Medway Council
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Cabinet

19 December 2023

Treasury Management Strategy Mid-Year Review Report 2023/24

Portfolio Holder: Councillor Vince Maple, Leader of the Council

Report from: Phil Watts, Chief Operating Officer

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Summary

This report gives an overview of treasury management activity since 1 April 2023 and presents a review of the Treasury Strategy approved by Council on 23 February 2023.

The report was considered by the Audit Committee on 29 November 2023, the minutes of which are set out at section 10 of the report.

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	82,147	91,532	51,149	6,158
Capital Financing Requirement (CFR) at year end	491,736	537,903	556,321	547,814
External Borrowing	468,934	515,101	533,519	525,012
Underborrowing	22,802	22,802	22,802	22,802

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	457,593	491,736	537,903	556,321
In Year Borrowing Requirement	41,358	54,428	46,262	6,158
Less MRP & VRP*	(6,059)	(5,608)	(5,711)	(5,499)
Less Repaid from Receipts, Grants & Contributions	0	(1,543)	(21,068)	(8,143)

Less KCC Debt Repayment	(1,156)	(1,110)	(1,065)	(1,023)
Closing CFR	491,736	537,903	556,321	547,814

* Minimum Revenue Provision (MRP) relates to general fund and Voluntary Revenue Provision (VRP) relates to Housing Revenue Account.

1. Recommendations

1.1. The Cabinet is requested to note the comments of the Audit Committee set out at section 10 of the report.

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

2. Suggested reason for decisions

2.1. In accordance with the Chartered Institute of Public Finance Accountancy's (CIPFA) Code of Practice for Treasury Management, there should be a review of the strategy at least half yearly.

3. Budget and Policy Framework

3.1. 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.

3.2. 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.

3.3. This report has previously been considered by the Audit Committee and is also scheduled for consideration by full Council on 25 January 2024.

4. Background

4.1. 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

4.2. 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.

4.3. 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.

4.4. 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."

4.5. 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.

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

4.6. 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 4);
- A review of the Council's borrowing strategy for 2023/24 (Section 5);
- A review of the Council's investment portfolio for 2023/24 (Section 6);
- A review of any debt rescheduling undertaken during 2023/24 (Section 7);
- A review of compliance with Treasury and Prudential Limits for 2023/24. (Section 8);
- An economic update for the first part of 2023/24 (Appendix 1).

5. Treasury Management Strategy Statement and Annual Investment Strategy Update

5.1. Full Council approved the 2023/24 Treasury Management Annual Investment Strategy on the 23 February 2023.

5.2. The Strategy stated that in the long-term aim of officers is to smooth out the maturity profile and reduce reliance on short-term borrowing but whilst holding some short-term debt to manage cash flow. However, as and a significant amount of capital receipts are expected in the next few years, a higher level of short to medium-term loans from other local authorities will be held in the immediate term. At 31 March 2023 short-term borrowing stood at £94.52million, 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 £82.656million as at 13 November 2023. This figure includes £32.5million due for repayment before 31 March 2024. The aim over the next few months will be to avoid increasing the overall amount due for repayment in 2024/25 and concentrate new borrowing for repayment in 2025/26 and 2026/27. Many of the new loans are likely to be taken from the Public Works Loans Board (PWLB). Any further smoothing would require the use of longer-term funding from PWLB but the continued high levels in interest rates mean this would be expensive. The current position is shown in the graph at 5.8.

6. Borrowing & Borrowing Limits

6.1. 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.

6.2. 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 2024	540,386	537,903
External Debt	463,363	515,101
Under-borrowing	77,023	22,802
Estimated In Year Borrowing Required	12,575	54,428

6.3. The revision compared with the estimates arise from the evolution of the capital programme including changes to profiling and funding since the Strategy was formulated in late 2022.

6.4. The Chief Operating Officer (S.151 Officer) reports that no difficulties are envisaged for the current or future years in ensuring that borrowing does not exceed CFR.

