MIDDLESBROUGH COUNCIL	

Report of:	Director of Finance (S151 Officer)

Relevant Executive Member:	Executive Member for Finance and Governance

Submitted to:	Executive

Date:	28 February 2024

Title:	Prudential Indicators and Treasury Management Strategy 2024/25

Report for:	Decision

Status:	Public

Strategic priority:	All

Key decision:	Yes
Why:	Decision(s) will incur expenditure or savings above £250,000

Subject to call in?	No
Why:	Part of the statutory budget setting process

Proposed decision(s)
For Executive to review and endorse the following and refer for consideration and approval by Council at the budget meeting on 8 March 2024: - The Prudential Indicators (PI) and limits for 2024/25 to 2026/27 relating to capital expenditure and treasury management activity. - The Treasury Management Strategy (TMS) for 2024/25, which includes the Annual Investment Strategy for 2024/25. - The Minimum Revenue Provision (MRP) Policy 2024/25. - An Authorised Limit for External Debt of £372m for the financial year.

Executive summary
The Council is required to approve annually a Treasury Management Strategy and a set of Prudential Indicators, which self-regulate the level of capital financing activities of the Council and the affordability of the capital programme. These need to be set on an annual basis to comply with the Local Government Act 2003 and the Chartered Institute of Public Finance and Accountancy (CIPFA) Codes of Practice on Capital Finance and Treasury Management. The Treasury Management Strategy is important from both a financial and governance perspective as it sets the framework within which the Council manages its borrowing and investments, how it delivers these services, and how it controls the risks attached to financial decisions made. It also sets out the parameters and criteria that govern the day-to-day cashflow management activity and how these impact on medium to long term financial planning. These include achieving value for money from any borrowing undertaken, managing risk, and protecting any resources that have been invested. The Prudential Indicators are an integral part of the CIPFA Capital Finance Code and demonstrate whether the capital programme is affordable, sustainable, and prudent. They include the level of capital expenditure over the next three years, how this has been financed, the maximum level of external debt and the cost to the revenue budget. The MRP policy governs how the Council plans to account for the repayment of loan principal in relation to its borrowing activities and has a fundamental impact upon the annual revenue cost of borrowing and over the long term. The Council adopted its current MRP policy in 2021/22 which is based on a 2% annuity model in line Government permitted prudent methodologies available to and used by all local authorities. The effect of this methodology compared to others available, is to improve annual affordability over the medium term which are offset by higher revenue charges in 25 – 50 years' time. The Council's underlying need to borrow is measured by the Capital Financing Requirement (CFR) which is forecast to be £331.863m at the end of 2024/25 rising to £352.332m by 2026/27. This results in the annual cost of revenue cost of borrowing of £11.154m (7.8% of Net Revenue Budget) in 2024/25 rising to £14.496m (9.8% of Net Revenue Budget) as shown below. This level of borrowing is provided to include the contingency sums repayable if the Council is required to utilise the full amount of Exceptional Financial Support (EFS) of £13.4m as explained further below. The actual level of borrowing will be less provided that revenue savings are delivered to plan and capital receipts from planned asset sales realised to fund transformation as set out in the 2024/25 Budget and MTFP report.

	2022/23 actual	2023/24 forecast	2024/25 forecast	2025/26 forecast	2026/27 forecast
Financing costs (£m)	8.058	9.376	**11.154**	12.814	14.496
Net Revenue Budget (£m)	118.329	126.354	**143.190**	148.601	148.127
Proportion of net revenue budget (%)	6.8%	7.4%	**7.8%**	8.6%	9.8%

Whilst the Council is not an outlier compared to other authorities in terms of its level of total debt (see the graph below), it is approaching the CIPFA advisory limit of 10% for revenue affordability on borrowing to fund its future capital investment. The Council will therefore need to strictly prioritise its capital investment decisions over the medium and longer term and secure its financing through third party funds such as contributions and grants or further capital receipts from the sale of assets in order to maintain borrowing at affordable levels over the longer term.

