Medway COUNCIL
Serving You

COUNCIL

19 JANUARY 2023

TREASURY MANAGEMENT STRATEGY MID-YEAR REVIEW REPORT 2022/23

Portfolio Holder: Councillor Alan Jarrett, Leader of the Council

Report from: Phil Watts, Chief Operating 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 report was considered by the Audit Committee on 3 November 2022 and by the Cabinet on 13 December 2022. The comments of the Committee and decisions of the Cabinet are set out at sections 8 and 9 of the report respectively.

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 was considered by the Audit Committee on 3 November 2022 and by the Cabinet on 13 December 2022.

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.

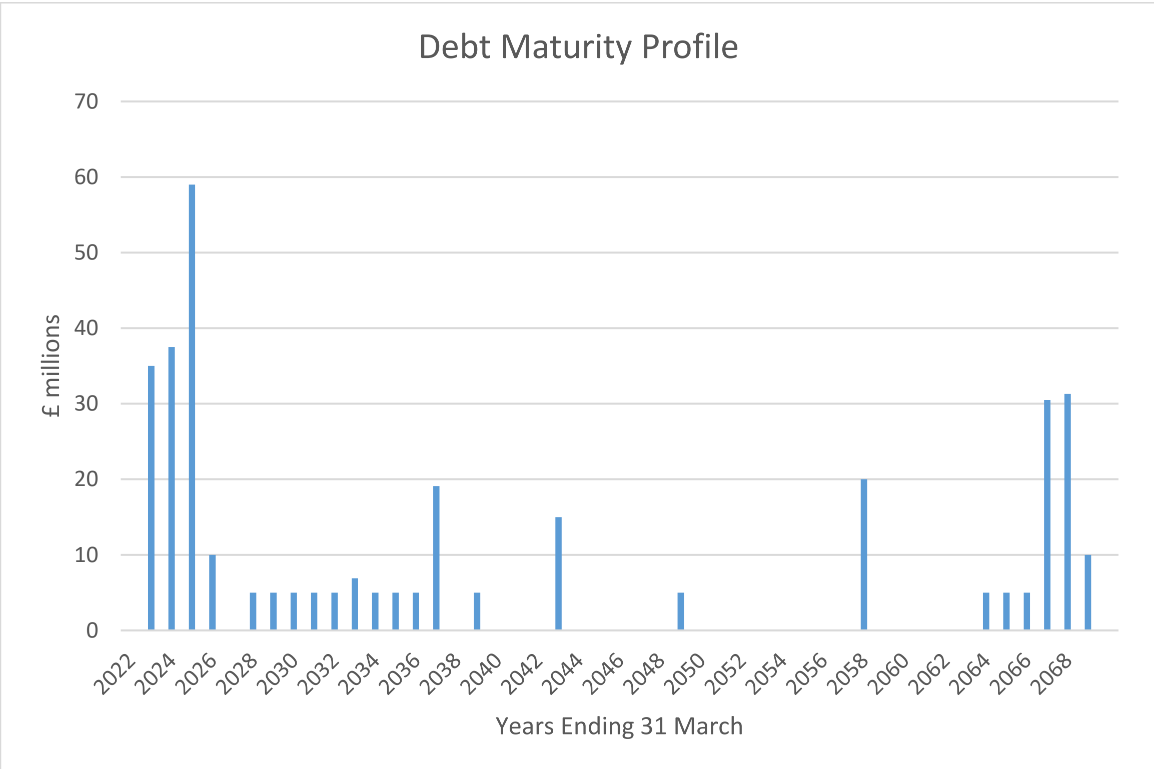
4.4 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit, which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the 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

