

CABINET

24 OCTOBER 2023

TREASURY MANAGEMENT REPORT: QUARTER 1

Portfolio Holder: Councillor Vince Maple, 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 for 2023/24 Quarter 1. The report was previously considered by the Audit Committee on 28 September 2023, the minutes of which are set out at section 10 of the report.

1. Recommendation

1.1. The Cabinet is asked to note the treasury management report.

2. Suggested reasons for decision

2.1. In accordance with the Chartered Institute of Public Finance Accountancy's (CIPFA) Code of Practice for Treasury Management, there should be a report on treasury every quarter.

3. Budget and Policy Framework

3.1. The Council's Treasury Management Strategy and Policy are approved by Full Council following consideration by Cabinet and Audit Committee. The Audit Committee is responsible for approving the quarterly treasury reports.

4. Background

4.1. The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management 2021 recommends that members be updated on treasury management activities at least quarterly. This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

4.2. During 2023/24 the minimum reporting requirements were that the full Council should receive the following reports:

- An annual treasury strategy in advance of the year (Council 23 February 2023),

- A mid-year treasury review report.

In addition, Audit Committee and the Cabinet will receive reports for quarter 1 (this report) and quarter 3.

5. Interest Rate Forecasts

- 5.1. The Council has appointed Link Group as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. The PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1st November 2012.
- 5.2. The latest forecast, made on 26th June, sets out a view that both short and long-dated interest rates will be elevated for some little while, as the Bank of England seeks to squeeze inflation out of the economy, against a backdrop of a stubbornly robust economy and a tight labour market.
- 5.3. Link's forecasts have steadily increased during the quarter as the data continued to spring upside surprises, and the Bank of England continued to under-estimate how prevalent inflation is, and how tight the labour market is. The Government has also noted that despite immigration increasing markedly, high levels of ill-health amongst the workforce has led to wage demands remaining strong until such time as there is a loosening in demand for business services.

Link's current and previous PWLB rate forecasts below are based on the Certainty Rate.

Link Group Interest Rate View 26.06.23													
	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26
BANK RATE	5.00	5.50	5.50	5.50	5.25	4.75	4.25	3.75	3.25	2.75	2.75	2.50	2.50
3 month ave earnings	5.30	5.60	5.50	5.30	5.00	4.50	4.00	3.50	3.00	2.70	2.60	2.50	2.50
6 month ave earnings	5.80	5.90	5.70	5.50	5.10	4.60	4.00	3.50	3.00	2.70	2.60	2.60	2.60
12 month ave earnings	6.30	6.20	6.00	5.70	5.30	4.80	4.10	3.60	3.10	2.80	2.70	2.70	2.70
5 yr PWLB	5.50	5.60	5.30	5.10	4.80	4.50	4.20	3.90	3.60	3.40	3.30	3.30	3.20
10 yr PWLB	5.10	5.20	5.00	4.90	4.70	4.40	4.20	3.90	3.70	3.50	3.50	3.50	3.40
25 yr PWLB	5.30	5.40	5.20	5.10	4.90	4.70	4.50	4.20	4.00	3.90	3.80	3.80	3.70
50 yr PWLB	5.00	5.10	5.00	4.90	4.70	4.50	4.30	4.00	3.80	3.60	3.60	3.50	3.50

Link Group Interest Rate View 24.05.23													
	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26
BANK RATE	4.75	5.00	5.00	4.75	4.50	4.00	3.50	3.25	2.75	2.50	2.50	2.50	2.50
3 month ave earnings	4.80	5.00	5.00	4.80	4.50	4.00	3.50	3.30	2.80	2.50	2.50	2.50	2.50
6 month ave earnings	5.10	5.20	5.10	4.90	4.50	3.90	3.40	3.20	2.90	2.60	2.60	2.60	2.60
12 month ave earnings	5.40	5.40	5.30	5.00	4.50	3.90	3.40	3.20	2.90	2.70	2.70	2.70	2.70
5 yr PWLB	5.00	5.00	5.00	4.80	4.50	4.10	3.70	3.50	3.30	3.20	3.20	3.10	3.10
10 yr PWLB	5.00	5.00	5.00	4.80	4.40	4.10	3.80	3.60	3.50	3.40	3.30	3.30	3.30
25 yr PWLB	5.30	5.30	5.20	5.10	4.80	4.50	4.20	4.00	3.80	3.70	3.60	3.60	3.60
50 yr PWLB	5.10	5.10	5.00	4.90	4.60	4.30	4.00	3.80	3.60	3.50	3.40	3.40	3.40