Total debt as percentage of core spending power

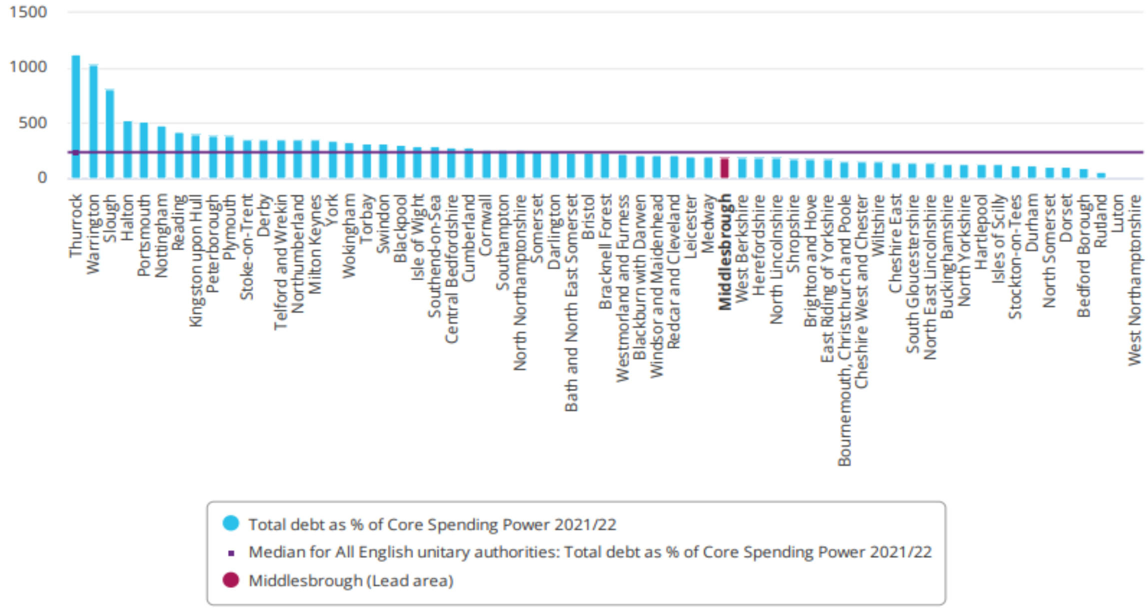
'Total debt' is Capital Financing Requirement, a measure of capital indebtedness that the council has built up over many years of capital financing decisions, but based on a methodology. (It is perhaps more accurate to describe this as the amount of capital expenditure that has not yet been funded by capital receipts, capital grants or revenue contributions and which therefore will need to be funded in future years. As such is some kind of measure of capital indebtedness, but arguably not a perfect one.

Core Spending Power is a measure of the funding the government makes available to councils for service delivery but it excludes several important elements that may be contributing to the servicing of debt including schools grants, investment income, service income and housing rents.

In 2021/22, the total debt as a percentage of Core Spending Power for Middlesbrough was 190.1%, which was below the All English unitary authorities median percentage of 229.4%.

Note the metric on total debt as a percentage of core spending power used by Oflog uses different financial years for the denominator and numerator, whereas LG Inform uses the same financial year so the numbers will differ slightly.

Total debt as % of Core Spending Power (2021/22) for All English unitary authorities



Source:
Calculated by LG Inform, N/A, Total debt as % of Core Spending Power , **Data updated:** 22 Nov 2023

The Council is reliant upon the capitalisation of £4.7m of revenue expenditure to balance its 2024/25 revenue budget. In the absence of available capital receipts this will be funded by borrowing via Exceptional Financial Support (EFS) over a period of up to 20 years. The period and rate of borrowing will be determined at an appropriate point during 2024/25, taking account the Council's financial performance, prevailing interest rates and the impact and affordability of revenue repayments over the period. This will be a professional judgement of the s151 Officer, based upon the expert advice of the Head of Finance and Investments and the Council's external Treasury Management advisers. A contingency amount of £0.6m is provided in relation to setting the revenue budget.

