worcestershire
countycouncil

CABINET
26 OCTOBER 2023

TREASURY MANAGEMENT MID-YEAR UPDATE TO 31 AUGUST 2023

Relevant Cabinet Member
Mr S E Geraghty, Cabinet Member with Responsibility for Finance

Relevant Officer
Chief Financial Officer

Recommendation

1. **The Cabinet Member with Responsibility for Finance (who is also the Leader of the Council) recommends that Cabinet:**
   (a) notes this report, recognising that the Council is operating within its approved Treasury Management Strategy; and
   (b) endorses the conclusions that the Treasury Management activities continue to be cost effective.

Introduction

2. This mid-year report covers the period to 31 August 2023 in order to ensure that Cabinet receives timely updates and to ensure compliance with CIPFA's Code of Practice on Treasury Management (the Code), the report includes a mid-year update on:

   - An economic financial year to date update
   - A review of the Council's investment portfolio
   - A review of the Council's current borrowing strategy
   - A review of compliance with Treasury and Prudential Limits

Economic Update

3. Finance officers monitor and maintain the Council's treasury activity in line with its Treasury Management Strategy. The Council employs Link Group as its treasury management advisor and officers hold regular meetings with them concerning existing and future potential economic circumstances regarding both investments and short / long-term borrowing.

4. The last two quarters have undergone a significant change in the economic position and outlook. The Country was already experiencing a period of growing inflation and economic impact from the conflict in Ukraine, as well as other global factors such as the strength of the US Dollar whilst others have seen a quickening of monetary policy tightening. Recently the UK has also seen a significant increase in its interest rates, to tame inflation, and further rises are forecast by advisors. The last 6 months data seems to show that this is starting to work as CPI has stopped rising and is now falling slowly.

5. The Bank of England raised its policy interest rate by 25bps to 5.25% at its August meeting, marking the 14th consecutive hike. This decision pushed borrowing costs to their highest level since the 2008 financial crisis, all to combat persistent inflation. Following key data releases in September, which showed inflation moving in the right direction, the Bank of England maintained base rate at 5.25% at its September meeting. Economists are reporting that this may signal that the Monetary Policy tightening is at an end and base rate has now peaked. However, the MPC reserved the right to restart rate hiking, if future data required it to do so, to hit its inflation target.

6. Consumer Price Inflation (CPI) in the UK fell to 6.3% in August 2023, below the previous month’s figure of 6.4%. The rate remained significantly higher than the Bank of England's target of 2.0%. The core rate, which excludes food and energy, rose by 6.2% in August 2023, down from 6.9% in July 2023, an indication that inflation is now moving in the right direction.

The Council’s Investment Portfolio as at 31 August 2023

7. 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 which is consistent with the Council’s risk appetite.

8. The Council holds investments with HM Treasury’s Debt Management Office (DMO) as well as highly rated Money Market Funds, highly rated bond funds and with our bankers, Barclays. In addition, from time to time, when the cashflow forecast indicates that our cash balances will support them, we place investments of up to 1 year with other local authorities.

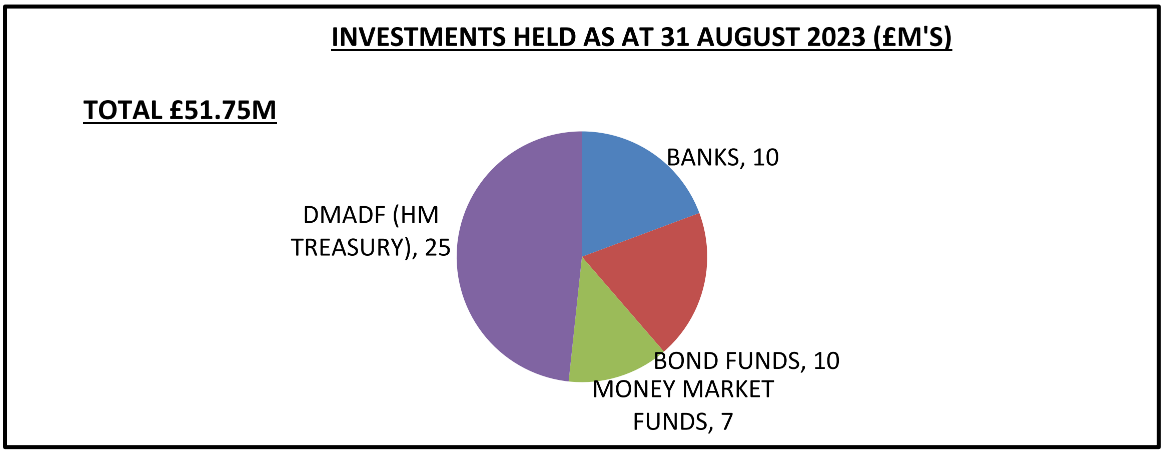
9. There has been significant press coverage around some local authorities, who have taken these types of deposits and used them to fund their own longer-term commercial investments, however, as with all investment classes, there are risks and for some authorities there have been examples of getting it spectacularly wrong. Worcestershire has not undertaken these types of investments. Commercial property asset prices have, in some cases, halved from their pre-Covid values. CIPFA has now updated its Prudential Guidance to attempt to minimise this risk going forward. Worcestershire is following this guidance and practice.

