4.50	4.50	4.40	4.30	4.20	4.00	3.90	3.70	3.60	3.50	3.40	3.30	3.20
25 yr PWLB	4.70	4.70	4.60	4.50	4.40	4.30	4.10	4.00	3.90	3.70	3.60	3.50	3.50
50 yr PWLB	4.30	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.40	3.30	3.20	3.20

The PWLB rate forecasts above are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1st November 2012.

1.4 The Treasury Management Strategy Statement, (TMSS), for 2022/23 was approved by this Council on 2 March 2022.

The underlying TMSS approved previously requires revision in the light of economic and operational movements during the year. The proposed changes and supporting detail for the changes are set out below:

- Following the report published by The Chartered Institute of Public Finance and Accountancy (CIPFA) into the Councils financial position, and the recommendations set out in the DLUHC action plan to reach financial sustainability, the Council continues to review all capital projects with a view to restricting new borrowing. The Capital Programme agreed by Council for the year was £116m which included a technical adjustment of £22m relating to the transition to IFRS16 and a target reduction of £9.2m against projects to be funded from new borrowing. This was increased to £125.5m through slippage of schemes from 2021/22 but then subsequently reduced by £21.5m when an exercise was undertaken to reprofile schemes, and £22m due to the deferral of IFRS16, which provides a revised Capital Programme of £82m.

Table 1

Original Budget inc Slippage from 21/22 (£m)	Revised Budget after reduction (£m)	Actual Expenditure to Sept 22 (£m)	Forecast Outturn (£m)
116	82	19.1	54.4

- The Capital Strategy states that, wherever possible, all capital expenditure should be funded by third party contributions or capital receipts. The revised capital programme is shown in Table 1 above, forecasting expenditure of £54.4m by the end of the 2022/23 financial year. Whilst new borrowing is not required to fund the Capital Programme, there may be a need to undertake short-term borrowing due to delays in realising capital receipts.

- The current investment strategy provides limited scope to invest surplus cash balances, and this report seeks approval to expand the scope to use a wider range of counterparties and for longer durations, but within a framework of achieving the right balance of risk and return. The Council would look to utilise the expertise of its current Treasury Advisor, Link Group to run this selection process on its behalf.

- The prudential indicator for the Authorised Limit has been updated to reflect the correct limits.

1.5 The final performance against the revised strategy will be reported to Audit Committee in July 2023 alongside the Statement of Accounts, and as part of the Outturn Report which will report the financial performance for the year.

2. PURPOSE AND REASON FOR REPORT

2.1 The purpose of this report is to present current performance and the forecast outturn position against the Prudential Indicators in the strategy.

2.2 This report is for Audit Committee to consider under its Terms of Reference No. 2.2.2.18 to consider the Council's arrangements for corporate governance and agreeing necessary actions to ensure compliance with best practice.

3. TIMESCALES

Is this a Major Policy Item/Statutory Plan?	**NO**	If yes, date for Cabinet meeting	N/A

4. CORPORATE PRIORITIES

4.1 The recommendations are linked to all of the Council's Corporate Priorities as securing the Council's cash and enabling capital expenditure ensures that these priorities are achieved.

1. *The Economy & Inclusive Growth*
   - *Environment (including a summary of the outcome of a completed Carbon Impact Assessment, to be submitted in full to the Transport and Environment Team)*
   - *Homes and Workplaces*
   - *Jobs and Money*
2. *Our Places & Communities*
   - *Places and Safety (including any rural implications)*
   - *Lives and Work*
   - *Health and Wellbeing*
3. *Prevention, Independence & Resilience*
   - *Educations and Skills for All*
   - *Adults*
   - *Children*
4. *Sustainable Future City Council*
   - *How we Work*
   - *How we Serve*
   - *How we Enable*

5. TREASURY MANAGEMENT STRATEGY PRUDENTIAL INDICATORS

5.1 The 2022/23 Prudential Indicators are shown in Appendix A. During the half year ending 30th September 2022, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2022/23.

6. CONSULTATION

6.1 The Council's Prudential Indicators and Treasury Management Strategy 2022/23 - 2024/25 have undergone full consultation, and been through the scrutiny process, as it forms part of the Annual MTFS.