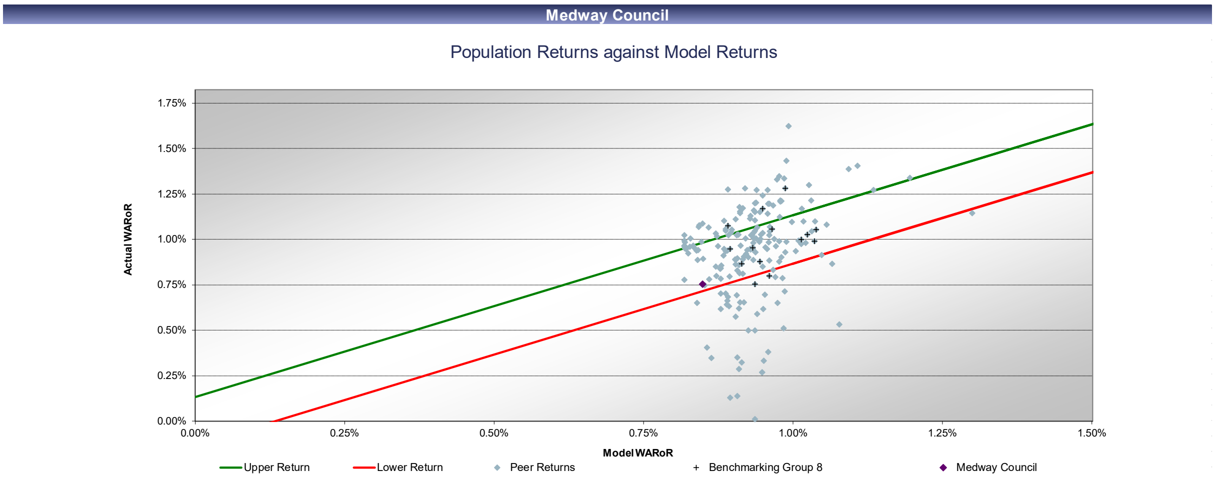
5.5 The Council’s finance and interest net expenditure for 2021/22 is expected to overspend due to the recent rapid rise in interest rates. The amount of overspend depends on actual cash-flow requirements and the timing of capital expenditure, which in turn will affect the extent and timing of external 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.



	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. Audit Committee

8.1 The Audit Committee considered the report at its meeting on 3 November 2022 and its comments are set out below:

8.2 The Finance Business Partner - Technical Accounting advised the Committee that work continued to balance the need to smooth the debt maturity profile whilst minimising costs for the revenue account. To achieve this the Council continued to use short term borrowing. Short term borrowing was £70 million on 31 March 2022. The amount repayable before 31st March 2022 had fallen to £20 million on 3 November 2022 due to a combination of repayments and replacement longer term loans being secured.

8.3 Borrowing remained within the Capital Financing Requirement (CFR) and cash investment was also low, this had impacted upon the return on investment, however, this was day to day cash, investment returns remained within expectations.

8.4 The recent rise in interest rates had caused a projected overspend on borrowing costs of approximately £700,000, as set out in paragraph 5.5 of the report.

8.5 Members then raised a number of questions and comments which included:

8.6 **Lender Option Borrower Option (LOBO)** – In response to a question whether any providers had made contact regarding the potential for the early redemption of loans, the Finance Business Partner - Technical Accounting reported that he had received one exploratory phone call from a provider, however there had not been an offer. If such an offer was received the Council would consider whether it was in its interests to make early repayment.

8.7 In response to a further question, what would be the response if providers asked for early repayment, the Council would consider refinancing if it was beneficial, for example, to smooth out the debt maturity profile. The aim would be that repayments would better match the Minimum Revenue Provision (MRP).

8.8 **Debt Maturing in 2025** – In response to a question whether there was a plan in place for the high level of debt maturing in 2025, the Finance Business Partner - Technical Accounting stated the Council would consider at that time whether to pay the loans if it had the available monies or refinance.

8.9 **Interest rates** – In response to a question whether the Council had considered longer term borrowing due to changes in interest rates, the Finance Business Partner - Technical Accounting stated it was difficult to predict the cash flow accurately over the longer period and any decision would be dependent on the Capital Programme. He advised that there is a cost to holding borrowed funds before they were needed. The Capital Strategy was being considered and this would help inform any decision.

