DF/23/104
Corporate Infrastructure & Regulatory Services Scrutiny Committee
16 November 2023

TREASURY MANAGEMENT – MID YEAR STEWARDSHIP REPORT 2023/24

Report of the Director of Finance and Public Value

Please note that the following recommendations are subject to consideration and determination by the Committee before taking effect.

1) Recommendation

That the Committee consider whether it wishes to draw to the attention of the Cabinet any observations on the Treasury Management Mid-Year Stewardship Report.

2) Introduction

2.1 The County Council has adopted the CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management in the Public Services. A revised Code of Practice was published by CIPFA in December 2021 and a revised Policy Statement and Treasury Management Practices (TMPs) were agreed by Council in February 2022. The Treasury Management and Investment Strategy for 2023/24 was agreed by Council in February 2023 and forms part of the published budget book.

2.2 The purpose of this report is to inform members of any key matters arising from the Council's Treasury and Debt Management activities during the first seven months of the 2023/24 financial year. It is intended to enable members to ensure that agreed policy is being implemented. This report, together with any comments offered by this committee, will be considered by Cabinet on 13th December.

3) Minimum Revenue Positions

3.1 Each year the Council has a statutory obligation to charge to the revenue account an annual amount of Minimum Revenue Provision (MRP), which is a charge to make provision for the repayment of the authority's external debt and internal borrowing. The charge is based on the historic borrowing required to fund the Council's capital programme.

3.2 The current policy is to charge MRP based on the period of benefit of the capital investment, i.e. straight line, over the life of the asset. However, all supported borrowing up to 1st April 2008 is charged over the life of the assets, calculated using the annuity method. The budgeted MRP for 2023/24 was £11.948 million. It is now forecast that the actual MRP will be below budget, at £11.597 million, an underspend of £352,000.

.

4) Borrowing Strategy 2023/24 to 2026/27

4.1 The overall aims of the borrowing strategy are to achieve:

- Borrowing at the lowest rates possible in the most appropriate periods;
- The minimum borrowing costs and expenses;
- A reduction in the average interest rate of the debt portfolio.

4.2 Since 2009 the Council has followed a policy of containing the capital programme, taking out no new external borrowing and repaying debt whenever this can be done without incurring a financial penalty. The Medium Term Financial Strategy (MTFS) and Capital Strategy set out in the budget book for 2023/24 continued to assume was that no new long-term borrowing would be required. However, it raised the possibility that reducing cash resources may mean that should the authority wish to undertake or invest in a major strategic project, then additional external borrowing could be needed.

4.3 The Council's external debt is comprised of loans from the Public Works Loans Board (PWLB) and Lender Option Borrower Option (LOBO) loans from the commercial banking sector. LOBOs can operate in a number of ways, but in our case the loans were taken out between 2001 and 2004 at an initial low rate which then increased to a higher rate after an initial period. The bank then has the option each six months to increase the rate, at which point the Council then has the option to accept the higher rate or repay the loan in full plus any outstanding interest, but with no additional premium. As at 31st March 2023, the Council had three LOBO loans from Bayerische Landesbank, while a loan from Barclays was converted from a LOBO loan to a standard fixed rate loan some years ago.

4.4 In September, Bayerische notified the Council that they wished to increase the rate on two of the loans, each of £5 million, from 5.6% to 6.6% and from 5.99% to 6.7% respectively. The decision was taken to repay the £10 million loan rather than accept the higher interest rates. Repayment of the loan will save £290,000 in interest payments in the current year and £580,000 over a full year, but this is offset to some degree by a reduction of £10 million in the cash available for investment.

4.5 The Council's long-term debt as at 31st March 2023 and as at 31st October 2023 is detailed in the following table, reflecting the £10 million reduction in external debt as a result of the loan repayments.

Analysis of Long Term Debt

	Actual 31.03.23 £'m	Interest Rate %	Actual 31.10.23 £'m	Interest Rate %
Fixed Rate Debt				
PWLB	436.35	4.99	436.35	4.99
Money Market	71.50	5.83	61.50	5.83
Variable Debt				
PWLB	0.00		0.00	
Money Market	0.00		0.00	
Total External Borrowing	**507.85**	**5.11**	**497.85**	**5.10**

4.6 Bayerische have also indicated that they are likely to seek to increase the rate on their remaining loan at the next call date at the end of March. The remaining loan is of a much higher figure, at £36.5 million, and has a current interest rate of 5.99%. If Bayerische do seek to increase the rate, then we would look to repay the loan. At this point in time, it is difficult to assess whether we could afford to repay from the Council's cash balances, or whether we would need to take out new loans in order to make the repayment. Should we need to re-borrow, then we could do so at lower rates than the interest rate on the current loan.

