MIDDLESBROUGH COUNCIL	Middlesbrough moving forward

Report of:	Director of Finance
Relevant Executive Member:	Executive Member for Finance & Governance
Submitted to:	Executive
Date:	26 June 2024
Title:	Treasury Management Outturn Report – 2023/24
Report for:	Information
Status:	Public
Council Plan priority:	Delivering Best Value
Key decision:	No
Why:	Report is for information only
Subject to call in?:	No
Why:	Report is for information only

Proposed decision(s)
This report is for information purposes. However, it is an important aspect of the Council's financial reporting, its compliance with legislative requirements, and the local authority codes of practice on capital finance and treasury management. Both are cornerstones of good financial management by the organisation.

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

related decisions. It also sets out the parameters and criteria that govern the day-to-day cashflow management activity and how these impact on the 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 report sets out the year-end outturn results for the 2023/24 financial year against the annual treasury management strategy approved by Council and gives an analysis of the results achieved.

The key points for Members to note on this are as follows:

- No prudential or treasury management indicators agreed as part of the treasury strategy for 2023/24 were breached during the financial year.
- The amount of borrowing required during the year was lower than planned at £18.469m as against £27.436m in the original budget for the year due to slippage on capital schemes into future years.
- The Council’s need to borrow or Capital Financing Requirement (CFR) is £292.090m at 31 March 2024.
- The Council’s total external debt is £248.104m at 31st March 2024.
- The Council is therefore ‘under borrowed’ by £43.986m or 15.1% at the financial year end. This means that it is using its internal cash balances rather than borrowing externally on the market.
- This is in line with practice adopted by most other local authorities and avoids the cost of carry of any unnecessary external debt against the overall cashflow and liquidity need for the Council as it finances the delivery of its revenue and capital budgets.
- The Council’s external debt portfolio is predominantly long term from the Public Works Loan Board (PWLB) and has less reliance on short-term borrowing from local authorities than in previous years.
- Cash balances have been maintained at a minimum level during the financial year to minimise any further external borrowing required for cash flow purposes.
- All cash investments have been made in line with the Council’s credit worthiness criteria, generally with either central government or other local authorities.
- The net annual revenue cost of financing the Council’s current and historic debt, less income from its historic commercial investments and on cash balances is £9.235m or 7.4% of the net revenue budget for the financial year.
- The cost of capital financing in future years rises markedly over the medium-term financial plan to be almost 9% by 2026/27.

Whilst the Council is not an outlier in terms of its level of total debt measured by its CFR, it is starting to reach its limit of revenue affordability on borrowing to fund its future capital investment. It will need to prioritise its capital investment decisions over the medium and longer term and secure its financing through third party funds such as contributions and grants, and capital receipts from the sale of assets to maintain borrowing costs within affordable limits.

1. Purpose

1.1 This report provides important information regarding the regulation and management of the Council's borrowing, investments, and cash-flow for the 2023/24 financial year. It is a requirement of the Council's reporting procedures under the CIPFA Treasury Management Code of Practice, and by regulations issued under the Local Government Act 2003, to produce an annual review that covers the treasury activity and compares the performance against the original strategy set by the Council. It should be read in conjunction with the Council's revenue and capital outturn report for 2023/24, both of which have a significant impact on treasury arrangements.

1.2 The report also provides the Prudential Indicators results for 2023/24 in accordance with the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Capital Finance, which is best practice in terms of governance in this area.

2. Recommendations

2.1 That the Executive:

- Note the Prudential Indicators for 2023/24 as the Council's year-end position in relation to capital finance activities and overall indebtedness. (Tables 1- 5)
- Note the performance of the treasury management function against the Council's approved strategy for the last financial year. (Para 4.32 – 4.37)

3. Rationale for the recommended decision(s)

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

- Compliance with the CIPFA Prudential Code for Capital Finance for local authorities.
- Compliance with the CIPFA Treasury Management Code for local authorities.
- Compliance with the Local Government Act 2003 Section 1 in relation to borrowing.

4. Background and relevant information

4.1 The Council's treasury management strategy for 2023/24 (including prudential indicators) was approved at the annual budget setting meeting on 27 February 2023. The Authority both borrows and invests substantial sums of money to provide liquidity for its revenue and capital plans, and is therefore exposed to various financial risks, including the potential loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the treasury management strategy each year.