Link Group Interest Rate View 27.03.23													
	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26
BANK RATE	4.50	4.50	4.25	4.00	3.50	3.25	3.00	2.75	2.75	2.50	2.50	2.50	2.50
3 month ave earnings	4.50	4.50	4.30	4.00	3.50	3.30	3.00	2.80	2.80	2.50	2.50	2.50	2.50
6 month ave earnings	4.50	4.40	4.20	3.90	3.40	3.20	2.90	2.80	2.80	2.60	2.60	2.60	2.60
12 month ave earnings	4.50	4.40	4.20	3.80	3.30	3.10	2.70	2.70	2.70	2.70	2.70	2.70	2.70
5 yr PWLB	4.10	4.10	3.90	3.80	3.70	3.60	3.50	3.40	3.30	3.20	3.20	3.10	3.10
10 yr PWLB	4.20	4.20	4.00	3.90	3.80	3.70	3.50	3.50	3.40	3.30	3.30	3.30	3.20
25 yr PWLB	4.60	4.50	4.40	4.20	4.10	4.00	3.80	3.70	3.60	3.50	3.50	3.50	3.40
50 yr PWLB	4.30	4.20	4.10	3.90	3.80	3.70	3.50	3.50	3.30	3.20	3.20	3.20	3.10

- LIBOR (London Inter Bank Offered Rate) and LIBID (London Inter Bank Bid Rate) rates ceased at the end of 2021. In a continuation of previous views, money market yield forecasts are based on expected average earnings by local authorities.
- The Link forecast for average earnings are averages i.e., rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short-term cash at any one point in time.

6. Borrowing

- 6.1. Total borrowing increased by less than £3 million during the quarter. However maturing loans were replaced by new loans with longer durations where available. The maturing loans had interest rates of between 0.55% and 2.1%. Loans are often arranged some time before the funds are received. The new loans received in Q1 have interest rates of 1.7% to 2% but these were arranged between May and June 2022. Recent loans, arranged between June 2023 and August 2023, are at rates between 5.3% and 5.85%.
- 6.2. The Council's CFR (capital financing requirement) for the year is shown below and represents a key prudential indicator.

CFR: General Fund	2022/23 Actual* £000	2023/24 Per Strategy £000	2023/24 R1 Forecast £000
Opening balance	371,770	483,434	435,567
Add unfinanced capital expenditure	65,375	66,924	72,191
Less MRP	374	5,409	5,669
Less KCC Debt Repayment	1,204	1,156	1,156
Less repayment from Capital Receipts	0	52,411	0
Closing balance	435,567	491,382	500,933

*CFR is provisional as work is continuing preparing the Statement of Accounts for both 2021/22 and 2022/23

CFR: HRA	2022/23 Actual £000	2023/24 Per Strategy £000	2023/24 R1 Forecast £000
Opening balance	40,682	44,377	42,829
Add unfinanced capital expenditure	2,210	5,016	3,200
Less VRP	63	390	390
Closing balance	42,829	49,003	45,639

- 6.3. Borrowing is forecast to remain below the CFR and both the operational and authorised limits set in the Treasury Strategy.