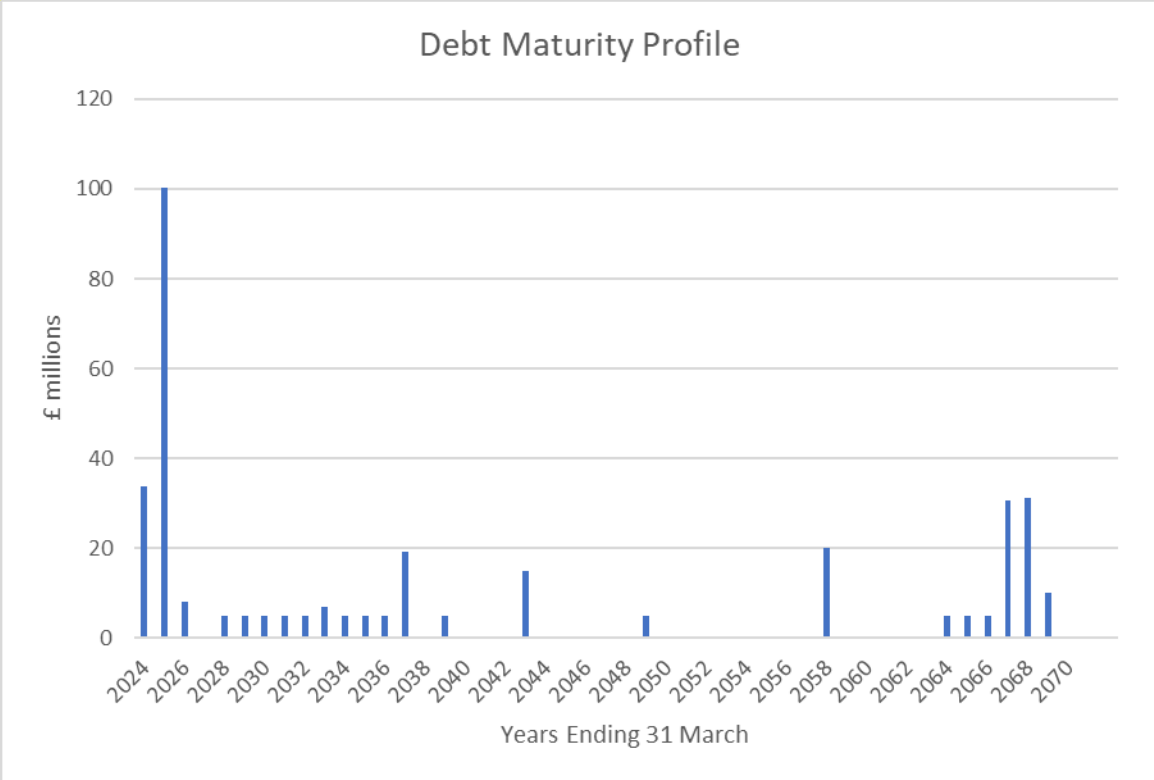
6.5. A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit, which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the 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 2023/24 is £706.624 million and it will not exceed this limit.

6.6. 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. The 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 4.2 above.

6.7. Link's latest forecast of interest rates issued on 25th September 2023 is as follows:

Link Group Interest Rate View	25.09.23												
	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26
BANK RATE	5.25	5.25	5.25	5.00	4.50	4.00	3.50	3.00	2.75	2.75	2.75	2.75	2.75
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.00	2.80	2.80	2.80	2.80	2.80
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.10	2.90	2.90	2.90	2.90	2.90
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.20	3.00	3.00	3.00	3.00	3.00
5 yr PWLB	5.10	5.00	4.90	4.70	4.40	4.20	4.00	3.90	3.70	3.70	3.60	3.60	3.50
10 yr PWLB	5.00	4.90	4.80	4.60	4.40	4.20	4.00	3.80	3.70	3.60	3.60	3.50	3.50
25 yr PWLB	5.40	5.20	5.10	4.90	4.70	4.40	4.30	4.10	4.00	3.90	3.80	3.80	3.80
50 yr PWLB	5.20	5.00	4.90	4.70	4.50	4.20	4.10	3.90	3.80	3.70	3.60	3.60	3.60

6.8. The graph in below shows the debt portfolio repayment profile as at 13 November 2023. 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. One LOBO of £5m was repaid on a call date in August 2023 following notice of an increase in the interest rate payable.



7. Investment Portfolio 2023/24

7.1. 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.

7.2. The investment portfolio yield on cash investments at 13 November 2023 ranges from 0.0% to 5.19%.

7.3. A full list of in house investments held as at 13 November 2023 is shown below:

Investments: Core Investments	**Principal 13 November 2023 £**	**Interest %**
CCLA Property Fund (September 2023 market value)	11,693,715	n/a
Patriza Hannover Property UT (September 2023 market value)	4,973,700	n/a
Lothbury Property Trust (September 2023 market value)	3,948,758	n/a
Total Core Investments	**20,616,173**	n/a
Investments: Liquid investments	**Principal 13 November 2023 £**	**Interest] %**
Svenska Handelsbanken	1,152	0.00%
Lloyds	283,779	5.14%
Barclays	4,427	0.00%
Santander	0	3.43%
CCLA Public Sector Deposit Fund	8,763,822	5.19%
Total Liquid Investment	**9,053,179**	n/a

Investments	Principal 13 November 2023 £	Interest %
Total In house Investments	29,669,352	n/a

7.4. 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)		20,616,173
Capital (Loss) to Date		(2,383,192)
Dividends Received 2015/16 to 2020/22	4,233,381	
Dividends 23/24 to Date*	415,175	
Total Dividends to Date		4,648,556
Total Return to Date		2,265,364

*Patriza has yet to declare the dividend for the second quarter. The dividend for the first quarter was £48,607. The amount of £415,175 reflects only the amounts actually received.

7.5. Redemptions in Lothbury Property Fund are suspended. The fund managers have issued a Notice of Termination under which, unless an alternative solution can be found, the Fund will be would up on 31 December 2023. This may crystalise a loss of around £1.05m which will need to be recognised in the Council's revenue account. However, the latest information from Lothbury indicates that the fund may merge with one operated by another fund manager, which may avoid crystallisation.