4.2 The Council is a net borrower overall. The borrowing required to fund its capital programme is significantly higher than its normal cash balances that are available for investments. As a result, the timing of capital financing decisions has a significant impact on the overall treasury strategy within the Council and how risk is managed.

4.3 The structure of this report to assess performance against the 2023/24 approved treasury strategy is as follows:

- Capital expenditure and financing for 2023/24
- The Council's overall borrowing need
- Prudential indicators and any compliance issues
- Treasury position as at 31 March 2024
- The economic background for the 2023/24 financial year
- A summary of the Treasury Management Strategy approved for 2023/24
- Treasury Management activity and compliance during 2023/24

Capital Expenditure and Financing 2023/24

4.4 The Council undertakes capital expenditure on long term assets, which can be financed as follows:

- immediately during the year of incurring the expenditure, through capital receipts, capital grants, contributions or from revenue.
- if insufficient financing is available, prudential borrowing can be used to spread these costs over future financial years.

4.5 Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies – predominantly the Public Works Loan Board (PWLB), other banks and financial institutions, or by utilising temporary cash resources within the Council (internal borrowing). The wider treasury activities also include managing the day-to-day cash flow position, its previous borrowing activities, and the investment of surplus funds from cash balances that are not required immediately. These activities are structured to manage risk foremost and then optimise performance where appropriate.

4.6 Capital Expenditure forms one of the prudential indicators that are used to regulate treasury activity. Table 1 shows total capital expenditure and how this was financed, compared with what was expected to be spent and how this would have been financed. Further information on the capital variances at directorate level can be found in the 2023/24 revenue and capital outturn report, but this predominantly relates to capital schemes that have not yet been delivered or grants received in advance of need.

Table 1: Capital expenditure and financing in £ millions

	2022/23 actual	2023/24 original budget	2023/24 revised budget	2023/24 actual	2023/24 variance
Prudential Borrowing	24.597	27.436	20.470	18.469	(2.001)
Capital Receipts	0.755	5.965	-	-	-
Flexible Use of Capital Receipts	-	-	3.000	2.399	(0.601)
Grants	30.653	45.542	48.588	26.375	(22.213)
Contributions	2.957	1.531	0.585	0.471	(0.114)
TOTAL	**58.962**	**80.474**	**72.643**	**47.714**	**(24.929)**

<u>The Council's overall borrowing requirement</u>

4.7 The Council's underlying need to borrow is called the Capital Financing Requirement. The CFR results from the capital activity of the Council and resources used to pay for the capital expenditure over time. It represents 2023/24 and prior years' net capital expenditure which has not yet been paid for by revenue, capital receipts or other external resources and therefore must be met from borrowing.

4.8 The CFR will normally be a combination of external borrowing (from third parties in the form of loan arrangements) or from internal borrowing (from the council's own unapplied revenue and capital resources). External borrowing incurs both principal and interest costs as part of the Council's capital financing budget. Internal borrowing is from the Council's own cash resources and has an opportunity cost in that the cash is spent on capital activities, rather than invested.

4.9 Part of the Council's treasury role is to meet the funding requirements for this borrowing need. Depending on the funding requirements of the capital programme, the treasury team organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the government, through the PWLB, or the money markets).

4.10 The Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory guidance is in place to ensure that capital expenditure is broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a principal loan repayment of the long-term borrowing need from the revenue budget.

4.11 The Council's capital financing requirement for the year is shown in Table 2 and represents a key prudential indicator for the Council. The CFR outturn for 2023/24 is

£292.090m which is £7.083m lower than forecast due to how repayments on loans made to outside bodies have been accounted for.

Table 2: change in the Capital Financing Requirement 2023/24 - in £ millions

Opening CFR at 1 April 2023	**284.748**
Add: Capital expenditure financed by borrowing	18.469
Less: Minimum Revenue Provision	(3.882)
Less: Other adjustments	(7.245)
Closing CFR at 31 March 2024	**292.090**
Approved CFR at Q3 2023/24	**299.173**

Treasury Position for 2023/24

4.12 Whilst the measure of the Council's underlying need to borrow is the CFR, the Director of Finance can manage the Council's actual borrowing position by:

- borrowing to the CFR level; or
- choosing to utilise some temporary cash flows instead of borrowing ("under borrowing").

4.13 Most local authorities have a degree of under borrowing within their CFR at present. This tends to be in the range of 10% - 20% of the total CFR. This means that external debt is lower than the need to borrow and other resources available have been used to bridge the gap. This strategy has been common as part of an approach to generating revenue savings in relation to annual capital financing costs, by deferring external borrowing, to a later point in time driven by cash flow needs.

