OVERVIEW AND SCRUTINY COMMITTEE – 20 NOVEMBER 2023

TREASURY MANAGEMENT MID-YEAR REVIEW 2023-24

Executive Summary

To comply with the CIPFA (Chartered Institute of Public Finance Accountants) Code of Practice on Treasury Management, the Council has agreed that the Overview and Scrutiny Committee would be responsible for ensuring effective scrutiny of the treasury management strategy and policies. In December 2021, CIPFA, issued revised Prudential and Treasury Management Codes.

This report to the Overview and Scrutiny Committee provides an overview of Treasury Management for the first six months of the year against the Treasury Management Strategy and Prudential Indicators for 2023/24.

Recommendations

The Committee is requested to:

RESOLVE That

(i) the report be received and compliance with the Council's approved strategy be noted.

The Committee has the authority to determine the recommendation(s) set out above.

Background Papers: None.

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1.0 Introduction

1.1 The CIPFA (Chartered Institute of Public Finance Accountants) Code of Practice on Treasury Management requires formal scrutiny of the Treasury Management function. The Council has agreed that the Overview and Scrutiny Committee would be responsible for ensuring effective scrutiny of the treasury management strategy and policies. This report to the Overview and Scrutiny Committee provides an overview of Treasury Management for the first six months of the year against the Treasury Management Strategy and Prudential Indicators for 2023/24.

1.2 CIPFA published updated Treasury Management and Prudential Codes on 20th December 2021 with the changes coming into effect in 2023/24. The changes include new requirements such as the purpose, objectives, and management arrangements for commercial & service investments needing to be defined in the Council's Capital or Investment Strategy. The strategies are being reviewed to ensure they comply with the updated guidance and a new suite of strategies will be published with the budget reports in February 2024.

1.3 There is overlap between the Capital and Investment Strategies, and the Council's Treasury Management strategy. Therefore, the three strategies will be presented together, as part of the budget setting papers in February, enabling the links to be highlighted whilst minimising duplication.

1.4 The information in appendix A reports on total interest receipts and payments for the year to date. It also contains a comprehensive section on Treasury Management, detailing external commitments (borrowing, deposits and investments in and other advances to group companies, joint ventures and external organisations), details of long-term loans, and deals outstanding at the quarter end.

1.5 The information presented needs to be considered in the context of the wider reviews of the Council's financial position. As discussed later in the report, the interest variation of £4.9m assumes that the 2023/24 interest and principal repayments on the loans made by the Council to its Group Companies will be received. However, due to the financial position of the companies, these repayments have been suspended pending further reviews of the solvency of the subsidiaries. If this income is not received then there will be a forecast shortfall of £41m against the interest income budget. This will increase the interest budget monitoring variance position (shown in the Appendix A) by £41m by the year end.

1.6 The Council has commissioned consultancy advice on a Commercial Strategy, which will include strategic options for key regenerations schemes such as Sheerwater and Victoria Square. The Commercial Strategy is in development with the support of Commissioners and will be reported to Council in the coming months. This will inform reviews of the Minimum Revenue Provision (MRP) position and Bad Debt on the Council's loans to its subsidiary companies. The strategy and reviews will determine how much of the Council's group investments will be recoverable.

<u>Capital Strategy</u>

1.7 The Capital Strategy has a wide scope covering the Council's overall approach to capital investment. It demonstrates how the Council takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability.

1.8 The purpose of the capital strategy is to give a clear and concise view of how the Council determines its priorities for capital investment, decides how much it can afford to borrow and sets its risk appetite. It includes references to elements of the Investment Strategy, Treasury Management Strategy and the Council's Investment Programme.

1.9 The Capital Strategy sets out the Council's long-term approach in line with the long-term nature of capital and investment decisions. There is a direct link to the Council's Local Plan, place shaping activities and other long-term strategies.

1.10 Group activities and joint ventures are also included in the Capital Strategy, including the processes for ensuring effective due diligence and defining the Authority's risk appetite.

1.11 The guidance requires that proportionality, in respect of overall resources, is also considered.

1.12 As discussed in the Section 114 Notice issued in June 2023, the Council's previous Capital and Investment strategies have resulted in unaffordable borrowing, inadequate steps to repay that borrowing, and high values of irrecoverable loan investments.

1.13 The Capital Programme has therefore been largely suspended with provisions only for items such as urgent health and safety and regulatory works, Housing Asset Management Programmes, and payments only being made to companies and joint ventures to cover contractually committed capital expenditure or business cases agreed with The Commissioners\DLUHC.

