Serving You

AUDIT COMMITTEE

3 NOVEMBER 2022

TREASURY MANAGEMENT STRATEGY MID-YEAR REVIEW REPORT 2021/22

Report from: Phil Watts, Chief Finance Officer

Author: Jonathan Lloyd, Finance Business Partner – Technical Accounting

Summary

This report gives an overview of treasury management activity since 1 April 2022 and presents a review of the Treasury Strategy approved by Council on 24 February 2022.

The key indicators are set out in the table below:

Indicator	2022/23 £000	2023/24 £000	2024/25 £000	2025/26 £000
Capital Expenditure	175,148	120,548	165,556	11,543
Capital Financing Requirement (CFR) at year end	549,319	612,878	552,244	551,302
External Borrowing	475,770	558,107	515,669	503,461
Underborrowing	73,549	54,771	36,575	17,841

The movement in the capital financing requirement is shown below:

Capital Financing Requirement	2022/23 £000	2023/24 £000	2024/25 £000	2025/26 £000
Opening Balance	412,452	549,319	612,878	552,244
In Year Borrowing Requirement	139,280	74,104	33,682	10,851
Less MRP & VRP*	-1,209	-9,389	-9,098	-9,367
Less Repaid from Receipts, Grants & Contributions	0	0	-84,108	-31,361
Less KCC Debt Repayment	-1,204	-1,156	-1,110	-1,065
Closing CFR	549,319	612,878	552,244	521,302

* Minimum Revenue Provision (MRP) relating to general fund and Voluntary Revenue Provision (VRP) relating to Housing Revenue Account are net of the repayment holiday identified by Link.

1. Budget and Policy Framework

1.1 Audit Committee is responsible for the scrutiny of the Council's Treasury Management, Investment Strategy and Minimum Revenue Provision Policy Statement along with Treasury Management Practices and associated Schedules.

1.2 There needs to be, as a minimum, a mid-year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved.

1.3 This report is also scheduled for consideration by Cabinet on 13 December 2022 and full Council on 19 January 2023.

2. Background

2.1 In December 2017 the Chartered Institute of Public Finance and Accountancy (CIPFA) issued revised Prudential and Treasury Management Codes. These require all local authorities to prepare a Capital Strategy which is to provide the following:

- A high level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of service
- An overview of how the associated risk is managed
- The implications for future financial sustainability

2.2 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensures this cash flow is adequately planned, with surplus monies being invested in low-risk counterparties, providing adequate liquidity initially, before optimising investment return.

2.3 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing requirements of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending liabilities. This management of longer-term cash may involve arranging long or short-term loans, or using long-term cash flow surpluses, and on occasion, debt previously incurred may be restructured to meet Council risk or cost objectives.

2.4 As a consequence treasury management is defined as:

"The management of the local authority's 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."

2.5 The principal requirements of the Code are as follows:

(i) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities;

(ii) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives;

(iii) Receipt by full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities undertaken during the previous year;

(iv) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific committee.

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

- A review of the Treasury Management Strategy Statement and Annual Investment Strategy (Section 3);
- A review of the Council's borrowing strategy for 2022/23 (Section 4);
- A review of the Council's investment portfolio for 2022/23 (Section 5);
- A review of any debt rescheduling undertaken during 2022/23 (Section 6);
- A review of compliance with Treasury and Prudential Limits for 2022/23. (Section 7);
- An economic update for the first part of 2022/23 (Appendix).

3. Treasury Management Strategy Statement and Annual Investment Strategy Update

3.1 Full Council approved the 2022/23 Treasury Management Annual Investment Strategy on the 24 February 2022.

3.2 The Strategy stated that in the long-term officers would aim to smooth out the maturity profile and reduce reliance on short term debt but that while short-term borrowing rates remained below Public Works Loan Board (PWLB) rates a higher level of short- and medium-term loans would be held. At 31 March 2022 short-term borrowing stood at £70m, but after repayments and refinancing through 2-year and 3-year loans from other local authorities the amount due for repayment within 12 months has reduced to £45m at 17 October. This figure includes £35m due for repayment before 31 March 2023. Further reductions may require the use of longer-term funding from PWLB but recent steep increases in interest rates mean this will be expensive. The current position is shown in the graph at 4.7.

