worcestershire county council

AUDIT AND GOVERNANCE COMMITTEE
1 DECEMBER 2023

TREASURY MANAGEMENT UPDATE QUARTER 2 2023-24

Recommendation

1. **The Chief Financial Officer recommends that the Treasury Management Update to the end of September 2023 Report 2023-24 be noted.**

Background

2. In accordance with our Treasury Management Strategy and in compliance with CIPFA's Code of Practice on Treasury Management. This report highlights the treasury management activities of the Council. It outlines the economic background against which decisions have been made. It also provides an update on the performance of the treasury management function and covers the following, for the first quarter of the 2023-24 financial year:

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

3. The Treasury Management Strategy for 2023-24 was approved by Full Council on 16 February 2023 with further update reports scheduled for during the remainder of this financial year.

Economic Update

4. 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.

5. The Bank of England's Monetary Policy Committee (MPC) kept rates on hold at 5.25% for the first time in 15 meetings. It was certainly a close decision, with Governor Bailey's vote being the determining factor in a 5-4 split vote.

6. In the immediate aftermath of the decision, markets have concluded that rates have more than likely peaked at 5.25% although there remains an outside chance of one more increase to come before the tightening cycle is concluded. Interestingly, the markets are also pricing in a rate cut before the end of 2024.

7. Consumer Price Inflation (CPI) in the UK increased to 6.7% in September 2023. The rate remained significantly higher than the Bank of England's target of 2.0%.

Council's Investment Portfolio as at 30 September 2023

8. The Treasury Management Strategy Statement (TMSS) for 2023/24, which includes the Annual Investment Strategy, was approved by the Council in February 2023. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being Security of capital, Liquidity, Yield. The Council will aim to achieve the optimum return (yield) on its investments aligned with proper levels of security and liquidity, aligned with the Council's risk appetite. In the current economic climate, over and above keeping investments short-term to cover cash flow needs, there is a benefit to seek out value available in periods up to 12 months with high credit rated financial institutions.

9. The current investment counterparty criteria selection approved in the TMSS is being met. Officers continue to closely monitor the credit ratings, and other measures of creditworthiness of the counterparties to ensure that only appropriate counterparties are considered for investment purposes.

Investment balances

10. The average level of funds available for investment purposes during the quarter was **£82m**. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme.

11. The Council holds investments with the Debt Management Office (DMO), which is part of HM Treasury, as well as highly rated Money Market Funds, highly rated bond funds and with our bank, Barclays. In addition, from time to time, when the Cashflow Forecast indicates that our cash balances will support it The Council places investments of up to 1 year with other local authorities.

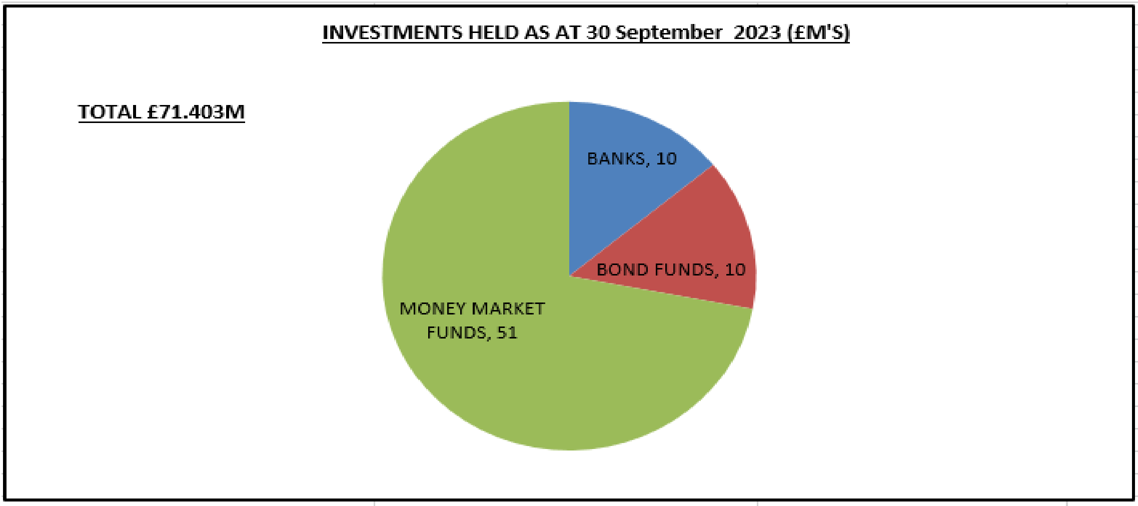
12. There has been significant press coverage around some local authorities, who have taken these types of deposits and used them to fund their own longer-term commercial investments, some of which have been less than successful. CIPFA has now updated its Prudential Guidance to attempt to minimise this risk going forward. The Council continues to follow this guidance and practice.