8.10 **Capital Finance Requirement** (CFR) – In response to a question regarding the CFR and debt to turnover ratio, the Finance Business Partner - Technical Accounting reported the CFR would rise when the Council invested. In the Annual Treasury Management Strategy report the Council reviewed the ratio of debt costs to net income of the authority for the HRA and the general fund, both of those figures were reasonable at the time calculated.

8.11 **Authorised borrowing limit** – In response to a question seeking clarification regarding the authorised borrowing limits, the Finance Business Partner - Technical Accounting stated the authorised borrowing limit represented the CFR plus a contingent amount. The borrowing limit would not exceed the CFR, except in the short term.

8.12 In response to another question regarding the authorised borrowing limit, the headroom was the difference between the authorised borrowing limit and the CFR. The headroom stood at £40m.

8.13 **Repayments from receipts, grants and contributions** - In response to a request for clarification on the figures in the table Movement in Capital Financing Requirement (page 15 refers) and whether it included receipts from the MDC, the Finance Business Partner - Technical Accounting stated the figures were assumptions relating to schemes where the Council had borrowed in lieu of capital receipts. The table assumed the receipt was received two years after investment and included receipts from MDC in 2024-25.

8.14 **Property Investment** – In response to a request to include the yield of separate investments including the property fund, the Finance Business Partner - Technical Accounting highlighted that table in paragraph 5.4 of the report provided the cumulative return on investment figures. However, this information was not split by individual funds, and he undertook to consider how this would be shown differently in future reports.

8.15 In response to a comment that the Council had made a reasonable return on property investment, the Finance Business Partner - Technical Accounting agreed and stated that there were other properties which were not considered a treasury investment. He also differentiated between treasury management property investments and other commercial investments, eg Pentagon Centre, which were treated as capital expenditure.

8.16 **Loan to MDC** – In response to a question regarding where the return on the loan provided to MDC was shown in the accounts, the Finance Business Partner - Technical Accounting stated those figures were shown in the finance and interest costs which were budgeted for each year but not shown in the Mid-Year Treasury Management Report.

8.17 **Diversification of investment** – in response to a question whether the Council was considering different types of investment due to interest rate rises, the Finance Business Partner - Technical Accounting stated the Council had only day-to-day money available. His advice would be against speculative investment.

8.18 In response to a question whether investments in the property funds were easily accessible, the Finance Business Partner - Technical Accounting stated the Council could sell these investments, however there was normally a notice period of a few months, similar to other real estate trust investments.

8.19 **Interest rate charges** - In response to a question whether the overspend on borrowing took account of recent changes in interest rates, the Finance Business Partner - Technical Accounting stated the figure was based on worst case scenario assumptions of 5% interest rates and all programmed capital expenditure occurring before the end of the financial year.

8.20 **Benchmarking** - In response to a question regarding Medway's investment performance compared to other authorities, the Finance Business Partner - Technical Accounting stated the Council used day to day monies so did not have cash in hand to invest, this impacted on investment return and consequently the weighted average maturity and weighted average total time of investment were both at zero.

8.21 **Decision**:

The Committee considered the report, noted its contents and noted that the report will also be referred to Cabinet and Full Council.

9. Cabinet

9.1. The Cabinet considered the report at its meeting on 13 December 2022 and its decisions are set out below:

9.2. The Cabinet noted the comments of the Audit Committee set out at section 8 of the report.

9.3. The Cabinet considered this report, noted its contents and noted that the report would also be referred to Full Council.

10. Risk management

10.1. 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.

11. Financial and legal implications

11.1. 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 Operating Officer, who will act in accordance with the Council's policy statement and Treasury Management Practices.

12. Recommendation

12.1. The Council is requested to note the report.

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