EFS of up to a further £3.5m is required to provide capital financing to cover the risk of any shortfall in the delivery of savings and up to £4.6m for any shortfall on the timing of realising planned capital receipts required to fund transformation expenditure under Flexible Capital Receipts regulations. Provided that savings are delivered to plan, and flexible receipts are realised in accordance with expected profiles, it will not be necessary to draw down this borrowing.

However, this does emphasise that the successful delivery of all savings to plan during 2024/25 is critical to the Council's financial recovery and its medium term financial sustainability. Further, that investment in transformation must deliver substantial revenue savings in excess of the projected budget gap of £7.965m in the 2024/25 Budget and MTFP report presented elsewhere on this agenda, given that further financial challenges are likely to occur within the financial planning period that are not yet known.

The revenue costs of borrowing under EFS of up to £13.4m for a period of up to 20 years (£1.150m maximum per annum) is factored into the TM Strategy and is within the Prudential Indicators and authorised limits. This reflects the borrowing required to support the proposed budget and MTFP as set out elsewhere in this agenda.

1. Purpose

This report outlines the Council's prudential indicators for the financial years 2024/25 – 2026/27 and sets the framework and approves the limits within which the treasury management operations for this period. It fulfils key legislative and guidance requirements:

(a) The setting of the prudential indicators in relation to the expected capital activities and treasury management prudential indicators (included as treasury indicators) in line with the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice.

(b) The treasury management strategy statement which sets out how the Council's treasury function will support capital decisions taken above, day to day treasury management activities on service delivery and any limitations on these, via the treasury prudential indicators.

(c) The approval of the Council's Minimum Revenue Provision (MRP) Policy, which sets out how the Council will pay for borrowing to fund capital investment through the revenue budget each year.

(d) The key indicator is the Authorised Limit, the maximum amount of debt the Council could enter into during the financial year. This amount acts as the legal limit for debt activity.

(e) The investment strategy which sets out the Council's criteria for choosing the investment counterparties and limiting exposures to the risk of loss.

The information contained in the report regarding the Council's capital expenditure plans, Treasury Management and Prudential Borrowing activities indicate that they are:

- Within the statutory framework and consistent with the relevant codes of practice.

- Prudent, affordable, and sustainable.

- An integral part of the Council's Revenue and Capital Medium Term Financial Plans.

2. Recommendations

That the Executive review and endorse and recommend for approval and adoption at the Council meeting on the budget on 8 March 2024:

- To approve the Prudential Indicators and limits for 2024/25 to 2026/27 relating to capital expenditure and treasury management activity set out in tables 1 to 10 of Appendix 1.
- To approve the Treasury Management Strategy for 2024/25, which includes the Annual Investment Strategy for 2024/25 at Appendix 1
- To approve the Minimum Revenue Provision (MRP) Policy for 2024/25 at Appendix 1.
- To approve an Authorised Limit for External Debt of £372m for the 2024/25 financial year.

3. Rationale for the recommended decision(s)

The recommendations above will fulfil the following for the local authority:

a) To comply with the Prudential Code for Capital Finance in Local Authorities and the Department for Levelling Up, Housing & Communities (DLUHC) guidance on investments.

b) To comply with the Treasury Management Code of Practice for Local Authorities.

c) To comply with the requirements of the Local Government Act 2003 Part 1.

d) To approve a financial governance framework within which officers will operate when making both borrowing and investment decisions and entering financial transactions.

4. **Background and relevant information**

4.1. The PI & TMS for 2024/25 covers the following areas:

- How the capital programme is financed including the impact of Exceptional Financial Support required to set a lawfully balanced revenue budget.
- The relevant prudential Indicators to monitor the performance, revenue budget affordability and sustainability of the capital expenditure being proposed in line with the requirements of the prudential code.
- Treasury Management arrangements in place for investing surplus funds and borrowing to fund capital expenditure.
- The types of investments the Council makes as part of managing its cash balances – the Annual Investment Strategy.
- Knowledge and skills of staff involved in the Treasury Management process.
- Minimum Revenue Provision policy – including outlining how much the Council accounts for the revenue costs of re-paying borrowing incurred in relation to historical and future capital investment to support the operational delivery of services.