Non-treasury Investment Strategy

1.14 The Investment Strategy covers investments which have been made in support of service objectives rather than as part of treasury management activity. It is intended to provide a better explanation of investment activities, explaining 'why' as well as 'what' investments are made. A range of indicators and disclosures are recommended in the guidance.

1.15 Investments held for treasury management purposes are covered by the Treasury Management Strategy (see below), with the focus of the Investment Strategy being other investments such as loans, shares and property.

1.16 Whilst the Council has a significant property portfolio, these assets are not held primarily for financial return. Each asset has a strategic purpose with a direct link to Council objectives or services. Shares and loans are also used to support the Council's objectives. Property, loans and shares are usually treated as capital expenditure and financed as with other Investment Programme projects. However, these items are disclosed as assets held as investments on the Council's balance sheet and so the guidance has been applied.

1.17 As discussed above, the Council now has an unaffordable level of borrowing due to the irrecoverability of its service loan investments and inadequate MRP being made. Officers are reviewing the property portfolio to identify suitable assets to dispose of in order to reduce the level of overall debt. This work is a key element of the Commercial and Finance workstreams of the Council's Improvement and Recovery Plan developed in conjunction with Commissioners.

2.0 Treasury Management Prudential Indicators

2.1 On 23 February 2023 the Council approved Prudential Indicators for the period 2023/24 to 2025/26 as part of the annual budget process. Performance as at 30th September 2023 against the approved limits is shown below.

	2023/24	2023/24
TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**
	Approved limit	**Actual at 30/9/23**
Authorised limit for external borrowing -		
Borrowing	£2,288,278	£2,033,585
Other long-term liabilities	£20,989	£22,601*
Total authorised limit for external borrowing	£2,309,267	£2,056,186
Operational boundary for external borrowing -		
Borrowing	£2,278,278	£2,033,585
Other long-term liabilities	£20,989	£22,601*
Total operational boundary for external borrowing	£2,299,267	£2,056,186
Upper limit for fixed interest rate exposure	100%	100%
Upper limit for variable rate exposure	70%	0%
Upper limit for total principal sums invested for over 364 days (per maturity date)	£3,000	£0

2.2 *Estimate based on September 2023 projections. The PFI Finance Lease Liability will reduce during 2023/24 and the budget reflects the end of year position.

2.3 These indicators will be reviewed in the Annual Treasury Management Strategy that will be approved as part of the 2024/25 budget.

3.0 Current Treasury Position

3.1 The Council's treasury position at 30th September 2023 comprised:

	Principal	*Ave Rate*
<u>Borrowing</u>	£000	%
Long term borrowing	1,767,383	2.65%
Short term borrowing	266,202	4.92%
Total Borrowing	**2,033,585**	
<u>Deposits</u>		
External Investments		
- Short term on advice of TUK	0	0.00%
- Short term WBC Treasury	29,000	5.35%
- on call with Lloyds TSB	3,360	3.90%
Total External Deposits	**32,360**	
Long Term Investments in Group Companies/ Joint Ventures/External Organisations	**1,326,547**	3.33%

3.2 Appendix A shows the current interest variance against budget for the financial year to the end of September. As discussed above, many of the loans the Council has made to its subsidiary companies are not recoverable and some level of assistance from Government will be required to deal with the Council's debt. It is not known what form of assistance (if any) will be provided. Currently, in order to ensure that the Council does not borrow to finance revenue loans to the Group companies, loan repayments from Subsidiaries to the Council have been suspended.

The interest due from the group investments is being accrued in the accounts. Until the reviews into the Companies have been completed, it is not known which loans will be recoverable and what interest will be due.

3.3 There are effectively two interest positions to monitor against in 2023/24;

1) The 'Business as Usual' position of the Council which assumes the 2023/24 interest from loans to the Group companies will be received. This approach allows the core financial position of the Council to be measured. Due to the size of the capital financing budget, any movements in the budget can distort the bottom line monitoring position of the Council's core services. On this basis, as shown in Appendix A, the interest from the group companies is assumed to be received in full (reflecting the position currently being assumed in the Council's accounts). As more is known about the financial position of the Group, the recoverability of the Council's investments in its subsidiaries, and any Government support, the interest variance will be updated to reflect the latest position.

   The 2022/23 Draft Final Accounts contain an accrual for the interest owed by the subsidiary companies to the Council as at 31st March 2023 (i.e. the accounts assume that this will be paid at a later date). The interest position reported in appendix A assumes that this income relating to 2022/23 will not be received and therefore creates an overspend in year.

2) The interest income from investments in the group makes up £42.1m of total £43.3m interest income budget. The £1.2b deficit reported in the Section 114 notice assumed that this income would not be forthcoming as the underlying loans will be written off. It is not yet known how much of this income will be recoverable. £41m of the £43m interest budget is at risk of not being received.

