Report to Audit and Governance Committee

Date: 23rd November 2022

Title: **Treasury Management Mid-Year Update Report**

Cabinet Member(s): Cllr John Chilver - Cabinet Member for Accessible Housing and Resources and Cllr Tim Butcher - Deputy Cabinet Member for Accessible Housing and Resources

Contact officer: Julie Edwards

Ward(s) affected: None specific

Recommendations: **The Committee is asked to note the Treasury Management Mid-Year Update Report for 2022/23.**

1. Executive summary

1.1 The Council is required to report to members on the current year's treasury management activity. It has been agreed that a mid-year report on the treasury management activity for the first six months of the financial year would be reported to the Audit and Governance Committee.

1.2 The table below is a summary of the Council's borrowing.

£000	**1st April 2020**	**31st March 2021**	**31st March 2022**	**30th Sept 2022**	**31st March 2023**	**31st March 2024**
PWLB	333,193	286,459	279,638	**266,194**	262,728	255,728
LOBO	30,000	30,000	30,000	**30,000**	30,000	30,000
Total	363,193	316,459	309,638	**296,194**	292,728	285,728

1.3 The treasury cash (investments) position is summarised overleaf.

£000	31st Dec 2021	31st March 2022	30th June 2022	30th Sept 2022	31st Dec 2022	31st March 2023	30th June 2023
Term Deposits							
UK Banks	5,000	5,000	15,000	**15,000**	20,000	20,000	20,000
Overseas Banks	5,000	10,000	10,000	**20,000**	20,000	20,000	20,000
Building Societies	-	-	10,000	**10,000**	10,000	10,000	10,000
Local Authorities	113,000	103,000	70,000	**75,000**	65,000	55,000	45,000
UK Government	-	-	23,300	-	-	10,000	40,000
	123,000	118,000	128,300	**120,000**	115,000	115,000	135,000
Instant Access							
MMF	62,360	37,815	78,750	**53,510**	60,100	43,800	65,100
Property Fund							
CCLA	21,418	22,923	24,122	**23,098**	23,098	23,098	23,098
Total	206,778	178,738	231,172	**196,608**	198,198	181,898	223,198

1.4 In the current economic climate it is considered appropriate to keep 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.

1.5 In overall budget terms, the Council is forecast to be £2.800m net better off during the year, the increase in interest rates means that the Council is forecast to achieve £1.884m more investment income than budgeted for. The Council is forecast to spend £8.379m on interest for external borrowing activity in the financial year, an underspend of £916k compared to the budget of £9.295m. The budget assumed that the Council would undertake new borrowing in 2022/23, to date no new borrowing has been undertaken. The table overleaf summarises the budget monitoring position. Another factor, however, was the continuation of the Council's strategy to use surplus cash instead of borrowing, to reduce risks and keep external financing costs low. The Council will continue the strategy of internal borrowing while it makes sense to continue to do so. The table overleaf summarises the year end forecast for interest on external borrowing an interest receivable on term deposits / Money Market Funds.

	Budget £000	Year End Forecast £000	Variance £000
External Interest Costs	9,295	8,379	-916
Interest Receivable on Term Deposits / MMFs	-1,469	-3,353	-1,884
Net Position	**7,826**	**5,026**	**-2,800**

2. Content of report

2.1 The Council is required to operate a balanced budget, which broadly means that income raised during the year will meet expenditure. Part of the treasury management operation is to ensure that cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low-risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

2.2 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 that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

2.3 In line with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice for Treasury Management and the Council's Financial Procedure Rules, this Council is required to provide the Audit and Governance Committee with a mid-year report on the treasury management activity for the first six months of the financial year.

2.4 Treasury management is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code). CIPFA launched an updated Code of Practice in 2022.

2.5 The Code of Practice defines Treasury Management as: The management of the organisation's 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.

2.6 The Council's Treasury Management Strategy Statement (TMSS) was approved by Council on 23rd February 2022. There are no policy change proposed to the TMSS at this stage. The general policy is the prudent investment of its treasury balances and cost-effective borrowing to finance long term investment in the Council's assets. The approach to investments with other local authorities will be reviewed as part of the TMSS for 2023/24.

Interest rate forecasts

2.7 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 table overleaf based on the latest forecasts from Link and Capital Economics, a consultancy that supports Link to develop / sense check their interest rate forecasts. It suggests that both short and long-dated interest rates will be elevated for some time.