6.2 The Council continues to liaise with its treasury advisors, Link Group.

7. ANTICIPATED OUTCOMES OR IMPACT

7.1 As set out in the report.

8. REASON FOR THE RECOMMENDATION

8.1 This report is given to the Committee to review performance against the Prudential Indicators in the TMS set in the MTFS.

9. ALTERNATIVE OPTIONS CONSIDERED

9.1 The Treasury Management Strategy 2022/23 – 2024/25 is required to be prepared in accordance with the Treasury Management in the Public Services: Code of Practice 2021. This report sets out the performance against the associated prudential indicators. The options are therefore limited.

10. IMPLICATIONS

Financial Implications

10.1 To provide the Committee with the opportunity to review current performance against the Prudential Indicators.

Legal Implications

10.2 Treasury Management activities have to conform to the Local Government Act 2003, the Local Authorities (Capital; Finance and Accounting) (England) Regulations 2003 (SI 2003/3146), which specifies that the Council is required to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice and also the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414), which clarifies the requirements of the Minimum Revenue Provision guidance.

11. BACKGROUND DOCUMENTS

Used to prepare this report, in accordance with the Local Government (Access to Information) Act 1985

11.1 The Prudential Code for Capital Finance in Local Authorities – 2021 Edition, CIPFA; and Treasury Management in the Public Services, Code of Practice and Cross-Sectoral Guidance Notes – 2021 Edition, CIPFA.

12. APPENDICES

12.1 Appendix A - Treasury Management Strategy – Prudential Indicators – Forecast Outturn as at 30 September 2022.
Appendix B - Borrowing Strategy as at 30 September 2022
Appendix C - Investment Portfolio as at 30 September 2022
Appendix D - CFR, Debt Liability Benchmark and Borrowing

Treasury Management Strategy – Prudential Indicators – Forecast Outturn as at September 2022

The Prudential Code for Capital Finance in Local Authorities provides a framework for local authority capital finance to ensure that:

(a) capital expenditure plans are affordable,
(b) all external borrowing and other long-term liabilities are within prudent and sustainable levels;
(c) treasury management decisions are taken in accordance with professional good practice.

In taking decisions in relation to (a) and (c) above, the local authority is accountable by providing a clear and transparent framework.

The Code requires the Council to set a range of Prudential Indicators for the forthcoming financial year and at least the following two financial years.

The actual and forecast outturn, compared to those contained in the MTFS for the Prudential Indicators for this financial year are detailed below. The indicators include the Invest to Save schemes however the costs of borrowing associated with these schemes will be offset by the income generated by these projects.

The Councils Capital Position

This part of the report is structured to update:

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

1. Indicator 1: Capital Expenditure

This indicator is the estimated capital expenditure for the year based on the Capital Programme for that period.

Capital Expenditure	**2022/23 Indicator £m**	**2022/23 Actual at 30.09.2022 £m**	**2022/23 Forecast Outturn £m**
Capital Expenditure	90.8	16.9	50.8
Invest to Save	3.2	2.2	3.6
Total	**94.0**	**19.1**	54.4
IFRS16 Transition*	22.0	0	0

*The Chartered Institute of Public Finance and Accountancy (CIPFA) have deferred the implementation of IFRS 16 until 1 April 2024 due to the severe delays in the publication of audited local authority financial statements in England, thereby reducing resource pressures in the local audit framew ork.

Since the 2022/23 MTFS the decision to use the repayment of the Hotel Loan of £15m to fund new capital expenditure has changed and will now be used to repay Council borrowing reducing the Capital Financing Requirement (CFR) therefore no receipt is showing in the capital financing table forecast outturn below. See Indicator 2 for further detail.

The Capital Receipts – Asset Sales actuals at 30 September 2022 is £4.3m which includes £2.6m which is being used to repay debt so is not included in the financing of the capital programme shown below.

Financed By	**2022/23 Indicator £m**	**2022/23 Actual at 30.09.2022 £m**	**2022/23 Forecast Outturn £m**
Capital Receipts – Hotel Loan Repayment	15.0	0	0
Capital Receipts – Asset Sales	0	1.7	6.6
Capital Grants & Third Party Contributions	79.0	14.0	39.7
Total Financing	**94.0**	**15.7**	**46.3**
Borrowing Requirement	0	**3.4**	**8.1**

The table above draws together the main strategy elements of the capital expenditure plans, highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the 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. The TMS contained in the MTFS showed that the capital programme would be funded by either capital grants, or capital receipts as well as a reduction to the schemes so that no borrowing was incurred unless failure to do so would lead to a breach in the Councils statutory duties. The budget reduction exercise carried out over the summer months and further work undertaken has reduced the 2022/23 budget to £54.4m. Capital Board continue to work on reducing the capital programme further however there may be a need to undertake short-term borrowing due to delays in realising capital receipts.