3.4 The Section 114 Notice states that The Minimum Revenue Provision (MRP) calculation to set aside resources for the repayment of debt has not been undertaken in the manner required for a number of years. The Council's MRP strategy is being updated and will be presented with the Treasury Management Strategy in February. Both the additional MRP charged, and the lost interest income on irrecoverable loans to the group, will need to be considered as part of the £1.2bn deficit detailed in the Section 114 notice. The s114 notice identified that there needed to be a major revision to the MRP charge - there is both a backlog adjustment and an ongoing annual charge not currently in the budget.

4.0 Borrowing Requirement

4.1 The borrowing requirement for the current financial year set out in the 2023/24 strategy was £173m.

4.2 Due to the reasons outline above, and in the Section 114 Notice, the capital programme has been suspended apart from urgent health and safety and regulatory works, with payments only being made to companies and joint ventures to cover contractually committed capital expenditure or business cases approved by The Commissioners\DLUHC. This will be reflected in the Investment Programme section of the budget report going to the February Council.

4.3 In the wider economy, CPI inflation declined from 6.8% in July to 6.7% in August, the lowest rate since February 2022. However, inflation continues to be well above the Monetary Policy Committee's (MPC) 2% target with CPI inflation remaining at 6.7% in September. In order to tackle inflation, the first half of 2023/24 saw interest rates rise by a further 100bps, taking Bank Rate from 4.25% to 5.25% and, possibly, the peak in the tightening cycle.

4.4 Link Group (the Council's treasury management advisors) forecast the bank rate to peak at 5.25%. A table of Link's forecast rates is below;

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

4.5 50 year annuity PWLB rates continue to remain high starting the year at 4.62% rising to 5.6% by the end of September increasing the cost of any new long-term borrowing for the Council. Link Group are forecasting 50 year PWLB to be 5.2% in December 2023 and then to fall gradually to 4.20% in March 2025. However there has been market volatility and rates continue to be difficult to predict.

4.6 With interest rates remaining high through the first half of the year, Link advised that rates were above target rates and recommended not to lock in long term borrowing. Therefore, where the Council has borrowed in the current year, it has taken temporary borrowing with a view to refinancing this to long term PWLB borrowing when the rates fall. Borrowing has been deferred wherever possible by maintaining only small cash balances.

4.7 As at the 1st April 2023 the Council held £198,000,000 in temporary borrowing (less than 1 year outstanding). The majority of the Council's debt is long term (50 year) annuity loans reflecting the anticipated long life of the projects it was taking on. As discussed elsewhere in the report, the Council is reviewing its asset portfolio in order to identify assets to dispose of in order to reduce the Council's debt. It may be that medium term borrowing of between 1 and 5 years is taken rather than short term borrowing in order to match loan maturity dates to broadly coincide with asset sales.

4.8 There were no new long term fixed rate loans taken from the Public Works Loan Board (PWLB) during the first six months of 2023/24. The following short-term loans were taken from Local Lenders and the PWLB during the first six months of 2023/24: -

Loan number	Start date	Principal	Interest Rate	Type of Loan	Borrowing Period
612710	06/04/2023	20,000,000	4.69	Maturity	1 Year
4407	25/04/2023	5,000,000	4.3	Maturity	9 Months
4409	25/04/2023	5,000,000	4.6	Maturity	1 Year
625854	23/05/2023	10,000,000	4.96	Maturity	1 Year
4412	06/06/2023	10,000,000	5	Maturity	9 Months
4410	08/06/2023	10,000,000	4.75	Maturity	9 Months
634679	23/06/2023	12,000,000	5.86	Maturity	1 Year
636524	30/06/2023	10,000,000	6.13	Maturity	1 Year
4411	19/07/2023	5,000,000	5	Maturity	1 Year
641800	21/07/2023	5,000,000	6.1	Maturity	1 Year
644108	28/07/2023	10,000,000	5.97	Maturity	1 Year
644412	31/07/2023	5,000,000	5.83	Maturity	1 Year
650215	17/08/2023	10,000,000	5.81	Maturity	1 Year
652763	25/08/2023	5,000,000	6.05	Maturity	1 Year
656657	11/09/2023	10,000,000	5.84	Maturity	1 Year

657466	13/09/2023	5,900,000	5.91	Maturity	1 Year
660178	22/09/2023	5,000,000	5.77	Maturity	1 Year
660210	22/09/2023	3,300,000	5.77	Maturity	1 Year
Total		146,200,000			

4.9 £78m of the £146m was taken to re-finance loan maturities and £68.2m funded new expenditure in 2023/24.