Interest Rate Forecasts								
Bank Rate	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24
Link	4.00%	5.00%	5.00%	5.00%	4.50%	4.00%	3.75%	3.25%
Cap Econ	4.25%	5.00%	5.00%	5.00%	5.00%	4.75%	4.25%	3.75%
5Y PWLB RATE								
Link	5.00%	4.90%	4.70%	4.50%	4.20%	3.90%	3.70%	3.50%
Cap Econ	5.20%	5.00%	4.90%	4.70%	4.50%	4.30%	4.20%	4.00%
10Y PWLB RATE								
Link	4.90%	4.70%	4.60%	4.30%	4.10%	3.80%	3.60%	3.50%
Cap Econ	5.10%	4.90%	4.80%	4.70%	4.60%	4.40%	4.20%	4.00%
25Y PWLB RATE								
Link	5.10%	4.90%	4.80%	4.50%	4.30%	4.10%	3.90%	3.70%
Cap Econ	5.10%	5.00%	4.90%	4.90%	4.80%	4.60%	4.50%	4.30%
50Y PWLB RATE								
Link	4.80%	4.60%	4.50%	4.20%	4.00%	3.80%	3.60%	3.40%
Cap Econ	4.90%	4.90%	4.90%	4.80%	4.80%	4.60%	4.50%	4.30%

Borrowing

2.8 The Council has a combination of Public Works Loan Board (PWLB[1]) loans and loans from financial institutions to meet its current borrowing requirements. Loans outstanding totalled £296.194m on 30 September 2022; £266.194m was from the PWLB, £30m Lenders Option Borrowers Option (LOBOs[2]) from the money markets. The Council pursues a strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, to reduce risk and keep external financing costs low. The Council is forecast to spend £8.379m on interest for external borrowing activity in the financial year, an underspend compared to the budget of £9.295m, to date no new borrowing has been undertaken. The budget assumed that the Council would undertake new borrowing in 2022/23. The table overleaf is a summary of the Council's borrowing on 30th September 2022, the borrowing position on 1st April 2020 and 31st March 2021. The table also forecasts the borrowing position for the 31st March 2023 and 31st March 2024; the forecasts assume no new borrowing takes place in the meantime.

£000	1st April 2020	31st March 2021	31st March 2022	30th Sept 2022	31st March 2023	31st March 2024
PWLB	333,193	286,459	279,638	**266,194**	262,728	255,728
LOBO	30,000	30,000	30,000	**30,000**	30,000	30,000
Total	363,193	316,459	309,638	**296,194**	292,728	285,728

[1] PWLB Public Works Loans Board. The PWLB is a statutory body, part of HM Treasury; its purpose is to lend money to local authorities. The Council's main objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required.

[2]LOBOs Lender Option Borrower Option. LOBOs are long-term borrowing instruments which include an option for the lender to periodically revise the interest rate. If the lender decides to revise the interest rate, the borrower then has the option to pay the revised interest rate or repay the loan.

2.9 Debt rescheduling opportunities have been limited in the current economic climate and therefore no debt rescheduling has been undertaken to date in the current financial year. However, now that the whole of the yield curve has shifted higher there may be better opportunities in the future, although only prudent and affordable debt rescheduling will be considered.

Annual Investment Strategy

2.10 The TMSS for 2022/23, which includes the Council's Treasury Investment Strategy requires the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. In the current economic climate, it is considered appropriate to keep 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.

2.11 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year to 30th September 2022, the Council's cash balances averaged £223m, including the CCLA (Churches, Charities and Local Authorities) property fund investment.

2.12 The treasury cash (investments) position is summarised below.

£000	31st Dec 2021	31st March 2022	30th June 2022	30th Sept 2022	31st Dec 2022	31st March 2023	30th June 2023
Term Deposits							
UK Banks	5,000	5,000	15,000	**15,000**	20,000	20,000	20,000
Overseas Banks	5,000	10,000	10,000	**20,000**	20,000	20,000	20,000
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Local Authorities	113,000	103,000	70,000	**75,000**	65,000	55,000	45,000
UK Government	-	-	23,300			10,000	40,000
	123,000	118,000	128,300	**120,000**	115,000	115,000	135,000
Instant Access							
MMF	62,360	37,815	78,750	**53,510**	60,100	43,800	65,100
Property Fund							
CCLA	21,418	22,923	24,122	**23,098**	23,098	23,098	23,098
Total	206,778	178,738	231,172	**196,608**	198,198	181,898	223,198

2.13 Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. The Council is forecast to achieve £3.353m interest on its investments, an overachievement of income of £1.884m compared to the budget of £1.469m. Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the period ended 30th September 2022.