13. 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.

14. Against this backdrop, the Council held **£71.4m** of investments as at 30 September 2023 **(£77.5m** at 31 March 2023) and the average investment portfolio yield for the first 6 months of the year is 4.77% against a benchmark (7-day LIBID) of 0.06%. Gross income from treasury investments for the first 3 months of the financial year was £1.86m. Investments were diversified across Money Market Funds, Strategic funds and

in highly rated UK Banks. The Council uses AAA rated Money Market funds to maintain short term liquidity. A summary of investments held as at 30 September 2023 is included in **Chart 1.**

Chart 1 – Investments Held at 30 September 2023



15. The Council benchmarks its investment performance against a cohort of local authorities and against other County Councils, who use Link as their treasury advisers.

16. 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

17. The Council's borrowing activity for the first 6 months of the financial year can be summarised as follows:

a. **£55m** of new loans were taken between 1 April and 30 September 2023.
b. **£46m** of debt matured between 1 April and 30 September 2023.
c. There was **£540m** of debt outstanding on 30 September 2023 **(£547m** at 30 June 2023) at an average rate of 3.57% (3.52% at 30 June 2023)
d. Based on the latest Capital Programme update, the forecast for 31 March 2024 is **£576m**.

18. Whereas the Council has previously relied on the PWLB as its main source of funding, with a potential change in rates forecast it will now need to consider alternative cheaper sources of borrowing.

19. There is a very active Local Authority to Local Authority market, which provides the opportunity to borrow short term (1 month to 3 years) from other Local Authorities, at rates which are lower than those available from the PWLB.

20. The Council should always be mindful that the underlying purpose of our borrowing requirement is to support 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 and interest rates are high, it is also important to identify ways in which the council

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.

21. 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.

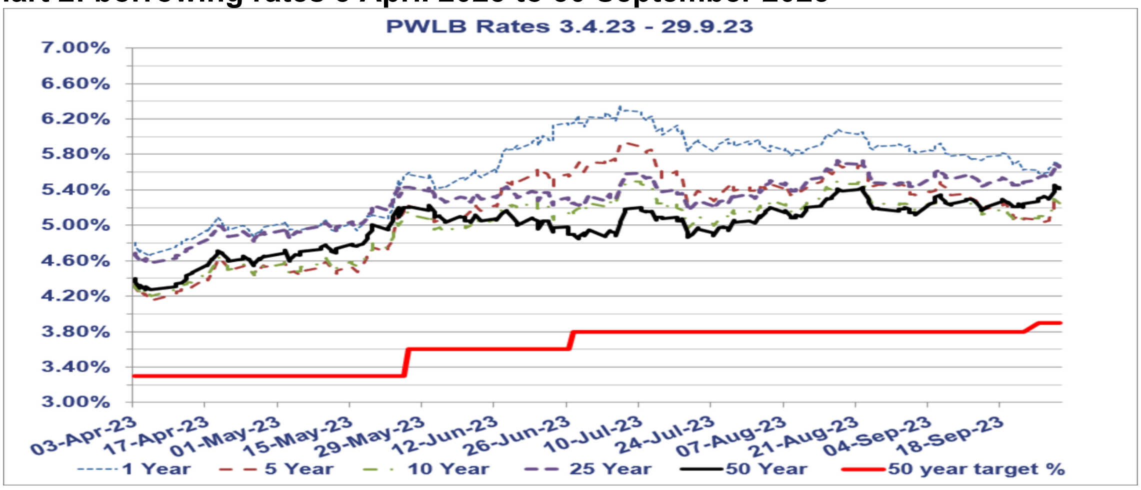
22. It is possible that the Municipal Bond Agency will be offering loans to the wider local authorities' market in the future. This Authority may make use of this new source of borrowing as and when appropriate.