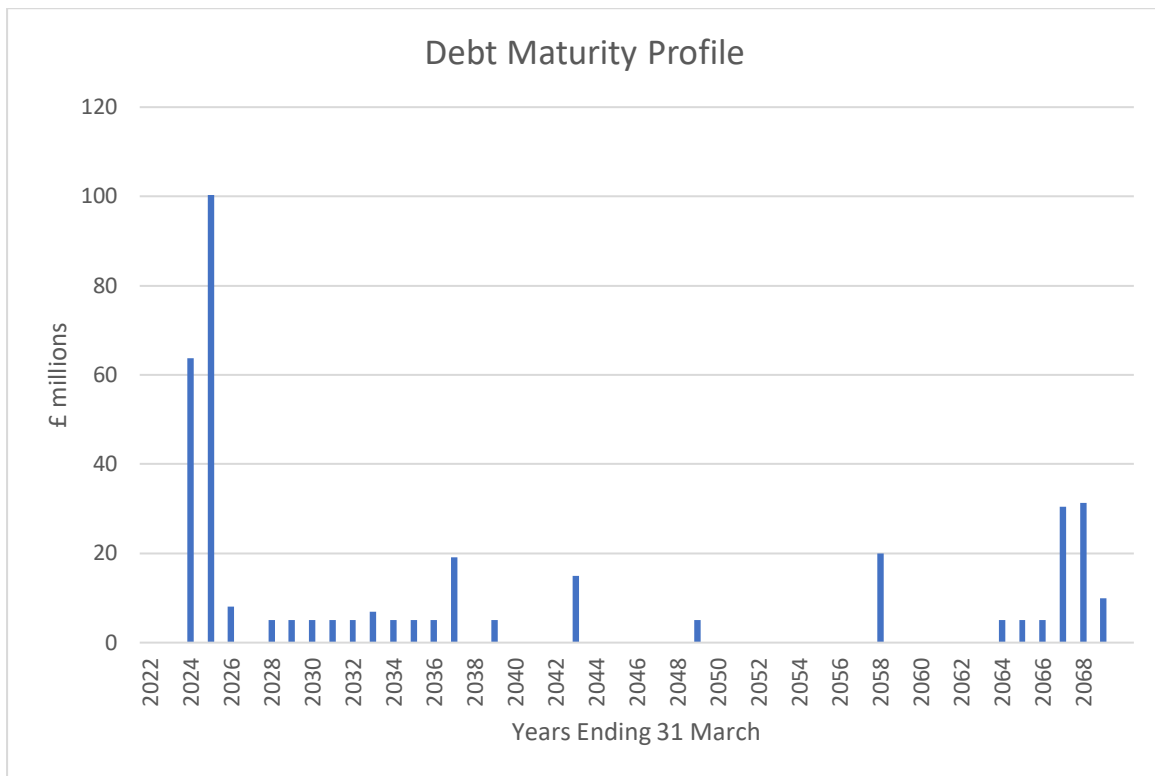
7. Treasury Position as at 30 June 2023

7.1. The Council's treasury management debt and investment position is organised by the treasury management officers to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the end of June 2023 the Council's treasury position was as follows:

Borrowing and investment levels:

	31/03/23 £000	Rate	30/06/23 £000	Rate
Long Term Borrowing – PWLB/LOBO	222,824	3.41%	222,824	3.41%
Long Term Borrowing – Other Local Authority	84,000	3.09%	90,000	3.53%
Long Term Borrowing – Growing Places/Salix/LEP	473	0.00%	462	0.00%
KCC Debt (includes approx. £1m short term)	28,901	4.41%	28,612	4.41%
Short Term Borrowing	94,520	3.25%	91,500	3.53%
Total Debt (Principal)	430,718		433,398	
Capital Financing Requirement (CFR)	478,396		546,572	
<i>(Under)/Over Borrowing</i>	<i>(47,678)</i>		<i>(113,174)</i>	
Less investments (exc. Property Funds & Loans to Subsidiaries)	14,505	3.90%	22,788	4.29%
Less Loan to Kyndi Ltd	1,345	5.00%	1,310	5.00%
Less Loan to MDC	69,373	6.00%	74,473	8.00%
Less Property Fund Investments *	21,098	-12.27%	20,999	-14.39%
Net borrowing	324,397		313,828	

* The return on the property fund investments includes the change in capital value.



- 7.2. The table above shows the debt maturity profile as at 17 August 2023. Where contractual arrangements have been entered into for the renewal of loans or their direct replacement with new loans liability is shown at the expiry of the new or replacement loan.
- 7.3. The Ministry of Housing, Communities and Local Government (MHCLG) guidance since 2011 has been to show the maturity date for Lenders Options, Borrowers Options (LOBOs) as the next call date. The table does not follow this guidance because no formal approaches were made in quarter 1 by lenders requiring early repayment. LOBOs have therefore been shown as maturing at their full term. However, one £5m loan was redeemed after the end of the quarter (see paragraph 8.2).
- 7.4. Upper limits for the proportion of debt maturing within various bands of years were set at the start of the year as shown below. There has been no breach of these limits.