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2. Indicator 2: Capital Financing Requirement (CFR)

The CFR measures the Council's underlying need to borrow money in the long term for capital purposes. Any capital expenditure which has not immediately been paid for will increase the CFR.

Capital Financing Requirement	**2022/23 Indicator £m**	**2022/23 Forecast Outturn £m**
CFR b/fwd	609.0	613.9
Borrowing required to fund the capital programme	18.8	4.5
Borrowing required to fund invest to save schemes	3.2	3.6
Capital receipts – Hotel loan repayment*	0	(15.0)
Repayment of debt - Minimum Revenue Provision	(17.9)	(19.1)
Total CFR C/fwd	**613.1**	**587.9**

*The receipt from the repayment of the hotel loan will now be used to redeem the loan expenditure in the CFR as per the agreed MRP policy

3. Indicator 3: Actuals and Estimates of the Ratio of Financing Costs to Net Revenue Budget

The Council must estimate the proportion of the revenue budget, which is taken up in financing capital expenditure i.e. the net interest cost and to make provision to repay debt.

Ratio of gross financing costs to net revenue Stream	**2022/23 Indicator £m**	**2022/23 Actual at 30.09.2022 £m**	**2022/23 Forecast Outturn £m**
Total Ratio	16.5%	1.8%	16.1%

4. Indicator 4: Proportion of Gross Debt to the Capital Financing Requirement (CFR)

This indicator shows the proportion of the Council's external borrowings (Gross Debt) against the CFR. In order to ensure that borrowing levels are prudent over the medium term and only for 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 the next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. The gross debt amount includes borrowing undertaken through lease arrangements and PFI (see following indicator).

Proportion of Gross Debt to the CFR	**2022/23 Indicator £m**	**2022/23 Forecast Outturn £m**
Gross Debt	531.0	468.9
CFR	**613.1**	**587.9**
% of Gross Debt to CFR	86.6%	79.8%

This indicator shows that the Council is maintaining an under-borrowed position. This means that the capital borrowing need (the CFR), is not fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow is being used. This strategy continues to be prudent, although the Council has begun to take advantage of the recent increases in interest rates to maximise investment returns where possible by using a broader range of counterparties while ensuring security and liquidity as a priority. The forecast outturn for the % of Gross debt to CFR is 79.8% which is less than that of the indicator at 86.6%. The indicator relates to the proportion of debt compared to the CFR which is within the target, £587.9m against £613.1m.

5. Indicator 5: The Operational Boundary

The Operational Boundary is a measure of the day to day likely borrowing for the Council. The code recognises that circumstances might arise when the boundary might be exceeded temporarily, but if this continues for a lengthy period then it ought to be investigated.

This indicator takes into consideration the capital programme over the life of the MTFS and the ability to phase the borrowing over this period. The indicator provides flexibility for the Council to take advantage of favourable interest rates in advance of the timing of the actual capital expenditure.

Operational Boundary	**2022/23 Indicator £m**	**2022/23 Actual at 30.09.2022 £m**	**2022/23 Forecast Outturn £m**
Borrowing	633.1	446.5	421.7
Other Liabilities	69.2	47.2	47.2
Total Operational Boundary	**702.3**	**493.7**	**468.9***

*debt is expected to reduce due to the repayment of further loans

6. Indicator 6: The Authorised Limit

The Authorised Limit represents the maximum amount the Council may borrow at any point in time in the year. It is set at a level the Council considers is "prudent".

The indicator takes account of the capital financing requirement estimated at the start of each year, plus the expected net borrowing requirement for the year. This makes allowance for the possibility to do borrowing earlier in the year if that is the optimum time to undertake it.

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.

Authorised Limit	**2022/23 Indicator £m**	**2022/23 Actual at 30.09.2022 £m**	**2022/23 Forecast Outturn £m**
Borrowing*	663.1	446.5	421.7
Other Liabilities	69.2	47.2	47.2
Total Authorised Limit	**732.3**	**493.7**	**468.9**

*This limit also incorporates a margin to allow for exceptional short-term movements in the Council's cash flow , bids from service departments to finance efficiencies, changes to the timing of capital payments and fluctuations in the realisation of capital receipts.