23. The Authority also minimises debt costs by delaying the externalisation of its debt. This is known as internal borrowing or under borrowing. The Authority 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 Authority), 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. As an Authority the Council manages our 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

24. Borrowing rate estimates provided by our Treasury Advisers for this financial year to date can be seen in **Chart 2**, and reflects the steady rise in rates so far. Rates are forecast to remain high in the short term but are thought to have reached 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 3 April 2023 to 30 September 2023



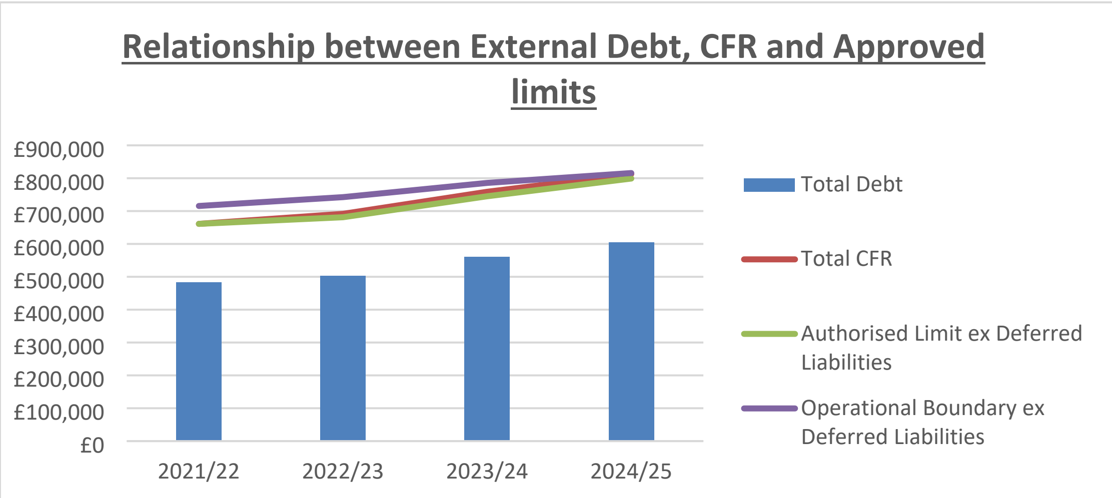
Compliance with Treasury and Prudential Limits for 2023/24

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

26. **Chart 3** shows the relationship between the Authority'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.

27. 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



28. Table 1 shows the extent to which the CFR has been externalised to date.

Table 1: 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	737	785
External Debt	532	569	576	609
% of CFR	73.6%	74.6%	78.1%	77.7%
Internal Debt	191	194	161	175
% of CFR	26.41%	25.43%	21.9%	22.3%

29. This shows the extent to which external debt has been avoided, however, it does rely on utilising cash backed reserves and investment balances being used. Therefore, should cash backed reserves fall, or cash balances fall, then external borrowing, or reduced expenditure will be required.

30. As mentioned in Paragraph 29 above, borrowing is usually taken to support the Capital Programme and its creation/purchase/improvement of long-term assets. As such

you would expect to see a Debt Maturity Profile skewed towards the long end. As you can see below, the Authority has exactly that type of profile.

31. The prudential indicators provide upper and lower limits for borrowing maturity structures. The Forecast Maturity Profile for the Council's debt compared with the those for Borrowing as at the 30 September 2023 is shown in **Table 2.**

Table 2: The Maturity Profile for the Council's debt as forecast at 31 March 2024

Maturing within	£m	% of Total Debt	% Lower/Upper Limit for Debt
1 year	104.0	18.04	0-25
1 – 2 years	53.7	9.31	0-25
2 – 5 years	24.5	4.24	0-50
5 – 10 years	25.0	4.34	0-75
10 years and over	369.3	66.04	25-100
Total Forecast External Debt	**576.4**	**100.0**	

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

33. The Chief Financial Officer can confirm that the management of debt and short-term investments continues to be cost effective.

Contact Points

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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:

- Treasury Management Strategy 2023-24