4.2 Capital Expenditure relates to how the Council plans to invest in long-term assets and infrastructure (such as property, equipment, vehicles, roads etc.). The Council must consider how this expenditure is paid for and what the long-term financial implications are of undertaking this investment. The Council is also permitted to borrow funds to finance the capital programme under the Local Government Act 2003. It needs to consider the impact on the revenue budget of the level of borrowing being proposed, how it funds the repayment of this debt and the period over which this debt is repaid.

4.3 The Council must ensure the capital programme and its plans to borrow to finance it are prudent and affordable. Where elements of this are funded by borrowing (either externally or internally), the Council must set aside budgetary allocations in the general fund revenue budget to meet the cost of this debt. These budgets include the interest payable to lenders on external borrowing and the setting aside of funds to re-pay the principal element of debt (known as the Minimum Revenue Provision).

Prudential Indicators and Capital Investment Plans

4.4 The Council demonstrates the concepts of affordability, sustainability, and prudence on its investment plans by setting a range of Prudential and Treasury Management indicators. These are set out in **Appendix 1** and are key metrics to the Director of Finance and Council when setting the budget plans each year.

4.5 Any variance from these indicators during a year indicates either a higher level of indebtedness or a lower level of prudence on the capital activities of the Council than when the budget was set. The following paragraphs give a brief commentary on these key indicators as we approach the start of the 2024/25 financial year.

4.6 There is total outstanding debt of **£233.491m** on 31 December 2023, with a further **c£25m** of borrowing expected to be required before 31 March 2024.

4.7 The forecast overall total long term external debt at the end of 2023/24 of **£259.498m** should be compared with the estimated *Capital Financing Requirement* (the underlying value which the Council needs to borrow to fund capital activities) of **£299.928m.** The Council therefore has an expected under-borrowed position of **£40.430m**, which provides some savings in interest payments as other revenue and capital cash has been used in lieu of external borrowing. This is a key strategic decision each year as to whether the under-borrowing position is increased or reduced and is influence by the expectation of interest rates available to generate income on investments vs interest rates incurred on borrowing.

4.8 **Table 6** in **Appendix 1** shows the profile of outstanding external debt over the whole of the medium-term financial planning period, and this will rise to a maximum of **£333.294m** by 31st March 2026 before starting to reduce in the following financial year. This increase in debt is a direct result of the amount required to fund the capital programme in each year, the EFS borrowing required, and any additional cash flow demands in each financial year.

4.9 The Council holds revenue budgets for repaying debt and interest (known as Capital Financing Costs). The repayment of debt costs for 2024/25 are **£11.154m** (**7.8%** of the net revenue budget for 2024/25). For comparison purposes the forecast capital financing costs in 2023/24 are expected to be £9.376m (which represented 7.4% of the planned net revenue budget for 2023/24).

Table 1: Prudential Indicators

Prudential Indicator	**2023/24 (£m)**	**2024/25 (£m)**	**2025/26 (£m)**	**2026/27 (£m)**
Capital Financing Requirement (underlying need to borrow)	**299.928**	**331.863**	**355.426**	**352.332**
External Borrowing	259.498	310.535	333.294	329.910
Internal Borrowing	40.430	21.328	22.132	22.422
Authorised limit for External Debt	**328.000**	**372.000**	**396.000**	**393.000**
Annual Capital Financing Cost	9.376	11.154	12.814	14.496
% of Net Revenue Budget on debt costs	7.4%	7.8%	8.6%	9.8%

4.10 The table above illustrates the key figures from paragraphs 4.6 to 4.9 and how these change over the period to 2026/27. It also shows that the proportion of capital financing costs is increasing over the period due to the level of external debt required to fund the capital programme and to provide for EFS of up to £13.4m in order to set a balanced and robust revenue budget.

4.11 Although the Council does not have relatively highly debt levels than its comparator authorities, the strain on the revenue budget is increasing. When CIPFA introduced the Capital Finance Code of Practice in 2007, an amount of 10% of the net revenue budget was advised as being a threshold for sustainability and financial prudence. Whilst some councils have exceeded this limit, the S151 Officer advises Members to constrain capital investment funded by borrowing going forward as a key criteria for achieving its financial sustainability plans.