4.7 With the current level of interest rates, it would also be possible to repay some of the Council's borrowing from the PWLB without incurring a premium. However, the loans that we could repay would be those at the lowest rates of interest of the current external debt. Should there be a need to borrow in the next 18-24 months, then any new borrowing would be likely to be at a higher rate than the loans that we could repay. Therefore, given the current uncertainty around the levels of available cash going forward, it would not be prudent to repay any of the current PWLB loans at the present time.

4.8 The most significant issue affecting the Council's cash balances is the position on Special Educational Needs and Disabilities (SEND). Unbudgeted expenditure has been charged to an unusable reserve, as required by the Government, which means it does not count towards the Council's budget outturn position. However, it does represent cash out the door, which puts pressure on the Council's cash balances. The deficit on the unusable reserve is forecast to rise to £162 million by 31 March 2024.

4.9 The Council is working to resolve the position through the Safety Valve programme being negotiated with the Department for Education. Should the current discussions result in additional funding being provided to the Council, this will reduce the pressure on the Council's cash balances, which may then prevent the need for the Council to take out new external borrowing to fund its capital priorities and/or allow the Council to reduce the current level of external debt. Any savings arising from reduced levels of debt or additional income from investment of higher cash balances resulting from any funding of the current deficit are likely to be ringfenced to resolving the ongoing deficit position on SEND.

4.10 In April 2022, the Cabinet agreed to support proposals for the creation of the Plymouth and South Devon Freeport. The Business Case includes the requirement for the Council to externally borrow up to £15 million for the capital works needed. The borrowing will not be required until 2024/25, but at that point will add to the Council's external debt. The additional external borrowing will be ringfenced to the Freeport, and all the associated capital financing costs will be funded by the additional business rate income derived from the scheme.

4.11 Active treasury management and the maintenance of levels of liquidity have ensured that no short-term borrowing has been required for the financial year to date. Cash positions are monitored daily and modelled over a monthly horizon to ensure that anticipated liquidity levels are forecast accurately.

5) Investment Strategy

5.1 The overall aim of the Council's investment strategy is to:

- Limit the risk to the loss of capital;
- Ensure that funds are always available to meet cash flow requirements;
- Maximise investment returns, consistent with the first two aims;
- Review new investment instruments as they come to the Local Authority market, and to assess whether they could be a useful part of our investment process.

5.2 The following table shows the County Council's fixed and variable rate investments as at the start of the financial year, and at the end of October.

Schedule of Investments

	Actual 31.03.23 £'m	Interest Rate %	Actual 13.10.23 £'m	Interest Rate %
Bank, Building Society & MMF Deposits				
Fixed Rates				
Term Deposits: Over 365 days	20.00	2.43	15.00	3.08
365 days & Under	96.00	2.95	108.00	5.03
Variable Rate				
Call Accounts	0.00	4.05	0.28	5.14
Notice Accounts	10.00	4.43	10.00	5.49
Money Market Funds (MMF's)	46.48	4.07	23.03	5.28
Property Fund	10.00	3.66	10.00	4.01
All Investments	**182.48**	**3.30**	**166.30**	**4.86**

5.3 The Treasury Management Strategy approved by the Council in February set an average interest rate target of 3%. However, rates have continued to rise as the Bank of England has sought to bring inflation back down to target levels. As a result, the rates that can be achieved on the Council's investments have improved substantially.

5.4 Higher rates can be achieved for loans made for longer periods than for immediately available cash. However, as the Council had made a number of 2-3 year investments prior to the recent rise in rates, the average rate on term deposits is currently lower than the rates available on money market and call accounts. As those older investments mature the average rate on term deposits should increase to above the rates being achieved on short term cash. During the Summer we were able to obtain rates of over 6% on new one year deposits, although current rates have come down a little following the Bank of England's decision not to increase the base rate in September.

5.5 The cash balance available for investment as at 13th October is below the level at the start of the financial year, but the average balance over the year to date has been higher than forecast. Generally, cash increases during the early part of the year as grants are received in advance of spend, with a gradual reduction during the Autumn and Winter.

5.6 Aside from any decision to repay debt, it is anticipated that the cash balance will fall further by the 31st March 2024. Without a resolution to the SEND deficit, the cash balance could fall to below £100 million, but that will also depend on the level of slippage on the capital programme and the level of carry-forwards at year end.

5.7 Revenue lending up to 13th October, including the use of term deposits, call accounts, money market funds and the CCLA property fund, has earned interest of £4.86 million against a full year budget of £3.75 million. It is forecast that the investment income for the full financial year will exceed budget by over £4 million.

5.8 This position results from the significant increases in interest rates since the budget for investment income was set in February, and the higher than forecast levels of cash available for investment during the year to date.