4. Borrowing & Borrowing Limits

4.1 The purpose of the Capital Financing Requirement (CFR) is to demonstrate that Council borrowing is undertaken to fund capital expenditure only. The CFR represents the long term assets of the Council that have not been funded from sources other than borrowing, such as grants and external contributions, capital receipts or revenue funding. External borrowing should not exceed the CFR over the medium term. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

4.2 An updated estimate of the CFR and borrowing position compared with the estimate included in the Treasury Strategy is shown in the table below:

CFR & Borrowing	Per Strategy £000	Revised Estimate £000
CFR 31 March 2023	442,601	549,319
External Debt	371,538	475,770
Under-borrowing	71,063	73,549
Estimated In Year Borrowing Required	80,401	139,280

The increased estimates arise from the evolution of the capital programme including changes to profiling and funding since the Strategy was formulated in late 2021.

4.3 The S151 Officer reports that no difficulties are envisaged for the current or future years in ensuring that borrowing does not exceed CFR.

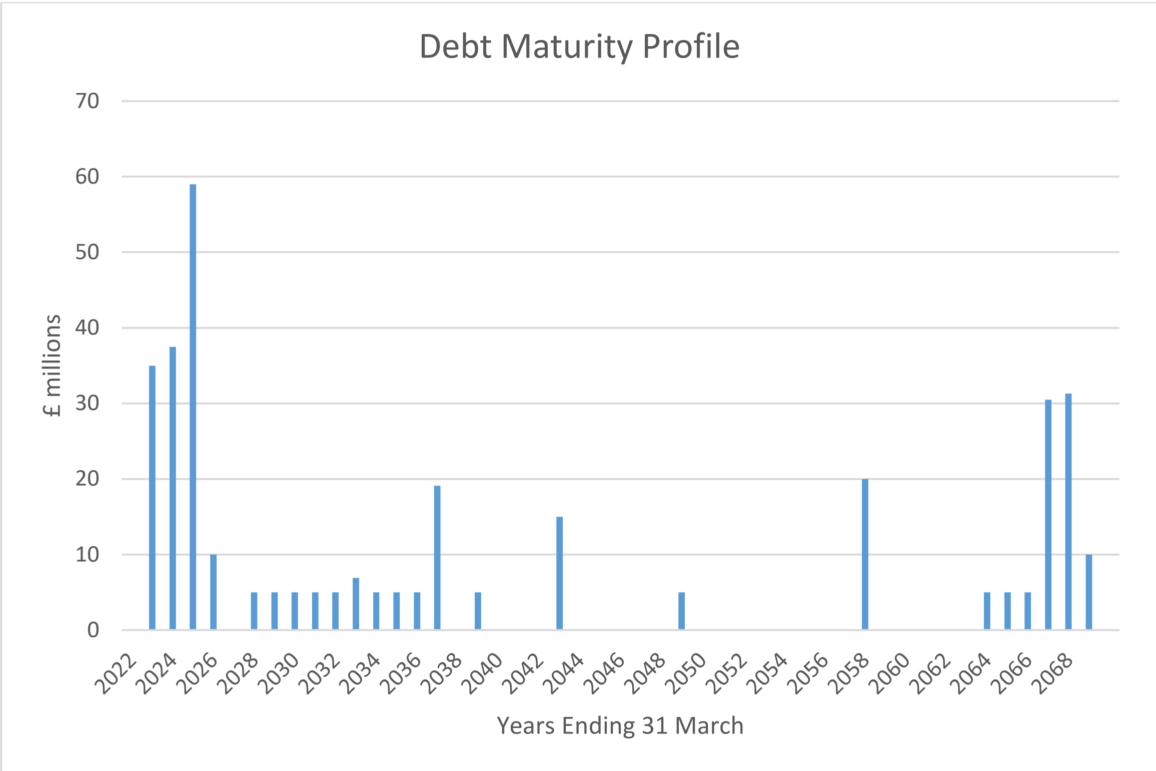
4.4 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit, which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in a longer-term scenario. It is a forecast of maximum borrowing requirement with some capacity for unexpected movements. This is the statutory limit determined under section 3(1) of the Local Government Act 2003. The Council's authorised borrowing limit for 2022/23 is £590.062 million and it will not exceed this limit.

4.5 One of the risks inherent within Treasury management is "Interest rate risk". This risk is high where a large proportion of an organisation's borrowing portfolio reach termination point at the same time. The organisation has then to re-finance a large proportion of their portfolio at a set point in time with the risk that interest rates may not be favourable. Recent strategy has been to reduce interest rate risk and smooth the borrowing repayment profile by taking out new borrowing for longer repayment terms. Progress towards this aim has been limited by the factors noted in 3.2 above.

