REPORT TO: **AUDIT AND GOVERNANCE COMMITTEE**

MEETING DATE: 19 December 2023

BY: Executive Director for Council Resources

SUBJECT: Treasury Management – Mid Year Review 2023-24

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1 PURPOSE

1.1 An update to the Committee on Treasury Management activity during the first six months of 2023-24.

2 RECOMMENDATIONS

2.1 The Committee is asked to note the content of the report.

3 BACKGROUND

3.1 A main function of treasury management operations is to ensure that the cash flow is adequately planned, with cash being available when it is required. Surplus monies are invested in low-risk counterparties, providing adequate liquidity initially before considering optimising investment return.

3.2 In addition, the treasury management service manages the accounting and funding of the Council's capital plans. The approved capital plans provide a guide to the borrowing need of the Council, including setting out the longer-term cash flow planning to ensure the Council can meet its capital spending obligations in future years. This management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses. On occasion, any debt previously incurred may be restructured to meet wider risk or cost objectives.

3.3 Treasury management is therefore defined as being 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. This mid-year report is reviewed against the current Treasury Management Strategy that was approved by Council in February 2023.

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

A. An economic update for the first part of the 2023-24 financial year;
B. A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
C. The Council's capital position (prudential indicators);
D. A review of the Council's investment portfolio for 2023-24.
E. A review of the Council's borrowing strategy for 2023-24.
F. A review of any debt rescheduling undertaken during 2023-24.

Part A – Economic Update

3.5 The Monetary Policy Committee (MPC) increased interest rates by a further 1%, taking Bank rate from 4.25% in March to 5.25% in August as inflation remained high. Although inflation fell to 6.7% in August, its lowest rate since February 2022, where it remained in September, it is still the highest across the G7 countries.

3.6 Interest rates are thought to have peaked and they are expected to remain at 5.25% until the second half of 2024 in line with the Bank of England strategy to for managing inflation, although they have not ruled out further tightening if there are persistent inflation pressures. Over the next six months the impact of the higher interest rates on businesses and individuals is expected to intensify.

3.7 The MPC's thoughts and the economic conditions have informed our Treasury advisors forecast for the period December 2023 to December 2026 as shown in Table 3.1. It shows Bank Rate remaining at 5.25% until June 2024 with predicted falls of 0.50% each quarter to 3.50% in June 2025, then projecting to fall at a slower pace of 0.25% until reaching 3.00% in December 2025 onward for the forecast period.

Table 3.1

Link Group Interest Rate View	07.11.23												
	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	3.25	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.30	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.40	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.50	3.30	3.30	3.30	3.30	3.30
5 yr PWLB	5.00	4.90	4.80	4.70	4.40	4.20	4.00	3.80	3.70	3.60	3.50	3.50	3.50
10 yr PWLB	5.10	5.00	4.80	4.70	4.40	4.20	4.00	3.80	3.70	3.70	3.60	3.60	3.50
25 yr PWLB	5.50	5.30	5.10	4.90	4.70	4.50	4.30	4.20	4.10	4.10	4.00	4.00	4.00
50 yr PWLB	5.30	5.10	4.90	4.70	4.50	4.30	4.10	4.00	3.90	3.90	3.80	3.80	3.80

Part B – Review of Treasury Management Strategy Statement and Annual Investment Strategy

3.8 The Treasury Management Strategy Statement (TMSS) sets out the wider Treasury and Investment Strategy and was approved by Council on 28 February 2023. The Strategy includes a number of key treasury management indicators. This report provides an update on the Treasury Management activity undertaken by the Council relative to the approved strategy taking account of the updated economic position and budgetary changes already approved.

3.9 Table 3.2 below provides a summary of the current position relative to approved indicators, with more details around the position on each indicator set out in the remainder of this report.

Table 3.2

Prudential Indicators 2023-24	Approved £m	Current Estimated Prudential Indicator £m
Capital Financing Requirement	669	618
Operational Boundary	669	618
Authorised Limit	711	659

Includes long term liabilities for PPP arrangements and finance leases

Part C - The Council's Capital Position (Prudential Indicators)

3.10 The current projections set against the approved indicators are set out below.

Capital Expenditure and Financing of the Capital Programme

3.11 Table 3.3 below sets out the current projected outturns for the Council's capital investment programmes for 2023-24 relative to the approved budget set on 28 February 2023.

The table sets out how the programme is financed, highlighting the supported and unsupported elements and the expected financing arrangements.

The borrowing requirement increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR). This in part will be offset by any revenue charges for the repayment of debt.

Table 3.3

Capital Expenditure	2023-24 Approved Budget £m	2023-24 Projected Outturn * £m
General Services	98.9	58.4
HRA	34.0	43.1
Total capital expenditure	**132.9**	**101.5**
Financed by:		
Capital receipts	15.6	11.9
Capital Grants	24.1	26.8
CFCR	1.2	1.2
Total financing	**40.9**	**39.9**
Borrowing requirement	**92**	**61.6**

** Projected outturn is based on the position to be reported in the December Council update and remains subject to change*

Impact on Prudential Indicators

3.12 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. Table 3.4 below, sets out the CFR and the expected debt position over the period, which is termed the Operational Boundary.