10. As security of funds is the first key element of our investment strategy, it should be noted that to date, none of these authorities have defaulted on their debt (our investment is their debt). In all cases the UK Government has stepped in to provide support and liquidity. There is no reason to believe that this situation will change, and therefore most Local Authorities will be rated on a par with the UK Government by rating agencies. To date all of Worcestershire CC’s investments have been repaid with full interest.

11. Against this backdrop, the Council held **£51.75 million of investments** as at 31 August 2023 (£77.48 million at 31 March 2023) and the investment portfolio yield for the first 5 months of the year is 4.63% against a benchmark (7-day LIBID) of 0.06%. Gross income from treasury investments for the first 5 months of the financial year was £1.5 million.

12. A summary of Investments held as at 31 August 2023 is included in chart 1 below.

Chart 1: Summary of Investments 1 April to 31 August 2023



13. The investment portfolio of £51.75m as at 31st August 2023 was diversified across Money Market Funds, the Government's Debt Management Account Deposit Facility, Strategic funds and in highly rated UK Banks. The Council uses AAA rated Money Market funds to maintain short term liquidity.

14. Cashflow will remain the key driver to placing those investments and the Council will always ensure the security and liquidity are considered before yield.

Council's Borrowing Strategy as at 31 August 2023

15. The Council's borrowing activity between 1 April and 31 August 2023, can be summarised as follows:

    a) £50m of new loans were taken.
    b) £41m of debt matured.
    c) The Council had **£539.7 million of debt** outstanding as at 31 August 2023 at an average rate of **3.518%.**

16. Whereas the Council has previously relied on the PWLB as its main source of funding, with an increasing rate environment it now needs to consider alternative cheaper sources of borrowing.

17. There is a very active inter Local Authority market, which provides the opportunity to borrow short term (between 1 and 36 months) from other Local Authorities, at rates which are lower than those available from the PWLB.

18. As an authority we should always be mindful that the underlying purpose of our borrowing requirement is to help fund the Capital Programme, which generally includes the creation or improvement of assets with asset lives of between 5 and 50 years. It is therefore best practice to seek out borrowing on a similar basis. However, when revenue budgets are tight it is also important to identify ways in which we can minimise debt interest costs. Provided it is carried out in moderation, borrowing a proportion of the debt pool on a short-term basis can provide interest cost savings, without exposing the authority to excessive liquidity and interest rate risk.

19. It is important to differentiate between: -

- the underlying need to borrow which is assessed through the Capital Strategy, Capital Programme and Treasury Management Strategy Statement, which consider and include, cost benefit analysis, asset value assessments, due diligence, and affordability considerations amongst other factors, and

- sources of finance, be those PWLB, Banks, other Local Authorities, which are assessed on credit rating, reliability, and interest rates.