4.6 Link's latest forecast of interest rates issued on 27th September 2022 is as follows:

Link Group Interest Rate View	27.09.22											
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
BANK RATE	4.00	5.00	5.00	5.00	4.50	4.00	3.75	3.25	3.00	2.75	2.75	2.50
3 month ave earnings	4.50	5.00	5.00	5.00	4.50	4.00	3.80	3.30	3.00	2.80	2.80	2.50
6 month ave earnings	4.70	5.20	5.10	5.00	4.60	4.10	3.90	3.40	3.10	3.00	2.90	2.60
12 month ave earnings	5.30	5.30	5.20	5.00	4.70	4.20	4.00	3.50	3.20	3.10	3.00	2.70
5 yr PWLB	5.00	4.90	4.70	4.50	4.20	3.90	3.70	3.50	3.40	3.30	3.20	3.20
10 yr PWLB	4.90	4.70	4.60	4.30	4.10	3.80	3.60	3.50	3.40	3.30	3.20	3.20
25 yr PWLB	5.10	4.90	4.80	4.50	4.30	4.10	3.90	3.70	3.60	3.60	3.50	3.40
50 yr PWLB	4.80	4.60	4.50	4.20	4.00	3.80	3.60	3.40	3.30	3.30	3.20	3.10

4.7 The graph in below shows the debt portfolio repayment profile as at 17 October 2022. All debts are being shown as repayable at term, although the LOBO's (Lender Option Borrower Option) have a variety of "call" periods of between 6 months and every 5 years. The risk of a call occurring is higher than before due to the rise in interest but at the time of writing no approaches have been made by the lenders.



5. Investment Portfolio 2022/23

5.1 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.

5.2 The investment portfolio yield on cash investments at 14 October 2022 ranges from 0.0% to about 2%.

5.3 A full list of in house investments held as at 14 October 2022 is shown below:

Investments: Core Investments (Local Authorities)	**Principal 14 October 2022 £**	**Interest %**
CCLA Property Fund (September 2022 market value)	14,520,180	n/a
Patriza Hannover Property UT (September 2022 market value)	5,955,282	n/a
Lothbury Property Trust (September 2022market value)	5,281,594	n/a
Total Core Investments	**25,757,056**	n/a
Investments: Liquid investments	**Principal 14 October 2022 £**	**Interest] %**
Svenska Handelsbanken	1,152	0.00%
Lloyds	10,910	0.15%
Barclays	4,289	0.00%
Santander	50,000	1.03%
CCLA Public Sector Deposit Fund	3,524,909	Approx. 2.00%
Total Liquid Investment	**3,591,260**	n/a

Investments	**Principal 14 October 2022 £**	**Interest %**
Total In house Investments	29,348,316	n/a

5.4 Members may like to note the overall performance of the investment in property funds since purchase as shown below.

Detail	**£**	**£**
Invested 2015/16	3,000,000	
Invested 2017/18	19,999,365	
Total Cost of Investment		22,999,365
Current Valuation (as above)		25,757,056
Capital Gain to Date		2,757,691
Dividends Received 2015/16 to 2020/22	4,233,381	
Dividends June 2022	206,322	
Total Dividends to Date		4,439,703
Total Return to Date		7,197,394

5.5 The Council's finance and interest net expenditure for 2021/22 is expected to overspend due to the recent rapid rise in interest rates. The amount of overspend depends on actual cash-flow requirements and the timing of capital expenditure, which in turn will affect the extent and timing of external borrowing. At the time of writing provisional estimates are for an overspend in the region of £700,000.

5.6 Investment Counterparty Criteria

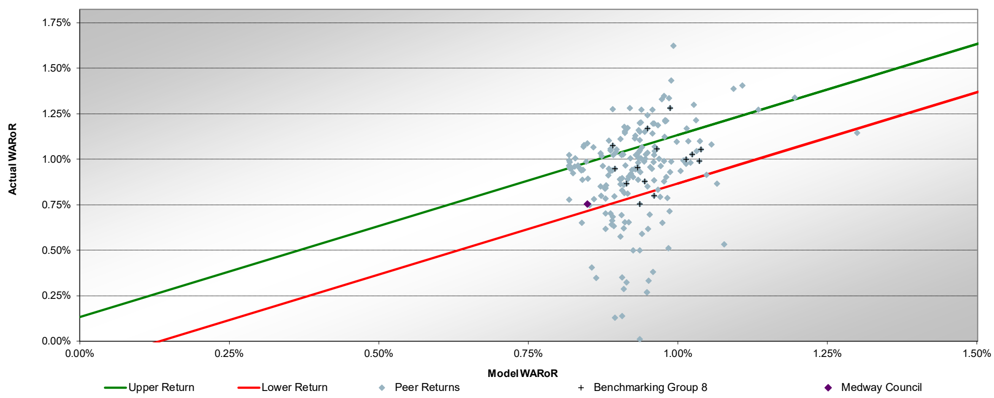
5.6.1 The current investment counterparty criteria selection approved in the Treasury Strategy is meeting the requirement of the treasury management function.