2.14 Treasury management's role is to ensure that the Council has cash available to meet its day-to-day requirements. Environmental, Social and Governance (ESG) treasury investments are being developed but do not represent a significant proportion. Treasury investments are generally short term, some overnight, secure, providing access to cash when the Council needs it. They do not include fossil fuels or companies with a large carbon footprint. Treasury investments place cash somewhere safe that generates a return to the benefit of the residents of Buckinghamshire.

2.15 **Externally Managed Pooled Funds** Buckinghamshire Council has invested £20m in the CCLA property fund in three tranches, currently worth £23.098m. The CCLA property fund is an externally managed strategic pooled property fund where short-term security and liquidity are lesser considerations; the objectives instead are regular revenue income and long-term price stability.

2.16 **Sovereign Limits** The Council will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of AAA from Fitch (or equivalent). The cash limit for AAA sovereign rated countries is £20m per country and £40m in aggregate – Australia, Denmark, Germany, Luxembourg, Netherlands, Norway, Singapore, Sweden and Switzerland are AAA. On 30th September 2022 £20m was invested in banks domiciled in AAA sovereign rated countries.

2.17 **Other Local Authorities** The Council invests with other local authorities. Local Authorities are considered to be quasi government risk. In addition, there is also specific protection under the Local Government Act 2003, which sets out that no local authority can offer security to a lender, however there is specific regulation on loans to local authorities which makes clear that all loans are secured on future revenues and this includes the ability to take legal action if any debts are not repaid.

2.18 The 2022/23 TMSS includes a statement that where a local authority has issued a section 114 notice or has been granted permissions to use capital to help with their revenue budgets the investment can only be placed with the prior approval of the Service Director of Finance in consultation with the Cabinet Member for Accessible Housing and Resources. Following recent articles in the press about high levels of indebtedness with other local authorities, the Council has received a letter of assurance from another local authority that an outstanding loan will be repaid to the Council on the 6th January 2023. The number of local authorities who are experiencing financial difficulties has increased significantly over recent years resulting in s114 notices, Best Value reports and Public Interest reports, applications for Capitalisation Directives, as well as reports of general financial pressures being experienced by councils. In this economic environment, future investments with other local authorities require advance approval from the Chief Executive and the Leader of the Council.

Prudential Indicators

2.19 Each year, the Council agrees Prudential Indicators under the Local Government Act 2003 which are affordable, prudent and sustainable. The indicators were agreed by full Council at its meeting on 23rd February 2022. During the half year ended 30th September, the Council has operated within the treasury and prudential indicators set out in the Council's TMSS for 2022/23. The Service Director of Finance reports that no difficulties are envisaged for the current or future years in complying with these indicators.

Borrowing Indicators

2.20 The Capital Financing Requirement (CFR) measures the Council's underlying external need to borrow for capital purposes. This is essentially the Council's outstanding debt, necessary to finance the Council's capital expenditure. Each year the CFR is increased by the amount of debt required to support the capital programme and reduced by revenue charges for the repayment of debt. The actual debt is dependent on the type and maturity of the borrowing undertaken as well as seeking the optimal cashflow situation.

2.21 Comparing gross debt with the capital financing requirement is an indicator of the Council's prudence in managing its capital expenditure and is designed to ensure that, over the medium term, external borrowing is only for capital purposes. Gross external borrowing should not, except in the short term, exceed the total of the CFR. The values are measured at the end of the financial year. The table below shows that the Council is projected to have borrowings of £292.728m by 31st March 2023 which means that it has utilised £286.98m of cash flow funds in lieu of borrowing (internal borrowing). The Council's estimated annual saving by not paying interest on external debt and foregoing investment interest, which is low in the current economic circumstances, is £1.8m. The estimates for 2022/23 and 2023/24 take into account the £100m potential borrowing facility that Council has delegated to Cabinet where there exists a robust and financially viable business case, although the restrictions on borrowing from PWLB to invest primarily for yield and higher PWLB borrowing costs mean that there are fewer prudential borrowing opportunities available.

Indicator	**Unit**	**Latest 2022/23**	**Estimate 2022/23**	**Estimate 2023/24**
Gross Debt	£m	292.78	405.54	405.27
Capital Financing Requirement	£m	579.76	579.76	573.78
Internal Borrowing	**£m**	**286.98**	**174.22**	**168.51**

2.22 The Authorised Limit for External Debt is required to separately identify external borrowing (gross of investments) and other long-term liabilities such as covenant repayments and finance lease obligations. The limit provides a maximum figure that the Council could borrow at any given point during each financial year.

2.23 The Operational Boundary for External Debt is a key management tool for in-year monitoring and is lower than the Authorised Limit as it is based on an estimate of the most likely level of external borrowing at any point in the year. In comparison, the authorised limit is the maximum allowable level of borrowing.