Maturity Structure of Fixed rate Borrowing during 2023/24	Upper Limit	Lower Limit
under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and above	100%	0%

7.5. Property fund investment and income are summarised below.

	CCLA	Lothbury	Patriza	Total
	£000	£000	£000	£000
Opening Value 31 March	11,848	4,152	5,098	21,098
Revaluation	-16	-69	-14	-99
Closing Value 30 June	11,832	4,083	5,084	20,999
Dividend Received	140	37	48	225
Overall Gain/ (Loss)	124	-32	34	126

7.6. Members will note the poor performance of the Lothbury Fund. The fund has suspended redemptions at present as it tries to sell properties in a controlled manner to satisfy redemption requests and to restructure the portfolio to improve future returns. The Council has not applied to exit the fund and the advice of our treasury advisors is not to panic sell in the secondary market. As with the other property fund holdings, the present strategy remains to hold the investment for the long term.

8. Debt Rescheduling

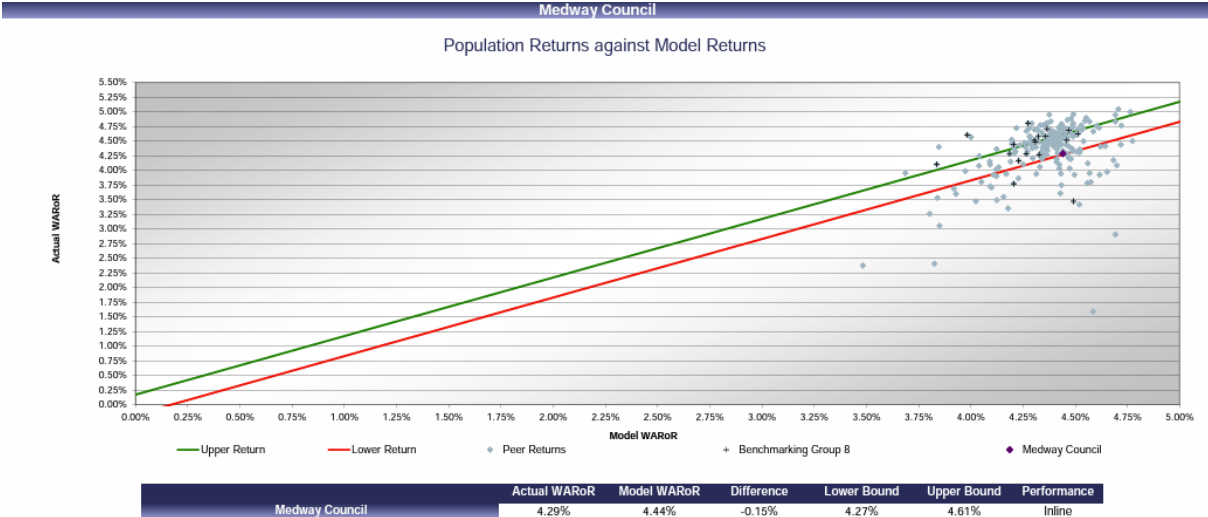
8.1. No debt restructuring was undertaken during quarter 1 as the average differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

8.2. Since the end of the quarter the Council received notice from one LOBO lender of an increase in interest rate. The Council exercised its right to repay the £5m principal on 23rd August at par.

9. Investments

9.1. At 30th June 2023 there were no investments with other local authorities.

9.2. The Council’s performance relative to our peer group is shown by the graph below, which is a snapshot produced by Link Asset Services as at June 2023. Medway is the bold dot just above the red line showing our performance to be in line with our peers.



9.3. Compliance with Treasury Limits

9.3.1. There were no breaches of the limits set in the Treasury Strategy during quarter 1.

10. Audit Committee

10.1. The Audit Committee considered the report on 28 September 2023 and the minutes of the discussion are as follows:

10.2. The Finance Business Partner – Technical Accounting introduced the report which provided an overview of treasury management activity in quarter one, 2023-24. He highlighted the current economic position which was that interest rates were thought to be near their peak and likely to stay elevated for some time.