4.12 It is a statutory requirement for the Council to set an authorised limit for external debt at the start of each financial year. This is an amount beyond which it would be ultra-vires (or outside of its powers) to exceed in a particular financial year. The authorised limit for 2023/24 is £328m, with this increasing to **£372m** for 2024/25 due to an increase in the level of borrowing required.

4.13 It should be noted that the authorised limit for the Council is currently higher than either the expected level of external debt or the capital financing requirement. This is common practice to enable local authorities to build in contingency for unexpected urgent capital expenditure, potential unexpected debt re-financing opportunities and the remote possibility of needing to borrow for any further exceptional revenue purposes. The Council's authorised legal limit is recommended to be set at £40m above its capital financing requirement. It is not recommended to go beyond the specified capital financing requirement other than for temporary and specifically defined borrowing purposes.

Treasury Management

4.14 Treasury Management is defined as *'the management of the Council's cash flows, borrowing and investments, and the associated risk'*. The main risks that affect a local authority include credit risk, interest rate risk, liquidity risk and refinancing risk.

4.15 The Council is generally cash rich in the short term as many grants and contributions are paid in advance of need. Because of this, any excess cash is invested with an appropriate counterparty until the funds are required. When making an investment, the Council follows the advice set out in the Local Government Act 2003 and within the Treasury Management Code with paramount consideration given to the security of the sum invested, followed by the liquidity position of the Council and finally the interest rate achievable on the investment.

4.16 Given that credit criteria are the most important factor when making an investment decision, the Council receives regular updates from its professional expert external treasury management adviser, Arlingclose, on changes in credit ratings for individual financial institutions. They also advise on maximum amounts to be invested with each counterparty and maximum durations for any fixed term deposits made. This framework helps to protect against the loss of any sums invested (credit risk), ensures liquidity is not compromised and earns interest to support the revenue budget (not a major factor at present).

4.17 On 31 December 2023, the Council had cash balances of **£21.847m** invested either on fixed term deposit with central government or in liquidity accounts with appropriate banks. The strategic level of cash holdings is a minimum of £15m, below which the Council will look to borrow to maintain liquidity.

4.18 In relation to external borrowing, the Council seeks to achieve a low but certain cost of finance, whilst retaining the flexibility to borrow for short-term periods and to respond to demands of the Investment Strategy as needed. The Council therefore looks to create a balance between taking advantage of generally lower rates of interest for short term borrowing (predominantly from other local authorities) versus the need to achieve certainty over rates of borrowing in the longer term from either government or financial institutions (mainly from the PWLB or other banks).

4.19 Of the **£233.491m** of external debt on 31 December 2023, 80% is long term from the Public Works Loan Board – the government agency for local authority borrowing and 20% is long term with financial institutions (generally banks). There is £18.3m short-term borrowing in place at present.

4.20 Current long term interest rates for borrowing from the PWLB are between 4.5% and 5.25% depending on the length of the loan (local authorities can borrow up to 50 years from central government) with short term rates being between 5.5% and 6.0% for up to one year in duration.

4.21 On local authority borrowing, there has been much interest from both regulators and the media in recent years around individual councils taking significant amounts of long-term debt from the PWLB for the sole purposes of commercial activity – generally property investment. Under the Prudential Code, local authorities have lots of freedom to conduct and self-regulate their own borrowing and investment activities.

4.22 Both the Government and the Chartered Institute of Public Finance & Accountancy have said that borrowing for the sole purposes of commercial investment is against the spirit of the Code. The PWLB has prevented any local authority applications for this type of activity from 1 April 2021 with Section 151 Officers having to confirm each year that their investment plans do not contain any of these types of activity.

4.23 Although the Council has undertaken some capital projects in recent years that have generated a revenue income stream, the primary aim has always been to regenerate the areas involved and to grow the wider economy within the Town. As a result, these activities can continue under the Code and with funding from the PWLB.