4.14 The Council's treasury management debt and investment position is organised by the Finance and Investment service 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 and through officer activity detailed in the Council's Treasury Management Practices.

4.15 A summary of outstanding balances is shown below.

Table 3 – summary of borrowing and investments

Treasury Position	2022/23 Principal (£m)	Avg Rate (%)	2023/24 Principal (£m)	Avg Rate %
Public Works Loan Board	171.529	3.34	206.018	3.61
Banks	33.000	5.87	18.000	6.26
Other loans	41.359	3.79	24.086	7.00
Total Debt	**245.888**		**248.104**	
Cash Investments	(24.894)	2.81	(12.723)	4.93
Net Debt	**220.995**		**235.381**	

4.16 Just over 80% of the Council's total debt is with central government via the PWLB at 31 March 2024. These loans vary in length from between 5 – 45 years and in essence match the lives of the capital assets they are financing. Most of the bank debt was taken out in the early 2000's when interest rates were higher, but these options were more attractive than borrowing from central government at the time. Due to the terms and conditions on these loans, there is no option to refinance them in the short term.

4.17 The other loans represent short-term borrowing from other local authorities. At times the Council will need cash liquidity to finance its revenue and capital commitments but interest rates for long term borrowing are not in line with the overall treasury strategy. In these cases, it is better value to finance this cash need over short periods of time, normally 1-3 months, even if interest rates are higher at that point. This allows the Council time to monitor market rates on long term debt for temporary reductions in rates caused by fluctuations in economic data and government policy.

4.18 Cash investments are temporary surpluses in liquidity that are either invested with central government via the debt management office or with other local authorities with a cash need. Over £0.700m in interest was earned during 2023/24 on these balances.

4.19 The Council's total debt outstanding as at 31st March 2024 was £248.104m. The Council's revised CFR position was estimated to be £299.173m at Q3. However, the actual out turn position was £292.090m. When comparing this to our actual borrowing, this meant that the Council was "under borrowed" by £43.986m or 15.1%.

4.20 This "under borrowed" amount was financed by internal borrowing from cash balances which means that the amount that could have been invested externally was reduced to cover this. The reduced under borrowed position has the dual effect of reducing revenue costs incurred by the General Fund budget because borrowing costs are generally greater than investment returns. It also reduces counterparty risk by reducing our exposure to the inherent risks that exist in commercial banks and other financial institutions.

4.21 Gross Borrowing and the CFR – in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2022/23) plus the estimates of any additional capital financing requirement for the current (2023/24) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2023/24, if required. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator as debt levels continue to be much lower than needed.

Table 4 – Gross Borrowing to Capital Financing Requirement comparison in millions

	2022/23 Actual	2023/24 Original	2023/24 Actual
Gross External Borrowing	245.888	263.359	248.104
Capital Financing Requirement	284.748	297.562	292.090
(Under)/Over borrowing	**(38.860)**	**(34.203)**	**(43.986)**
% of CFR	13.6	11.5	15.1

4.22 **The Authorised Limit** – The Authorised Limit is the "Affordable Borrowing Limit" required by section 3 of the Local Government Act 2003. The Council does not have power to borrow above this level.

4.23 **The Operational Boundary** – The Operational Boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the Boundary are both acceptable, subject to the Authorised Limit not being breached.

4.24 **Actual financing costs as a proportion of net revenue expenditure** - This identifies the trend in the revenue cost of capital (borrowing and other long term obligation costs net of investment income) as a proportion of the Council's net revenue budget. The actual for this indicator has risen from the previous year due to an increase in the Financing costs outturn.

Table 5 – Key Prudential indicators in millions

	2022/23 actual	2023/24 actual	2024/25 forecast	2025/26 forecast	2026/27 forecast
Authorised Limit (£m)	356.000	**328.000**	372.000	396.000	393.000
Operational Boundary (£m)	326.000	**308.000**	352.000	376.000	373.000
Capital Financing Requirement (£m)	284.748	**292.090**	331.863	355.426	352.332
Financing costs (£m)	8.058	**9.235**	11.154	12.753	12.960
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%	8.8%

4.25 The table above also shows the profile of debt required to fund the capital programme over the whole of the medium-term financial planning period, and that this will rise to a maximum of £355.426m on 31st March 2026 before starting to reduce in the following financial year. This increase in indebtedness is a direct result of the amount required to fund the capital programme in each financial year, the EFS borrowing required, and any additional cash flow demands in each financial year.