3.13 Overall the Council is currently projecting to be under the approved limits for both CFR and Operational Boundary. General Services capital expenditure was £14 million less than forecast for 22-23 which brought the opening CFR down. The expected closing CFR for General services is also lower due to in year expenditure being reduced by £35 million. HRA are projecting an increase in grants received (£4m) and also increased expenditure (£9m). The opening CFR was lower due to a £5m reduction in spend compared to forecast in 22-23. Future years Treasury indicators have been updated to take cognisance of the 2022-23 outturn, and the Council is expected to remain well within the Authorised Limit.

Table 3.4

Prudential Indicators	2023-24 Approved Limits £m	2023-24 Projected Outturn £m
Capital Financing Requirement		
CFR – General Services	403	352
CFR – HRA	266	266
Total CFR	**669**	**618**
Operational Boundary for external debt		
Borrowing	638	587
Other long term liabilities*	31	31
Total debt (year-end position)	**669**	**618**

** PPP arrangements and finance leases*

Limits to Borrowing Activity

3.14 One of the main key controls over the treasury activity is to ensure that over the medium term, net borrowing (borrowing 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 previous year plus the estimates of any additional CFR for 2023-24 and next two financial years. This allows some flexibility for limited early borrowing for future years should the need arise.

3.15 Table 3.5 below sets out that the Council is currently managing to operate within this limit and maintain an under-borrowed position. The table below shows that at the end of this financial year the Council is currently forecasting to have external borrowings of £490 million and to utilise £97 million of cash flow funds (under-borrowing) in lieu of borrowing. This is the most prudent and cost effective approach in the current economic climate and remains consistent with the approved Treasury Management Strategy.

Table 3.5

	2022-23 Estimate £m	**2022-23 Actual £m**	**2023-24 Original Estimate £m**	**2023-24 Revised Estimate £m**
External borrowing	491	441	573	490
Other long term liabilities*	32	32	31	31
Total external debt	523	474	604	521
CFR* (year end position)	**607**	**568**	**669**	**618**
Under-borrowing	**84**	**94**	**65**	**97**

** Includes PPP arrangements and finance leases etc.*

3.16 The Authorised Limit is a statutory requirement that represents the limit beyond which borrowing is prohibited and sets an overall control on the level of borrowing. This limit reflects the level of borrowing which while not desired, could be afforded in the short term, but is not sustainable in the longer term. The approved Authorised Limit for 2023-24 is £711 million and as highlighted in Table 3.2 above, the Council continues to operate well within approved limits, and therefore there is no change to the overall strategy required.

Part D - Investment Portfolio 2023-24

3.17 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return consistent with the Council's risk appetite. Wider loan interest rates remain in line with the latest Bank Rate. Bank interest rates are forecast remain at 5.25% for the remainder of the financial year and given this, investment returns will be higher than in 2022-23.

3.18 The Council's investment decisions are made in accordance with the approved strategy. Three short term investments were placed during this time, shown in Table 3.6. ESG (Ethical, Sustainable, Governance) investments are sought where interest rates are comparable with other bodies and the criteria for risk exposure are also met. Any surplus cash balances are held in the Council's bank account.

Table 3.6

Counterparty	Date	Principle	Maturity	Interest rate
DMO	12/07/23	£5m	12/09/23	5.12%
Standard Chartered Sustainable Deposit	12/07/23	£5m	12/10/23	5.42%
Cheshire East Council	24/08/23	£5m	25/10/23	5.32%

3.19 An external investment management company, Investec, manages East Lothian Council Common Good funds and Charitable Trust funds in two separate portfolios. The returns on these investments continue to be closely monitored during the year. At 30 September 2023:

- The East Lothian Charitable Trust portfolio was valued at £3.487m, which represents a decrease of £0.076m over the 6-month period. The performance of this portfolio for the first 6 months is below the benchmark.
- The Common Good portfolio was valued at £3.512m, a decrease of £0.0.87m over the 6 month period. performance of this portfolio for the first 6 months is lower than the benchmark.

Part E – Borrowing Strategy 2023-24

3.20 In recent years, the Council has predominately used PWLB as its main source of funding partly due to the level of risk and interest rates available. Consideration is given to both the maturity profile and interest rates to manage cost and refinancing risk. With regard to the interest rate forecast discussed in Part A, while increases in interest rates were included within the current approved capital investment and borrowing plans, that forecast was much lower than the actual increases in rates. The subsequent estimated reduction in interest rates were in an earlier timeframe than now forecast and has had an impact on interest on new borrowing undertaken and due to be taken in the current financial year.