It is ultra vires to exceed the Authorised Limit so this should be set to avoid circumstances in which the Council would need to borrow more money than this limit. However, the Council can revise the limit during the course of the year and has done so in 2022/23. The forecast outturn is lower than the indicator as the Council does not currently anticipate any exceptional cashflow movements or borrowing in advance of need.

7. Indicator 7: Fixed Interest rate exposure

This indicator places an upper limit on the total amount of net borrowing which is at fixed rates secured against future interest rate movements. The upper limit for fixed interest rate exposure was set to allow for flexibility in applying a proportion of the investment portfolio to finance new capital expenditure. It also reflected a position where the majority of borrowing was at fixed rates to provide budget certainty.

Upper limit for fixed rate exposure	**2022/23 Indicator £m**	**2022/23 Actual at 30.09.2022 £m**	**2022/23 Forecast Outturn £m**
Upper Limit	663.1	446.5	421.7
% of fixed interest rate exposure	100%	100%	100%

8. Indicator 8: Variable interest rate exposure

The indicator for actual and forecast outturn is zero due to the current borrowing strategy of borrowing only at a fixed interest rate in the current economic climate of volatile interest rates. Borrowing at fixed interest rates provides budget certainty for the Council

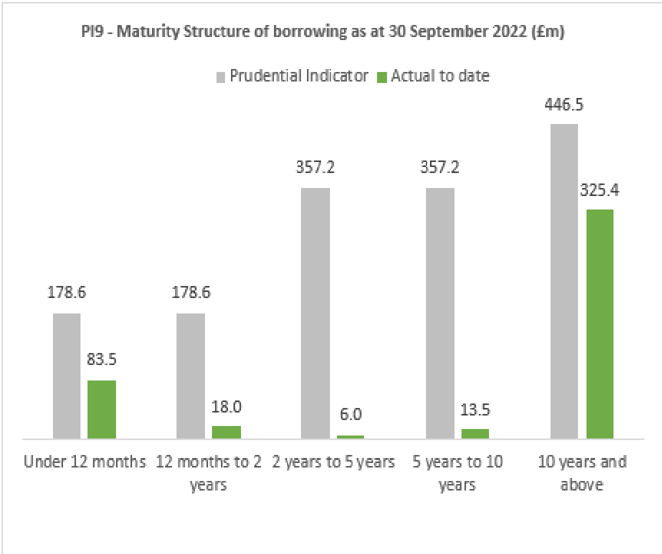
Upper limit for variable rate exposure	2022/23 Indicator £m	2022/23 Actual at 30.09.2022 £m	2022/23 Forecast Outturn £m
Upper Limit	165.8	0	0
% of variable interest rate exposure	25%	0%	0%

9. Indicator 9: Maturity structure of borrowing

The prudential limits have been set with regard to the maturity structure of the Council's borrowing and reflected the relatively beneficial long-term rates that were expected to be available over the next few years. The borrowing that the Council has actually taken up to the end of September 2022 is £446.5m shown in the indicator below.

Period	Upper Limit	2022/23 Actual at 30.09.2022 (£m)	
Under 12 months*	40%	18.7%	83.5
1 – 2 years	40%	4.0%	18.0
3 – 5 years	80%	1.3%	6.0
6 – 10 years	80%	3.0%	13.5
Over 10 years	100%	72.9%	325.5
Total Borrowing			**446.5**

** The borrowing for under 12 months includes £17.5m of Lenders Option Borrowers Option (LOBO) loans.*
Although the loans are due to mature in 20-32 years' time, they are classed as loans repayable within the financial year due to LOBO's having a call-in date every 6 months.



10. Indicator 10: Total Investments for periods longer than 365 days

Authorities are able to invest for longer than 365 days excluding loans. It would be unwise to lend a disproportionate amount of cash for too long a period particularly as the Council must maintain sufficient working capital for its operational needs, however if higher rates are available, it would be advantageous to consider other types of financial instruments to invest in.

