TORBAY COUNCIL

Meeting: Audit Committee **Date:** 13th December 2024

Wards affected: All wards in Torbay

Report Title: Treasury Management Mid – Year Review 2023/24

When does the decision need to be implemented? Immediate

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1. Purpose of Report

1.1 This report provides Members with a review of Treasury Management activities during the first part of 2023/24. The Treasury function aims to support the provision of all Council services through management of the Council's cash flow and debt & investment operations.

1.2 The report has been prepared based on performance and data at 30th September 2023 but updated for significant post-period events.

1.3 The key points in the Treasury Management review are as follows:

- Interest rates have risen steadily with Bank Rate reaching 5.25% in August 2023
- Gilt yields and therefore PWLB rates are around 1% higher than those at the start of the year.
- No new borrowing has been undertaken and internal resources used to fund capital expenditure.
- A proportion of cash balances have been locked into longer duration deposits at peak rates.
- Early repayment of an element of the debt portfolio was made after the period covered by this report.
- All decisions have complied fully with adopted principles and the Council's approved Treasury Management Strategy.

2. Reason for Proposal and its benefits

2.1 The preparation of a mid-year review on the performance of the treasury management function forms part of the minimum formal reporting arrangements required by the CIPFA Code of Practice for Treasury Management.

3. Recommendation(s) / Proposed Decision

3.1 that the Audit Committee provide any comments and/or recommendations on the Treasury Management mid-year review for 2023/24

Appendices

Appendix 1: Economic commentary
Appendix 2: Non-Treasury Management Investments

Background Documents

Treasury Management Strategy 2023/24

Supporting Information

1. Introduction

1.1 In February 2019 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Council to approve treasury management semi-annual and annual reports.

1.2 The Treasury Management strategy for 2023/24 was approved at a meeting on 7th March 2023. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Council's treasury management strategy.

1.3 Treasury Management decisions and strategies have been made in consultation with the Council's advisors, Arlingclose Ltd.

2. Economic Commentary

2.1 The significant economic events impacting the Treasury Management strategy during the year were:

- Persistently high inflation levels at the start of the period pushed up forecasts of Bank Rate rises. However inflation data at the end of the period was below expectations with markets reassessing the peak in rates.
- The Monetary Policy Committee continued to raise Bank Rate reaching 5.25% in August. Against expectations the rate was maintained at that level in September.
- Gilt yields rose steadily at the start of the year, peaking in August and then falling back.

2.2 A full economic commentary covering the first quarter 2023/24 by Arlingclose Ltd is provided at Appendix 1 to this report.

2.3 Arlingclose's key observations for the remainder of 2023/24 are set out below:

- Bank Rate has likely peaked at 5.25% and could stay at that level for a further 9 months before falling back.
- Inflation will fall over the next 12 months with interruptions from higher energy prices.
- Gilt yields are expected to fall from their current levels reflecting the medium-term path of Bank Rate. However, gilt yields will remain relatively higher than in the recent past.
- Geo-political events will give rise to heightened risk of substantial volatility in yields.

3. Local Context

3.1 On 31st March 2023, the Council had net borrowing of £294m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31st March 2023 Actual £m	31st March 2024 Forecast (at 30.9.23) £m	31st March 2024 Forecast (Current)* £m
Total Capital Financing Requirement (CFR)	**428**	**453**	**453**
Less: Other debt liabilities	(15)	(14)	(14)
Borrowing CFR	**413**	**439**	**439**
Financed by:			
External borrowing	**385**	**378**	**359**
Internal borrowing	28	61	80
Total	413	439	439
Internal Resources for investment:			
Useable Reserves	(96)	(86)	(86)
Working Capital/Other	(23)	(50)	(50)
Less: Cash resource applied to Internal Borrowing	28	61	80
Total Treasury Management Investments	**(91)**	**(75)**	**(56)**
Net Treasury Management Position			
External Borrowing	385	378	359
Investments	(91)	(75)	(56)
Net Total	**294**	**303**	**303**

* updated for post-period transaction – see paragraph 4.9

3.2 The treasury management position (nominal values) on 30th September 2023 and the change over the six months is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.23 Balance £m	Movement £m	30.9.23 Balance £m	30.9.23 Rate %
Long-term borrowing	385	(2)	383	2.98
Short-term borrowing	0	0	0	0
Total borrowing	**385**	**(2)**	**383**	**2.98**
Long-term investments	(15)	0	(15)	4.27
Short-term investments	(75)	7	(68)	4.90
Cash and cash equivalents	(1)	(8)	(9)	1.70
Total investments	**(91)**	**(1)**	**(92)**	**4.67**

4. Borrowing

4.1 There was a substantial rise in the cost of both short- and long-term borrowing over the last 18 months. Gilt yields, and consequently PWLB borrowing rates, rose and broadly remained at elevated levels. On 30th September, the PWLB certainty rates for maturity loans were 5.26% for 10-year loans, 5.64% for 20-year loans and 5.43% for 50-year loans. Their equivalents on 31st March 2023 were 4.33%, 4.70% and 4.41% respectively. More recently, rates have fallen back slightly, and current forecasts are for a further slow decline in borrowing levels.