Looking forward, the Council will need to consider further both the affordability of capital investment plans and potentially seek alternative sources and/or methods of borrowing in order to achieve the best rates and terms. Whilst it remains unclear as to the extent of any further increase in borrowing rates or the duration of any peak, the Council's treasury advisor, Link Asset Services provides regular forecasting of PWLB rates so that an informed decision can be made on the timing of the borrowing for the capital programme.

3.21 Two long term external loans were taken in the first 6 months of the financial year. Due to the overall financial position and the underlying need to borrow for capital purposes (the capital financing requirement – CFR, currently £618 million) it is currently estimated that additional new external borrowing of £87 million will be required during the second half of this financial year.

4 Table 3.7

Loan	Date	Principal	Maturity	Interest rate
PWLB - Maturity	18/08/23	£10m	6 years	4.19%
PWLB – EIP	18/04/23	£10m	11	4.18%

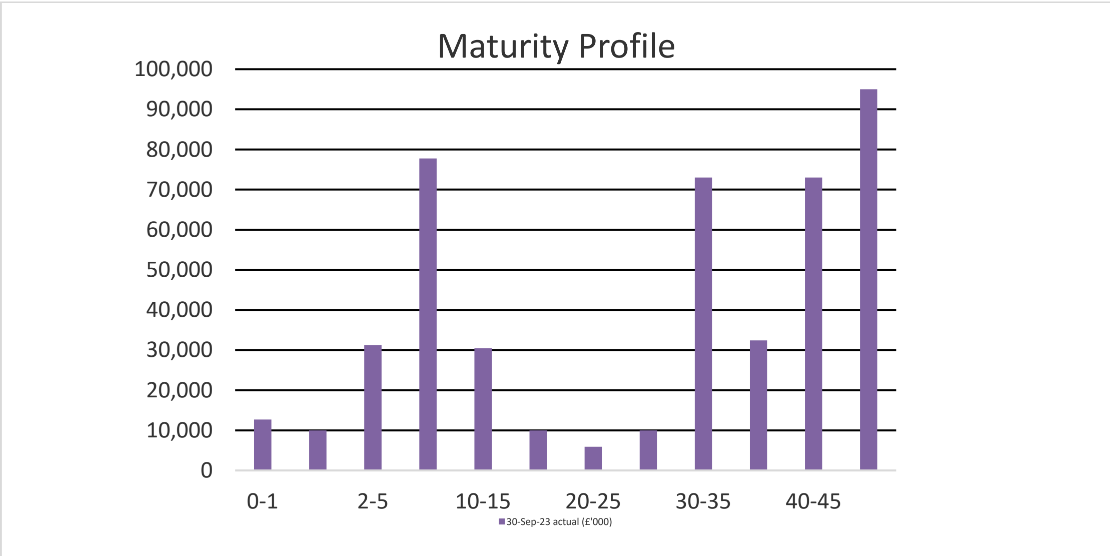
4.1 Three PWLB loans matured during the first six months and was repaid as set out in Table 3.8 below

Table 3.8

Loan	Date repaid	Principal	Maturity	Interest rate
PWLB	14/09/23	£0.662m	30 years	7.875%
PWLB	14/09/23	£0.129m	30 years	7.875%
PWLB	24/09/23	£10m	12 years	3.47%

Current Loan Maturity Profile

4.2 The graph below sets out the current external borrowing maturity profile for the Council.



Part F – Debt Rescheduling

4.3 Debt rescheduling opportunities have been very limited in the economic climate and as such, no debt rescheduling has been undertaken to date in the current financial year. As interest rates move higher this may provide opportunities going forward.

Part G - Introduction of Reporting Standard IFRS16

4.4 International Financial Reporting Standard 16 – Leases has been further delayed and will now come into operation from 1 April 2024. The standard brings the value of assets where the Council has the right of use including lease agreements onto the Council's balance sheet. The standard also requires that these values are reflected in both capital and debt calculations. This standard has implications on treasury prudential indicators, particularly the Capital Financing Requirement as well as the Operational Boundary and Authorised Limit.

4.5 Work is progressing on the implementation of the new standard and an update of the likely implications will be incorporated into future reporting and in the 2024-25 Treasury Strategy.

5 POLICY IMPLICATIONS

5.1 There are no direct policy implications associated with this report, however the Council's treasury management activity is determined by the policy framework set out in the approved Treasury Management Strategy. No changes to the current strategy are recommended on the basis of this mid-year review.

6 INTEGRATED IMPACT ASSESSMENT

6.1 The subject of this report has been considered and given there is no change in policy direction, there is no requirement to undertake any further impact assessment.

7 RESOURCE IMPLICATIONS

7.1 Financial - There are no direct financial implications associated with this report however the Council's Treasury Management and Capital activity clearly has a significant impact on the management of the Council's financial resources.

7.2 Personnel - none

7.3 Other – none

8 BACKGROUND PAPERS

8.1 Treasury Management Strategy 2023-24 to 2026-27 – East Lothian Council 28 February 2023

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