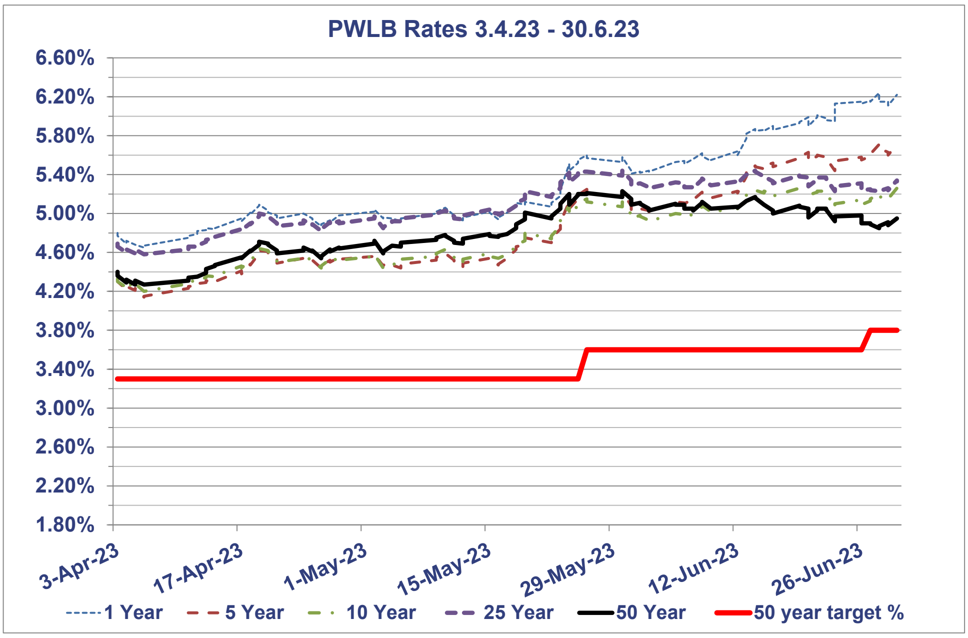
20. It is possible that the Municipal Bond Agency will be offering loans to the wider local authorities' market in the future. The Council may make use of this source of borrowing as and when appropriate.

21. The Council also minimises debt costs by delaying the externalisation of its debt. This is known as internal borrowing or under borrowing. In this scenario, the Council effectively manages down its cash and investment balances before seeking to take on further external debt. This strategy is highly effective at reducing interest costs (especially as borrowing rates tend to be higher than investment rates, which creates a cost of carry for the Council), however, at some point, if the planned capital expenditure takes place, or the reserves balances fall, the cash and investments alone cannot fund it. At that point further external debt is taken. Finance officers manage the Council cash flow with great care and attention, to minimise the liquidity and interest rate risks involved in applying this strategy, whilst maximising revenue savings.

Risk

22. Borrowing rate data provided by our treasury advisers for this financial year to date can be seen in chart 2, below and reflect the steady rise in rates so far. Rates are forecast to continue to increase in the short term, but are thought to be nearing their peak, but may remain inflated for the next year or so, which is good for investing, but not for borrowing. For this reason, the risk mitigation is to continue to borrow on a short-term basis until rates fall back.

Chart 2: borrowing rates 1 April to 30 June 2023



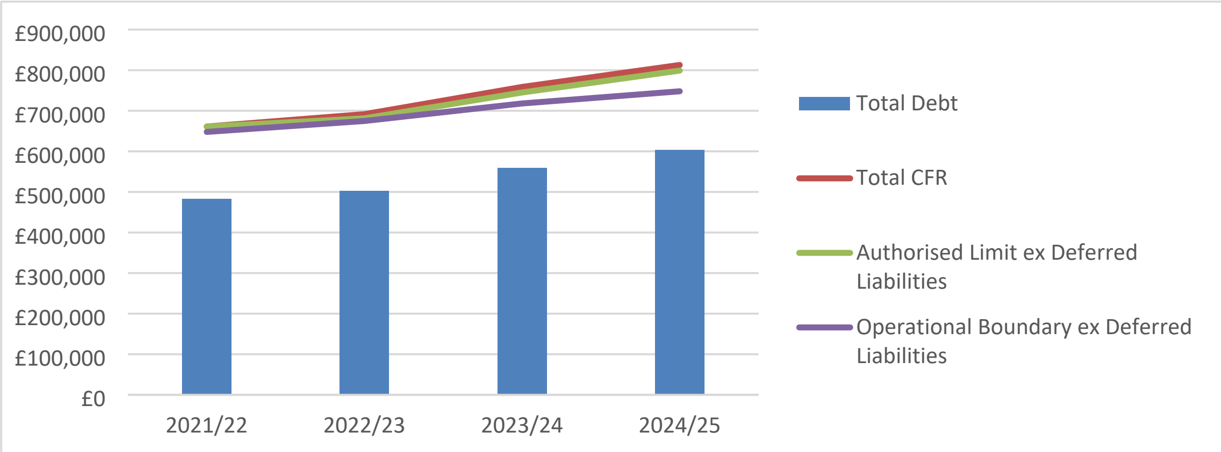
Compliance with Treasury and Prudential Limits for 2023/24

23. The Council is well within the Limits for outstanding debt and is projected to remain so for 2023/24.

24. Chart 3 below shows the relationship between the Council's Capital Financing Requirement (CFR - which is the past and future capital expenditure which will be funded through borrowing), the Approved Limit, Operational Boundary and External Borrowing.