Knowledge & Skills

4.24 This Strategy provide details of the knowledge and experience in place by Officers and the access to external advice and guidance made available to enhance this. Council officers have a broad range of skills to ensure treasury management decisions are informed and risk-assessed on a consistent basis. The Council uses external consultants (Arlingclose) to provide up to date and specialist advice which is bespoke for local government sector regulations, particularly focusing on risks and opportunities.

4.25 The Council also participates in a treasury management benchmarking club run by Arlingclose. This club provides access to data on other local authorities' approaches to Treasury Management, including strategic information, and the wider performance outputs of the Treasury Management activities.

4.26 As part of the Treasury Management Code, it is also a best practice requirement that elected members have the necessary skills & knowledge to scrutinise the Council's plans and processes in this area. This has been achieved in the past by providing training for Members but this training is planned to be delivered during 2024.

Minimum Revenue Provision

4.27 The Council is required under the Local Government Act 2003 Part 1 to maintain a policy for the repayment of historic external debt incurred from the annual revenue budget. The policy is split into different elements which are influenced by when the borrowing was originally incurred, the type of assets and the useful economic life of the assets the borrowing is funding. The Council has in previous years amended this policy to reflect the useful economic life of the funded assets more accurately and then in 2021/22 moved to an annuity basis of calculating these revenue costs. **No changes are being proposed to the MRP policy for 2024/25 financial year** and there is no further scope to make annual savings beyond those currently achieved through the current policy on a prudent basis. This policy is set out at the end of **Appendix 1** for information.

5. Other potential alternative(s) and why these have not been recommended

5.1 It is a statutory requirement to approve the annual treasury management strategy and set of prudential indicators by the Council. As a result, there are no alternatives available.

6. Impact(s) of the recommended decision(s)

The adoption of this report is an integral part of the annual process for the Council. Ensuring that the capital programme and its financing is within available and affordable revenue resources is a key judgement for the S151 Officer and will inform the Council's view of whether to approve the medium-term financial plans.

6.1 Financial (including procurement and Social Value)

6.1.1 All relevant financial implications are outlined within the body of this report and the supporting **Appendix 1**. The capital programme and financing being recommended in the budget report remains affordable within the revenue budget parameters but needs to be strictly managed and prioritised going forward. The treasury indicators and processes remain robust and within prudent limits. The policy on minimum revenue provision also remains in line with the appropriate regulations and government guidance.

6.1.2 **Table 1** in **Paragraph 4.9** outlines the key debt metrics and the capital financing costs as a % of the net revenue budget over the medium-term financial planning period.

6.2 Legal

6.2.1 There are no direct legal implications of this report. All activity on capital financing, investments and borrowing is under current local authority powers under either the local government act or the capital finance and accounting regulations.

6.2.2 If for any reason the Council exceeded its authorised limit for external debt in a financial year, the S151 Officer would be required to report this to Council at the earliest opportunity. This would need to set out any implications of this action and would recommend a new authorised limit for the financial year for approval.

6.3 Risk

6.3.1 Any risk related issues are set out within the report. Risk management is an integral part of the Council's treasury management strategy, and these are considered as part of business-as-usual activities and are set out in more detail within the Treasury Management Practices document.

6.4 Human Rights, Public Sector Equality Duty and Community Cohesion

6.4.1 There are no applicable issues to consider within this report.

6.5 Climate Change / Environmental

6.5.1 There are no applicable issues to consider within this report.

6.6 Children and Young People Cared for by the Authority and Care Leavers

6.6.1 There are no applicable issues to consider within this report.

6.7 Data Protection / GDPR

6.7.1 There are no applicable issues to consider within this report.

Actions to be taken to implement the recommended decision(s)

Action	Responsible Officer	Deadline
To implement and monitor the 2024/25 prudential indicators and treasury management strategy	Head of Finance & Investments	1 April 2024 (and during the 2024/25 financial year)

Appendices

1	Prudential Indicators & Treasury Management Strategy for 2024/25

Background papers

There are no background papers to this report.

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