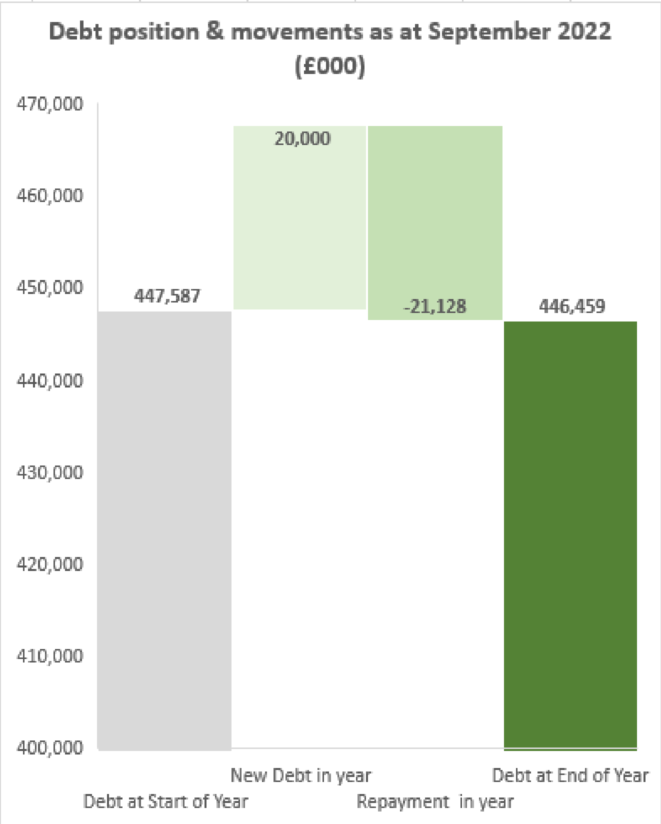
	2022/23 Indicator £m	2022/23 Actual at 30.09.2022 £m	2022/23 Forecast Outturn £m
Principal sums invested >365 days	10.0	**0.0**	**10.0**

This indicator reflects the Council's current lending policy of keeping investments short term for liquidity purposes. Also, the Council has minimised its available cash balances as an alternative to new borrowing. This is in line with the current strategy for revenue savings and avoids the 'cost of carry' associated with taking borrowing in advance of need.

Borrowing Position

The Council's forecast capital financing requirement (CFR) for 2022/23 is £587.9m. 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.

The Council's borrowing has reduced by a net £1.1m in year to date:



Due to the overall financial position and the underlying need to borrow for capital purposes (the CFR), new external borrowing of £20m was undertaken to refinance maturing debt. The capital programme is being kept under regular review due to the effects of inflationary pressures, shortages of materials and labour. Our borrowing strategy will, therefore, also be regularly reviewed and then revised, in order to achieve optimum value and risk exposure in the long-term.

PWLB maturity certainty rates (gilts plus 80bps) year to date to 30th September 2022

Gilt yields and PWLB rates were on a generally rising trend throughout H1 2022, the exception being a short rally in gilts in July/August. However, they rose exceptionally sharply towards the end of September, when compared to the MTFS assumptions on refinancing of maturing loans. The Council continues to liaise with Link Group on actions to mitigate any potential increased costs, with the current strategy being to borrow from the inter-authority market which typically provides access to short term funding at rates lower than equivalent PWLB rates.

The 50-year PWLB target certainty rate for new long-term borrowing started 2022/23 at 2.20% and finished the half year at 4.80%, albeit Link Group forecast rates to fall back to 3.20% by the end of September 2025.

Investment Portfolio

The Treasury Management Strategy Statement (TMSS) for 2022/23, which includes the Annual Investment Strategy, was approved by the Council on 2nd March 2022. 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. In the current economic climate, it is considered appropriate to keep the majority of investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach.
In addition, the Council is also seeking approval to explore the options to invest longer term in non-specified investments (Property Funds, Bond Funds and other pooled funds)

Investment Counterparty

The Council has begun to invest in a wider range of institutions to take advantage of rising interest rates. Surplus cash is invested for short periods with Barclays, the Churches, Charities and Local Authorities (CCLA) money market fund, and Federated Hermes Short Term Sterling Prime money market fund. The Council also currently has short term deposits with Standard Chartered, SMBC, Lloyds and Goldman Sachs banks and with other local authorities.

Investment balances

The Council held £57m of investments as at 30th September 2022. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of Covid grants, receipt of other grants and progress on the capital programme.
Estimated interest earned on investments as at 30th September 2022 is £400k.