4.26 Although the Council does not have relatively highly debt levels against its comparator authorities, the strain on the revenue budget is increasing. When CIPFA introduced the Capital Finance Code of Practice in 2007, a nominal amount of 10% of the net revenue budget was suggested as being a maximum threshold for sustainability and prudence. Although some councils have exceeded this over the years the S151 Officer would not advise Members to go much higher than current levels, particularly given the financial position and low level of unrestricted reserves.

4.27 The levels though do remain aligned to the operational boundary (the Council's capital planning total) and within the authorised limit approved by Members, which is the statutory limit for the Council in relation to external debt.

Economic Background 2023/24

4.28 A summary of the general economic conditions that have prevailed through 2023/24 provided by Arlingclose, the Council's treasury management advisors is attached at Appendix 1.

Summary of the Treasury Management Strategy agreed for 2023/24

4.29 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.

4.30 The borrowing approach outlined in the treasury strategy was to achieve the optimum value for money for the revenue budget by a combination of long-term borrowing from the Public Works Loan Board when interest rates reached a trigger rate of below 5% and the maturity term of the new borrowing fitted in with the Council's current debt portfolio. If these conditions did not exist when cash balances fell below £10.000m, then short term borrowing would be considered for the minimum period possible, given that interest rates were expected to rise over the period. Additionally short-term borrowing would be capped at a maximum of 20% of the total of the Council's gross external debt balance.

4.31 The approach to investing cash balances is to follow the relevant government and CIPFA guidance in prioritising and protecting the principal sums involved by only investing with institutions on the Council's approved lending list. This factor is paramount and more important than the higher interest rates that could be achieved on risker and illiquid investments with longer duration terms. Only 10% of total investments could be deposited for periods over one financial year given the higher levels of risk associated with these products.

Treasury Management activity during 2023/24

4.32 During the financial year, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the CFR), was not fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

4.33 All borrowing and investment activity undertaken during the financial year were in line with the approved strategy agreed for the financial year.

4.34 A total of £43.000m of new long-term borrowing was undertaken, with £10,000m of loans repaid. This was offset by the repayment of £24.415m of short-term borrowing and £6.369 of annuity loan repayments. The total level of external debt for the Council rose by £2.216m during 2023/24. All borrowing decisions were authorised in line with the treasury management policy and via consultation with external advisers.

4.35 Investments were made with either central government or other local authorities on an almost daily basis to ensure that the Council's overall liquidity position was protected. All principal sums invested have been repaid on time by each counterparty. The total interest earned on these temporary cash balances for 2023/24 was £0.729m and helped to balance the overall net capital financing budget.

4.36 The Councils Treasury Management function has complied with all the relevant statutory and regulatory requirements, which limit the levels of risk associated with its treasury management activities. The adoption and implementation of both the Prudential Code and the code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable and its treasury practices demonstrate a low-risk approach.

4.37 Officers of the Council are aware of the risks of passive management of the treasury portfolio and, with the support of Arlingclose, the Council's advisers, have proactively managed the debt and investments over the financial year.

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

5.1 Not relevant as the report is for information only.

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

Financial (including procurement and Social Value)

All relevant financial implications are outlined within the body of this report and the supporting appendix. The capital programme and financing being recommended in the budget report continues to remain affordable within the approved MTFP and revenue budget parameters. However, the Council needs to manage and prioritise its future capital investment and associated funding strategies more strictly over the term of the MTFP in order to maintain revenue cost of capital investment within affordable and prudent parameters. The prudential and treasury management indicators and processes remain robust and within prudent limits over the term of the MTFP.

Tables 3-5 outlines the key debt metrics, and the capital financing costs as a % of the net revenue budget over the medium-term financial planning period.

Legal

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.

Risk

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 maintained by the central finance team.

Human Rights, Public Sector Equality Duty and Community Cohesion

There are no applicable issues to consider within this report.

Climate Change / Environmental

There are no applicable issues to consider within this report.

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

There are no applicable issues to consider within this report.

Data Protection

There are no applicable issues to consider within this report.

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

Action	Responsible Officer	Deadline
Not applicable		

Appendices

1	Economic Background – 2023/24 financial year

Background papers

Body	Report title	Date
Council	Revenue Budget, Capital Programme, MTFS and Prudential Indicators – Budget Setting Report	27 February 2023

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