6) Prudential Indicators

6.1 Linked to its Treasury Management Strategy, the County Council is required to monitor its overall level of debt in line with the CIPFA Code of Practice. Part of the code requires consideration of a set of Prudential Indicators in order to allow the Council to form a judgement about the affordable, prudent and sustainable level of debt.

6.2 The purpose of the indicators is to demonstrate that:

- Capital expenditure plans are affordable;
- All external borrowing and other long term liabilities are within prudent and sustainable levels;

- Treasury management decisions are taken in accordance with professional good practice.

6.3 Three Prudential Indicators control the overall level of borrowing. They are:

- **The authorised limit** - this represents the limit beyond which any additional borrowing is prohibited until the limit is revised by the County Council. Revision may occur during the year if there are substantial and unforeseen changes in circumstances, for example, a significant delay in achieving forecast capital receipts. In normal circumstances this limit will not require revision until the estimate for the following year is revised as part of the budget setting process.
- **The operational boundary** – this indicator is based on the probable external debt and other long term liabilities during the year. Variations in cash flow may lead to occasional, short term breaches of the Operational Boundary that are acceptable.
- **The upper limit for net debt** - the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement.

6.4 In addition to the external debt, the borrowing figures for 2023/24 relevant to the prudential indicators also include internal borrowing to fund the capital programme (£72.7 million) and other long term liabilities related to Private Finance Initiative (PFI) contracts (£129.6 million). The borrowing limits set during the budget process also provided significant headroom in case the resolution to the SEND deficit involved a capitalisation directive from Government that would require additional borrowing. This is not now expected to be the outcome of the SEND discussions.

6.5 The following Borrowing Limits were set for 2023/24:

- Maximum borrowing during the period (Authorised Limit) £870.435 million.
- Expected maximum borrowing during the year (Operational Limit) £775.435 million.
- Maximum amount of fixed interest exposure (as a percentage of total) 100%.
- Maximum amount of variable interest exposure (as a percentage of total) 30%.

6.6 Members are asked to note that during 2023/24 to date the Council has remained within its set Borrowing Limits and complied with the interest rate exposure limits.

7) Prospects for 2024/25

7.1 With inflation beginning to come down from its peak of over 10%, the Bank of England's Monetary Policy Committee kept the bank rate unchanged at its

September meeting, breaking a run of fourteen consecutive increases. This may indicate that interest rates have now reached a peak, but if there were to be evidence of more persistent pressures, then further tightening in monetary policy may be required.

7.2 Link, the Council's treasury management advisors, and other economists are expecting rates to remain stable during 2024, with the potential for rate cuts from the Autumn of 2024 onwards.

7.3 From an investment point of view, the increase in interest rates has provided the opportunity to earn higher returns on the Council's cash balances. As a result, the target return for 2024/25 is likely to be set at around 4.75% to 5%, which is higher than the target set for the current year. Should the Council be required to take out external borrowing then the rate of interest payable will also be higher than the rates available in recent years.

7.4 The level of income achievable in 2024/25 will also depend on the cash balances available for investment. Should there be a significant reduction in the Council's cash balances, that will not only reduce the level of investment income that can be achieved but could also result in a need for new external borrowing.

7.5 Much uncertainty remains around the forecast level of cash balances for 2024/25. This will be influenced by the following:

- Budgeted use of earmarked reserves during 2023/24 and any budgeted use of or addition to reserves for 2024/25.
- The level of continued unbudgeted expenditure on Special Educational Needs and Disability (SEND), charged to an unusable reserve.
- The level of any additional funding provided by Government towards meeting the accumulated deficit on SEND expenditure.
- Spending of accumulated capital grants, for example Section 106 provision of infrastructure and major projects such as the North Devon Link Road.
- The requirement for borrowing (internal or external) to fund the 2024/25 Capital Programme.
- Spending of approved carry-forwards.

Some of these issues may become clearer by the time that the Council sets its budget and its Treasury Management Strategy for 2024/25 next February.

8) Summary

8.1 The Council's long-term external borrowing has reduced by £10 million since 31st March 2023 as the result of the repayment of two £5 million loans from Bayerische Landesbank.

8.2 No short-term borrowing has been undertaken to date in 2023/24.

8.3 The investment income achieved as at the 13th October stands at £4.86 million compared to the budget target for the year of £3.75 million.

8.4 The impact of current budget pressures on the Council's cash resources is still uncertain. The resolution of the issues around the Special Educational Needs deficit is likely to be key to determining how the Council manages its external debt over the next year and beyond.

Angie Sinclair
Director of Finance and Public Value

Electoral Divisions: All

Local Government Act 1972: List of background papers

Nil

Contact for enquiries:
Name: Mark Gayler
Telephone: 01392 383621
Address: County Hall Room 196