25. It illustrates that the projected path of existing external debt remains within both the limits and the CFR.

Chart 3: Relationship between External Debt, CFR and Approved Limits



26. Table 2 below shows the extent to which the CFR has been externalised to date: -

Table 2: Breakdown of Debt

Financial Year	2022-23 Actuals (£m)	2023-24 Estimates OE (£M)	2023-24 Estimates RE (£M)	2024-25 Estimates (£M)
CFR	723	763	745	799
External Debt	532	569	584	624
% of CFR	**73.6%**	**74.6%**	**78.4%**	**79.5%**
Internal Debt	191	194	161	175
% of CFR	**26.4%**	**25.4%**	**21.6%**	**20.5%**

27. Table 2 also shows the extent to which external debt has been avoided and the Council is well within its limits for outstanding debt and is projected to remain so for 2023/24. However, if the cash balances fall or the CFR increases, then external borrowing, or reduced/delayed expenditure will be required.

28. The prudential indicators provide upper and lower limits for borrowing maturity structures. The Forecast Maturity Profile for the Council's debt compared with those limits as at the 31 March 2024 is shown in Table 3 below.

Table 3: The Maturity Profile for the Council's debt as forecast at 31 March 2024

MATURITY STRUCTURE OF DEBT			
Maturing within	£m	% of Total Debt	% Lower/Upper Limit for Debt
1 year	104.0	17.81	0-25
1 – 2 years	61.2	10.48	0-25
2 – 5 years	24.5	4.19	0-50
5 – 10 years	25.0	4.28	0-75
10 years and over	369.3	63.24	25-100
Total Forecast External Debt	**584.0**	**100.0**	

29. The Council remains comfortably within its limits for the Maturity Structure of Borrowing and is anticipated to remain so for the foreseeable future.

30. The Chief Financial Officer and the Cabinet Member with Responsibility for Finance confirm that the management of debt and short-term investments continues to be cost effective.

Legal Implications

31. Legal advice will be provided to support any changes in service delivery in accordance with the requirements of the Council's policies and procedures.

Financial Implications

32. Members are required under Section 25 of the Local Government Act 2003 to have regard to the Chief Financial Officer's report when making decisions about the budget calculations for each financial year. This is undertaken through the approval of the annual budget in February each year.

33. Section 25 of the Act also covers budget monitoring, and this process monitors the robustness of budgets, adequacy of reserves and the management of financial risk throughout the year. This Cabinet report highlights forecast variances arising from current financial performance and the possible impact of existing pressures on future expenditure so that appropriate action may be taken.

34. In discharging governance and monitoring roles, Members are asked to consider the issues arising and the potential impact on the budget as well as the financial risks arising.

35. The Council's procedures for budget monitoring is reinforced through close financial support to managers and services on an ongoing basis to ensure processes and controls are in place to enable tight financial control.

HR Implications

36. There are no HR considerations as Council's treasury management budgets are operational financial budgets and do not include any staffing costs. Further, there are no

proposals to alter any staffing arrangements employed in the management of these services.

Equality Duty Considerations

37. The Council will continue to have due regard to proactively addressing the three elements of the Public Sector Equality Duty in all relevant areas – in particular the planning and delivery of our services. The Council will continue to assess the equality impact of all relevant transformational change programmes and will ensure that Full Council has sufficient equalities assessment information to enable it to have due regard to the three elements of the Equality Duty when considering any changes to the budget. The Council will continue to ensure best practice is followed regarding these requirements.

Risk Implications

38. The Cabinet report includes recommendations regarding endorsing the Council's activity to date for 2023/24 which specifically relates to managing interest rate risk and any risk of default in repayment of investments.

Privacy and Public Health Impact Assessment

39. This report is about confirming the treasury management activity at this stage of the year reflecting the cash implications of existing Cabinet decisions and policies.

40. Taking this into account, it has been concluded that there are no specific health impacts because of new decisions arising from this Cabinet report.

41. A similar assessment has been undertaken regarding privacy/data protection and has confirmed that there is no impact anticipated because of this report.

Contact Points

Specific Contact Points for this Report

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Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) the following are the background papers relating to the subject matter of this report:

Previous Cabinet Resources Reports