4.2 As outlined in the Treasury Management Strategy, the Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should long-term plans change being a secondary objective. The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

4.3 The Council's strategy for 2023/24 to use internal resources to fund capital spend has been reinforced by a rationalisation of the Capital Plan, reducing the forecast of Capital Financing Requirement in the short to medium term. New borrowing decisions are likely to be delayed and exposed to lower forecast rates in the future.

4.4 No new borrowing was undertaken while a £2m existing loan has been allowed to mature without replacement. A further loan of £7m maturing 31st March 2024 will also likely not be replaced.

4.5 The Council will continue to monitor with the support of its Treasury advisor's any alternative borrowing options.

4.6 Outstanding loans on 30th September 2023 are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.23 Balance £m	Net Movement £m	30.9.23 Balance £m	30.9.23 Weighted Average Rate %	30.9.23 Weighted Average Maturity (years)
Public Works Loan Board	375	(2)	373	2.935	26
Banks (LOBO)	5	0	5	4.395	55
Banks (fixed term)	5	0	5	4.700	51
Total borrowing	**385**	**(2)**	**383**	**2.977**	**27**

4.7 LOBO loans: The Council continues to hold £5m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. The lender option does not commence until 2028.

4.8 After £0.7m repayment of prior years' Private Finance Initiative debt, the balance outstanding stood at £15.0m on 30th September 2023, taking total debt to £398m.

4.9 Update. Recently (November 2023), the Director of Finance negotiated the early repayment of £18.7M of PWLB loans for the purpose of realigning the borrowing portfolio with revised capital plans over the medium term. The average rate of loans removed from the loans book was 4.585% and included the highest coupon loans held at the time (5.875% - 8.750%). A net revenue saving of £0.9M is forecast, accounted for over the term of the remaining life of the repaid loans.

4.10 The effect of the repayment on the borrowing figures in paragraph 4.9 is illustrated in the revised Table 3 below:

Table 3: Borrowing Position (re-stated)

	30.9.23 Balance £m	Net Movement £m	Current Balance £m	Current Weighted Average Rate %	Current Weighted Average Maturity (years)
Total borrowing	**383**	**(19)**	**364**	**2.894**	**26**

5. Treasury Investment Activity

5.1 The CIPFA TM Code defines treasury management investments as those which arise from the Council's cash flows or treasury risk management activity that ultimately represents balances which need to be invested until the cash is required for use in the course of business.

5.2 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year investment balances ranged between £83m and £102m due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.23 Balance £m	**Net Movement £m**	**30.9.23 Balance £m**	**30.9.23 Income Return %**	**30.9.23 Weighted Average Maturity days**
Banks & Building Societies	5.8	3.1	8.9	1.70	1
Government	20.0	9.5	29.5	5.22	78
Local Authorities	48.0	(10.0)	38.0	4.59	279
Money Market Funds	8.5	1.8	10.3	5.29	1
Other Pooled Funds:					
- Short-dated bond funds	4.0	(4.0)	0.0	-	-
- Property fund*	4.6	(0.1)	4.5	3.87	-
Total Investments	**90.9**	**0.3**	**91.2**	**4.56**	**149**

5.3 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.

5.4 Bank Rate increased by 1%, from 4.25% at the beginning of April to 5.25% by the end of September. Short-dated cash rates rose commensurately, with 3-month rates rising to around 5.25% and 12-month rates to nearly 6%. The rates on Government Debt Management Account Deposit Facility, (DMADF) deposits also rose, ranging between 5.17% and 5.29% by the end of September and Money Market Rates between 5.19% and 5.32%

5.5 Towards the latter part of the period a number of deposits of one-year duration were made with local authorities at rates of 5.85% and 5.95% in anticipation of falling market rates, reacting to improved inflation figures. Otherwise investments were kept short with the government DMADF facility and in Money Market Funds.

5.6 The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking exercise (Q2 to end September 2023) in Table 5 below.

Table 5: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
30.06.2023	4.56	A+	25%	132	4.09%
30.09.2023	4.45	AA-	22%	149	4.56%
Similar LAs	**4.47**	**AA-**	**59%**	**42**	**4.79%**
All LAs	**4.57**	**A+**	**65%**	**13**	**4.71%**

5.7 The benchmarking results reflect the Council's appetite for longer dated deposits with safest counterparties (DMADF, LA's) and the return has been weighed down by deposits taken in the previous financial year which will unwind when these mature after October 2023.