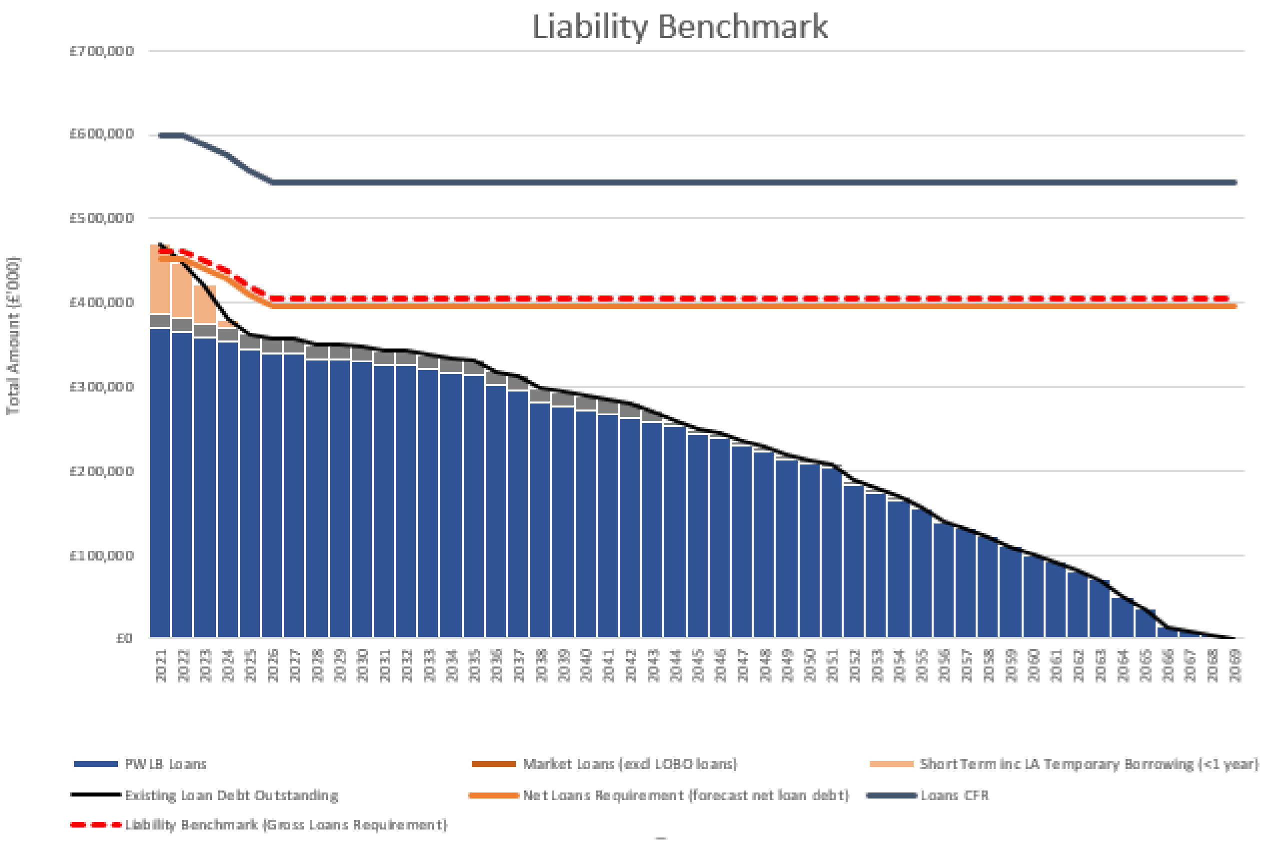
Investment performance year to date as at 30th September 2022

Investment Portfolio £'000	30-Sep-22		
	Principal	Average Rate (%)	Average Life (days)
MMFs	17,500	2.07	1*
Banks	32,554	1.87	61
Local Authorities	7,000	2.75	63
Total Investments	57,054	2.23	62

* MMFs have no set maturity date and can be accessed at short notice

CFR, Debt Liability Benchmark and Borrowing

Comparison of borrowing parameters to actual external borrowing:



The liability benchmark is effectively the net borrowing requirement plus a liquidity allowance.

It is calculated by deducting the amount of investable resources available on the balance sheet (reserves, cash flow balances) from the amount of outstanding external debt and then adding the minimum level of investments required to manage day-to-day cash flow.

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