5.7 Benchmarking

5.7.1 The in-house Treasury team, contribute to the Link Asset Services benchmarking club which produces quarterly reports. Shown below is a graph showing Medway's performance to June.

Medway Council

Population Returns against Model Returns



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
Medway Council	0.75%	0.85%	-0.10%	0.72%	0.98%	Inline

5.7.2 The "x" axis of the graph shows the "Model Weighted Average Rate of Return", this is easiest interpreted as the level of return we should expect for the level of risk that we are taking with our investment portfolio. This is then plotted against the "Actual Weighted Average Rate of Return" on the "y" scale, running diagonally upwards across the graph are two parallel lines, if a Council performance falls between these lines then they are deemed to be receiving a return as would be expected for their level of risk, below these two lines and performance is considered below that expected and above then the return being received is above that expected. As can be seen Medway's return fell in line with expectations for our level of risk. However, the data includes only at cash deposits and excludes property funds.

5.7.3 In assessing the risk inherent in an Investment Portfolio for the benchmarking, three factors are taken into account,

(i) The number of days to maturity of an investment. With a larger the number of days left to maturity the greater the risk that an adverse event could occur

(ii) The total number of days that the investment was originally invested for, again the longer an authority is comfortable to invest for the greater the risk it is willing to take.

(iii) The creditworthiness of the counterparties in which the authority invests.

5.7.4 The table below shows some detail from the June 2021 benchmarking data comparing Medway in-house performance against all participants of the benchmarking group; unitaries and other local councils.

Comparison of risk and returns table below:

Authority/Group	Model Weighted Average Rate of Return	Risk: Weighted Average Maturity (Days)	Risk: Weighted Average Total Time (Days)	Risk: Weighted Average Credit Risk	Weighted Average Rate of Return
Medway	**0.85%**	**0**	**0**	**2.03**	**0.75%**
Average English Unitaries (22)	0.96%	67	160	2.70	0.97%
Average Total Population (201)	n/a	75	147	3.06	0.93%
Average Local Benchmarking Group (15)	0.96%	105	193	3.46	0.97%
Brighton & Hove CC	1.04%	171	364	2.87	0.99%
East Sussex CC	0.93%	101	193	3.01	0.88%
Sevenoaks DC	0.94%	35	109	3.51	0.75%
Tonbridge and Malling BC	1.07%	41	73	2.39	0.89%

6. Debt Rescheduling

6.1 Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. During the first six months of the year, no debt rescheduling was undertaken, and it is not envisaged that any will occur before the end of the financial year. However, officers and the council's financial advisers, Link Asset Services, will continue to monitor the situation and opportunities will be carefully considered.

7. Compliance with Treasury and Prudential Limits

7.1 It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". Council's approved Treasury and Prudential Indicators (affordability limits) are outlined in the approved Treasury Management Strategy Statement.

7.2 During the financial year to date the Council has operated within the treasury limits set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

8. Risk management

8.1 Risk and the management thereof is a feature throughout the Strategy and in detail within the Treasury Management Practices 1 published alongside the Treasury Management Strategy at the start of 2022.

9. Financial and legal implications

9.1 The finance and legal implications are highlighted throughout this report. The Council has delegated responsibility for the execution and administration of treasury management decisions to the Chief Finance Officer, who will act in accordance with the Council's policy statement and Treasury Management Practices.

10. Recommendations

10.1 The Committee is requested to consider this report, note its contents and note that the report will also be referred to Cabinet and Full Council.

Lead officer contact

Jonathan Lloyd, Finance Business Partner – Technical Accounting
Telephone No: 01634 332787 Email: jonathan.lloyd@medway.gov.uk

Appendices

Appendix 1 – View of economic conditions

Background Papers

None