10.3. The Council's debt maturity profile noted £54million of debt was scheduled to mature in the current financial year with an additional £100million of debt maturing in 2024/25. As a consequence, although conditions favoured short terms loans, the Finance Business Partner – Technical Accounting was reluctant to take further loans which would mature in 2024/25 and new loans recently taken out were scheduled to mature in 2026/27.

10.4. Borrowing remained below the CFR (Capital Finance Requirement) during the quarter. Following the end of the quarter, one lender exercised their option to the rate payable known as the Lender Option Borrower Option (LOBO), the Council exercised its right to repay the loan which was refinanced.

10.5. Investment performance remained in line with peer authorities. The Council was a net borrower which would restrict the cash available to invest. The majority of monies invested was held as deposits in bank or in the property funds.

10.6. Capital Values of property funds had continued to decline, those capital losses were reported as reserve movements, however, if the Council sold those investments it would be recorded as revenue so there were no plans to sell those investments.

10.7. Members then raised a number of comments and questions, which included:

10.7.1. **Length of loans** – in response to a question why new loans were longer in duration when the aim was to borrow in the short term, the Finance Business Partner – Technical Accounting stated that he would prefer to have longer term loans, however with interest rates currently high, the Council did not want to lock into long term borrowing. The £100m loans maturing in the short term provided the Council with flexibility should it be required.

10.7.2. **LOBO** – in response to a question regarding the difference between loan redemption and refinancing, the Finance Business Partner – Technical Accounting reported the lender wanted to put up the interest rate to 6.35% and the Council paid off the loan and refinanced at around 5%.

10.7.3. **Future interest rate risk** – in response to a query regarding future interest rates and refinancing costs of £160million in loans scheduled to mature by

2026/27, the Finance Business Partner – Technical Accounting stated that advice received was that interest rates would be higher for some time so future loans would cost the Council more. Loans renewed this year had typically been around 2% higher.

10.7.4. **Property fund investment** – Members queried what the rate of return was on investment, the Finance Business Partner – Technical Accounting explained the 1% return was the dividend for the quarter. He added that the capital value had declined, though this was treated as a reserve movement, however, this was scheduled to end in March 2025.

10.7.5. **Investment performance** – in response to a query regarding what action could be taken to improve investment performance, the Finance Business Partner – Technical Accounting noted that the Council operated with very little cash on hand which limited opportunities for investment. Authorities that had more cash had more scope for investment but would require further loans so this was not advisable.

10.7.6. The Chief Operating Officer added that those local authorities which invested had probably borrowed more to facilitate that investment. This was contrary to CIPFA and Government guidance and a number of those authorities which had issued S114 notices had done so as a result of poor investments.

10.8. The Committee noted the treasury management report.

11. Risk Management

11.1. Risk and the management thereof is a key feature throughout the strategy and in detail within the treasury management practices (TMP1) within the Treasury Strategy.

12. Financial Implications

12.1. Overall, the Interest and Financing costs at round 1 were forecast to underspend the budget by £857,000.

12.2. A breakdown of the Interest and Financing budget is shown below:
Interest and Finance Budget against spend:

	Budget 2023/24 £000	Round 1 Forecast £000	(Under)/Overspend £000
Interest Earned	(5,841)	(9,475)	(3,634)
Interest Paid	13,430	16,588	3,158
KCC Principal	1,204	1,156	(48)
MRP	6,442	6,059	(383)
Treasury Costs	65	115	50
Total	15,300	14,443	(857)

12.3. The body of the report outlines the significant financial implications. Any transactions undertaken on either investments or borrowings are governed by the London Code of Conduct, the Council's treasury policy statement, and the CIPFA Code of Practice on Treasury Management in Local Authorities.

13. Legal implications

13.1. Our investments were managed in compliance with the Codes of Practices, guidance and regulations made under the Local Government Act 2003.

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Appendices

Appendix 1 Commentary by Link Asset Services on The Economy and Interest Rates
Appendix 2 Glossary of Terms

Background papers

None