Authorised limit £m	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Debt	510	510	510
Other long-term liabilities	10	10	10
Total	**520**	**520**	**520**

Operational boundary £m	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Debt	410	410	410
Other long-term liabilities	7.5	7.5	7.5
Total	**417.5**	**417.5**	**417.5**

2.24 The Operational Boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the Authorised Limit not being breached.

Treasury Management Indicators

2.25 The Council measures and manages its exposures to treasury management risks using the following indicators.

2.26 **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk. The weighted average credit rating of AA- exceeds the target A.

Credit Risk Indicator	Indicator as at 30th September 2022	Target
Portfolio average credit rating	AA-	A

Maturity structure of borrowing: This indicator is set to control the Council's exposure to large, fixed rate sums falling due for refinancing, and are required for upper and lower limits. The time periods start on the first day of the financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	Actual 2022/23	Upper Limit	Lower Limit
Under 12 months	5%	15%	0%
12 months to 2 years	7%	17%	0%
2 years to 5 years	12%	22%	0%
5 years to 10 years	26%	34%	0%
10 years to 20 years	20%	33%	0%
20 years to 30 years	16%	33%	0%
30 years to 40 years	4%	30%	0%
40 years and above	0%	30%	0%

2.27 **Investment performance / risk benchmarking -** the Council uses the 7 day SONIA (Sterling Overnight Index Average) compounded rate as an investment benchmark to assess the investment performance of its investment portfolio. To date average investment returns of 1.16% are 0.03% below the 7 day SONIA of 1.19%; this is due to the Council holding term deposits placed before the recent increases in interest rates. These term deposits will mature over the next few months.

Risk benchmarking	7 day SONIA	Average investment returns
Investment performance	1.19%	1.16%

2.28 **Investment treasury indicator and limit** - total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment and are based on the availability of funds after each year-end.

Upper limit for principal sums invested for longer than 365 days			
£m	**2022/23**	**2023/24**	**2024/25**
Investments on 30th September 2022 in excess of 1 year maturing in each year	£0m	£10m	£0m
Principal sums invested for longer than 365 days	£25m	£25m	£25m

2.29 CIPFA published a revised Treasury Management Code and Prudential Code on 20th December 2021 and has stated that formal adoption is not required until the 2023/24 financial year. This Council has to have regard to these codes of practice when it prepares the Treasury Management Strategy Statement and Annual Investment Strategy, and also related reports during the financial year.

2.30 The revised codes will have the following implications:

- a requirement for the Council to adopt a new debt liability benchmark treasury indicator to support the financing risk management of the capital financing requirement;
- clarify what CIPFA expects a local authority to borrow for and what they do not view as appropriate. This will include the requirement to set a proportionate approach to commercial and service capital investment;
- create new Investment Practices to manage risks associated with non-treasury investment (similar to the current Treasury Management Practices(TMPs));
- ensure that any long term treasury investment is supported by a business model;
- a requirement to effectively manage liquidity and longer term cash flow requirements;
- amendment to TMP1 to address ESG policy within the treasury management risk framework;
- amendment to the knowledge and skills register for individuals involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each council;
- a new requirement to clarify reporting requirements for service and commercial investment, (especially where supported by borrowing/leverage).

2.31 In addition, all investments and investment income must be attributed to one of the following three purposes: -

- **Treasury management** Arising from the organisation’s cash flows or treasury risk management activity, this type of investment represents balances which are only held until the cash is required for use. Treasury investments may also arise from other treasury risk management activity which seeks to prudently manage the risks, costs or income relating to existing or forecast debt or treasury investments.

- **Service delivery** Investments held primarily and directly for the delivery of public services including housing, regeneration and local infrastructure. Returns on this category of investment which are funded by borrowing are permitted only in cases where the income is "either related to the financial viability of the project in question or otherwise incidental to the primary purpose".
- **Commercial return** Investments held primarily for financial return with no treasury management or direct service provision purpose. Risks on such investments should be proportionate to a council's financial capacity – i.e., that 'plausible losses' could be absorbed in budgets or reserves without unmanageable detriment to local services. An authority must not arrange new borrowing from the PWLB to invest primarily for financial return, there is no requirement to sell existing commercial acquisitions.

3. Legal and financial implications

3.1 The publication of an annual strategy, a mid-year treasury report and an annual treasury management report conforms to best practice as required by the Code of Practice CIPFA Treasury Management in the Public Services.

4. Corporate implications

4.1 There are none.

5. Background papers

5.1 There are none.