4.10 Full details of the Council's loans are reported in Appendix A to this report.

4.11 The Council has been working with DLUHC and Commissioners to identify the borrowing needs of the Council going forward. Further borrowing is required in order to finance the remaining capital programme (which is now limited to the items discussed above) and to refinance loan maturities.

4.12 The new borrowing is likely to be a combination of PWLB and loans through other Local Authorities depending on the rates and availability of both. The Council will look to take longer term borrowing again, dependent on the Council's future borrowing needs and if there is a fall in medium\long-term rates (either through market volatility, the economy stabilising, and/or inflation subsiding).

4.13 There will be close monitoring of the rates and borrowing available over the next 6 months and in the longer term.

5.0 Debt Rescheduling

5.1 No debt rescheduling has taken place to date in the 2023/24 financial year and therefore the Treasury Management Panel has not met.

5.2 For prudence the Council has largely taken 50-year fixed rate loans to finance its long term projects and therefore the average loan duration is very much skewed towards longer dates. It is good Treasury Management to review the average duration of loans to ensure the organisation is borrowing as efficiently as possible.

5.3 Increasing interest rates can offer opportunities to redeem loans early and refinance them at current rates. The Council may then receive a discount on the original loan which it would spread over 10 years. This debt rescheduling could be used to find the optimum average loan duration and possibly achieve a revenue saving over the next 10 years. These benefits would need to be considered alongside the impact on the remainder of the loan term (not just the first 10 years) and the prudence of matching loans to the economic lives of the assets produced by the Council's projects.

5.4 Any debt rescheduling proposals will be discussed with the Treasury Management Panel.

6.0 Treasury Management Investment Strategy

6.1 The Council's treasury investments are held primarily to manage cashflows. Treasury investment priorities are the security of its capital, the liquidity of its investments and finally the return on the investment. The balances held during 2023/24 to date have been minimised to assist in delaying the need to borrow, and so it has not been necessary to use the range of investments available in the strategy.

6.2 The investments used to manage cash flow to date in 2023/24, and the limits applied, are as indicated below.

- Money market funds – four funds, two with a limit of £50m per fund, one with a limit of £70m, and one with a limit of £30m.

- Deposits with other local authorities – up to £4m per authority.

- Deposits with Lloyds Bank – no limit as this is the Council's banker.

6.3 Whilst deposits with other local authorities and Building Societies are permitted by the Strategy, it has not been necessary to make such investments or place funds on the advice of Tradition UK (TUK) during the year to date.

Creditworthiness Policy

6.4 The Council uses Fitch ratings to derive its investment criteria for investments other than with other local authorities and Building Societies. Where a counterparty does not have a Fitch rating, the equivalent Moody's rating will be used.

6.5 The Council takes account of Link Asset Services' creditworthiness service and receives notification of changes to ratings as well as a comprehensive weekly list. This service uses credit ratings from all three rating agencies (Fitch, Moodys and Standard and Poors), but also takes account of credit watches, credit outlooks and other information. These factors are combined to indicate the relative creditworthiness of counterparties and provide a recommended duration for investments.

Country Limits

6.6 Under the Code of Practice, the Council should determine the minimum credit limit on a country basis as well as for institutions. The Treasury Management Strategy sets out that the Council will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent agencies if Fitch does not provide). It should be noted that the UK is excluded from the minimum country limit as per the Executive decision on 30th June 2016; without this decision, the Council would have been unable to place investments in the UK.

6.7 Information on changes to country ratings is received as part of the Link Asset Services creditworthiness service, and records are updated by Treasury Management staff.

6.8 In the six months to 30th September, no deposits were placed outside of the UK.

7.0 Use of External Service Providers

7.1 The Council uses Link Group as its external treasury management advisors. Further external support and reviews of the Treasury Management functions have been carried out by Worth Technical Accounting Solutions Ltd and Martin Easton in 2023/24.

8.0 Corporate Strategy

8.1 The Capital, Investment and Treasury Management Strategies support the Council's use and prioritisation of resources in line with the Corporate Plan and Corporate Strategy

9.0 Implications

Finance and Risk

9.1 The financial implications are implicit in the body of this report.

Equalities and Human Resources

9.2 The CIPFA code requires members and staff involved in treasury management to receive training and the Council's training requirements will be reviewed in order to provide appropriate training.

9.3 The contract with Link Asset Services provides for staff attendance at various conferences and seminars as well as providing a helpline facility, and Treasury Management staff have attended seminars and courses run by Link Asset Services during the year.

Legal

9.4 This report has been reviewed by Legal Services who have not raised any issues.

10.0 Engagement and Consultation

10.1 No general public consultations have been undertaken in connection with this report.

REPORT ENDS