5.8 **Externally Managed Pooled Funds**: £5m of the Council's investments is held in an externally managed strategic pooled property fund where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. Over a year (30/09/22 to 30/09/23) this fund has generated an average total loss of 0.8m (-14.3%), comprising a £0.2m (3.9%) income return which is used to support services in year, and a £1.0m (-18.2%) reduction in the capital valuation of the Fund. (This reduction reverses a similar capital growth in the previous year.)

5.9 In view of the forecast for falling interest rates the Director of Finance is reviewing opportunities for further diversification into strategic investments. A process is being put in place and the outcome of the review will be reported within the next appropriate Treasury Management report.

6. Non-Treasury Investments

6.1 The definition of investments in the Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and/or for commercial purposes (made primarily for financial return).

6.2 A full list of the Council's non-treasury investments is presented at Appendix 2.

7. Impact of Treasury Performance on the Revenue Budget

7.1 The net revenue budget for treasury management is projected to be underspent (as reported to Overview and Scrutiny Board in November 2023) as a result of reduced external borrowing expectations and the rise in investment returns, as shown in table 6 below.

As at 30th September 2023	Budget 2023/24	Projected Outturn 2023/24	Variation
	£m	£m	£m
Investment Income	(1.3)	(2.9)	(1.6)
Interest Paid on Borrowing	12.2	11.8	(0.4)
Net Position (Interest)	**10.9**	**8.9**	**(2.0)**
Minimum Revenue Provision	7.6	7.6	(0.0)
Net Position (Other)	**7.6**	**7.6**	**(0.0)**
Net Position Overall	**18.5**	**16.5**	**(2.0)**

8. Compliance

8.1 The Chief Finance Officer reports that all treasury management activities undertaken during the period complied fully with the principles in the TM Code and the Council's approved Treasury Management Strategy. Compliance with specific limits is demonstrated in tables 7 and 8 below.

Table 7: Debt Limits

	2023/24 Maximum	**30.9.23 Actual**	**2023/24 Operational Boundary**	**2023/24 Authorised Limit**	**Complied?** Yes/No
Borrowing	£385m	£383m	£500m	£600m	Yes
PFI & Finance Leases	£15m	£15m	£20m	£20m	Yes
Total Debt	**£400m**	**£398m**	**£520m**	**£620m**	**Yes**

Table 8: Investment Limits

	Maximum in period	30.9.23 Actual	2023/24 Limit	Complied? Yes/No
Any single organisation, except the UK Government	£9m	£9m	£15m	Yes
UK Central Government	£30m	£30m	Unlimited	Yes
Money Market Funds	£20m	£10m	£60m	Yes

Treasury Management Indicators: The Council measures and manages its exposures to treasury management risks using the following indicators.

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating/credit score of its investment portfolio. The credit score is calculated by applying a value to each investment (AAA=1, AA+=2, …. A=6 etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	31.9.23 Actual	2023/24 Target	Complied?
Portfolio average credit rating (score)	AA- (4)	A (6)	Yes

Liquidity: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling one-month period, without additional borrowing.

	30.9.23 Actual	2023/24 Target	Complied?
Total cash available within one month	£19m	£10m	Yes

Interest rate exposures: This indicator is set to control the Council's exposure to interest rate risk.

The Council's debt portfolio is virtually all at fixed rate and therefore has no exposure to fluctuations in interest rates. As such no specific limits are proposed on interest rate exposure but any new borrowing will be restricted to a maximum 30% of the total portfolio exposed to variable interest rate. No new borrowing has been undertaken during the first part of the year.

Maturity structure of borrowing: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	30.9.23 Actual	Upper limit	Lower limit	Complied?
Under 12 months	3%	40%	0%	Yes
12 months and within 24 months	1%	40%	0%	Yes
24 months and within 5 years	4%	30%	0%	Yes
5 years and within 10 years	10%	40%	0%	Yes
10 years and within 20 years	17%	50%	0%	Yes
20 years and within 30 years	7%	60%	0%	Yes
30 years and within 40 years	39%	50%	0%	Yes
40 years and above	19%	50%	0%	Yes

Principal Sums Invested for Periods Longer than a year: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. An increase to the limit set within the Strategy 2023/24 was approved by Council in September 2023 and reflected in the table below:

	2023/24	2024/25	2025/26
Actual principal invested beyond year end	£15m	£5m	£5m
Limit on principal invested beyond year end	£30m	£30m	£30m
Complied?	Yes	Yes	Yes