7.6. If no merger is possible, the managers have stated that it is not necessary to sell all the properties held by the Fund by the termination date and that distributions of capital will take place over time.

7.7. No suspensions are expected for Patrizia or CCLA. The suspension on Lothbury was triggered by a large number of redemption applications following poor performance.

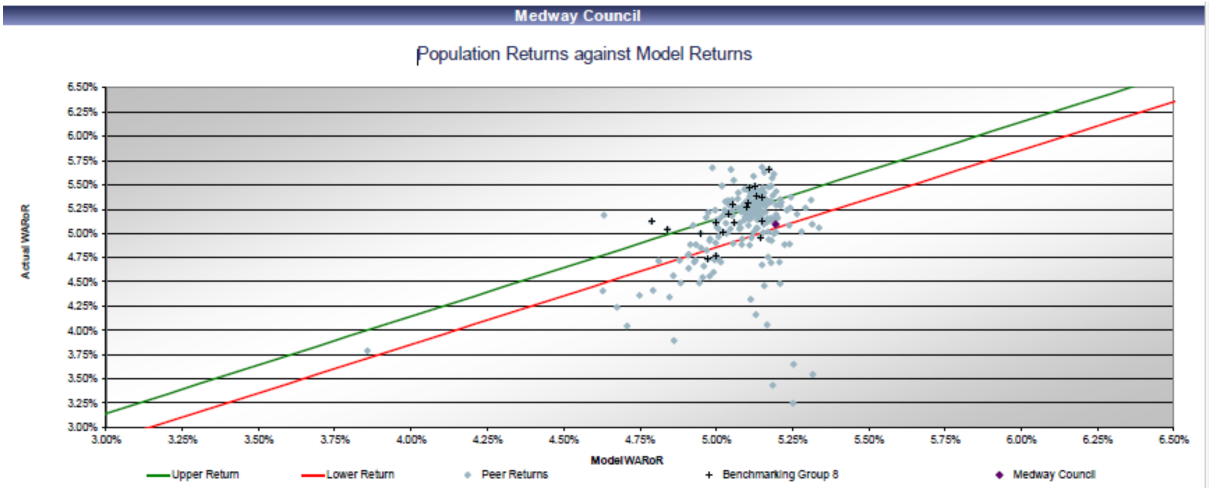
7.8. The Council's finance and interest net expenditure for 2023/24 is expected to remain within budget. Higher interest rates have been offset by delays in the timing of borrowing.

7.9. Investment Counterparty Criteria

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

7.10. Benchmarking

7.10.1. 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 September.



Medway Council	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
	5.10%	5.19%	-0.10%	5.05%	5.34%	Inline

7.10.2. 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.

7.10.3. 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.

7.10.4. The table below shows some detail from the September 2023 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	**5.19%**	**0**	**0**	**2.34**	**5.10%**
Average English Unitaries (24)	n/a	70	145	2.83	5.16%
Average Total Population (229)	n/a	79	154	2.81	5.09%
Average Local Benchmarking Group (20)	n/a	92	183	2.78	5.18%
Brighton & Hove CC	4.84%	162	386	3.18	5.04%
East Sussex CC	5.02%	85	200	3.01	5.01%
Sevenoaks DC	5.14%	0	0	1.24	4.96%
Tonbridge and Malling BC	5.11%	74	148	3.24	5.47%

8. Debt Rescheduling

8.1. 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.

9. Compliance with Treasury and Prudential Limits

9.1. 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.

9.2. 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.

10. Audit Committee

10.1. The report was considered by the Audit Committee on 29 November 2023. The draft minutes of the discussion are set out below.

10.2. The Head of Corporate Accounts introduced the report and highlighted the Council was forecast to under borrow by £6.8m which was an improvement on the position at quarter one. This was due to borrowing not being required as quickly as previously forecast. The Council continued to only borrow for the purposes of capital investment.

10.3. Investment had continued to grow in line with expectations, however property funds were excluded from this. Property funds had not performed well in the period though had previously performed well in the past.

10.4. The following issues were discussed:

10.5. Lothbury property fund - concern was raised relating to the position of Lothbury Property fund and potential exposure to a £1.5m cost were the scheme to close. The Chief Operating Officer confirmed that if the cost was realised it would be an additional budgetary pressure. The fund remained hopeful of securing a merger and the Council recently voted to defer the closure of the fund for that purpose.

10.6. Debt Maturity Profile – A Member noted there was a large amount of debt scheduled to mature in the next year and whether a review of the best course of action in relation to the debt maturity profile was required in light of the current high interest rates. The Head of Corporate Accounts agreed, all options would be considered but the Council did not want to lock into longer term borrowing currently when advice was that interest rates may well be lower in two years. This would form part of the Treasury Management Strategy.

10.7. The Chief Operating Officer added that the Council retained the ambition to smooth debt maturity profile and projections were for interest rates to drop significantly over the next two to three years.

10.8. Members commented that the Council continued to favour a mixed and cautious approach.

10.9. **Decision**

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

11. Risk management

11.1. 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 2023.

12. Financial and legal implications

12.1. 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.

Lead officer contact

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Appendices

Appendix 1 – View of economic conditions

Background Papers

None