MIDDLESBROUGH COUNCIL	Middlesbrough moving forward

Report of:	Director of Finance

Relevant Executive Member:	Executive Member for Finance

Submitted to:	Executive

Date:	4 December 2024

Title:	Treasury Management Mid-Year review – 2024/25

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 for the Executive to comply with legislative requirements and the local authority codes of practice on capital finance and treasury management in respect of the Executive's requirement to formally note:

- the mid-year Prudential Indicator results for 2024/25 as the Council's current position in relation to capital finance activities and overall indebtedness.
- the performance of the treasury management function against the Council's approved strategy for the 2024/25 financial year to date.

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Executive summary

In accordance 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 Council is required to approve a Treasury Management Strategy and a set of Prudential Indicators on an annual basis. This self-regulates the level of capital financing activities of the Council and the long-term affordability and the value for money achieved in delivering capital investment and managing the short, medium and long-term borrowing and investment decisions of the Council.

The Treasury Management Strategy is therefore a critical foundation of the Council's financial management and governance framework and is a key aspect of securing the Council's financial recovery and long-term financial resilience.

The report sets out the 2024/25 mid-year performance against the annual treasury management strategy approved by Council and gives an analysis of the results achieved to date. The key points for Members to note on this are as follows:

Borrowing

- Treasury management activity has remained compliant with approved prudential management indicators during the first six months of 2024/25.
- The amount of borrowing required during the year is expected to be £19.894m compared to an approved budget of £36.437m due primarily to slippage in expenditure in the capital programme and a lower level of Exceptional Financial Support (EFS) being required than planned.
- The Council's underlying need to borrow which reflects the total of all historical capital expenditure financed from borrowing is called the Capital Financing Requirement (CFR) and is expected to be £305.707m on 31 March 2025.
- The Council does not borrow externally for the total amount of the CFR as it holds internal cash balances against which it borrows internally as part of its Treasury Management Strategy. Total external debt was £249.300m on 30/09/24.
- The Council is therefore expected to be 'under borrowed' by £27.513m or 9.0% at the financial year end. This means that it is using its internal cash balances rather than borrowing externally to fully fund the CFR. This is good practice to avoid unnecessary revenue costs and effective cashflow management.

Investments

- All cash investments have been made in line with the Council's credit worthiness criteria, generally with either central government or other local authorities.

Affordability

- 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 £11.154m or 7.8% of the net revenue budget for the financial year. This reflects the cost of loan principal repayment (Minimum Revenue Provision - MRP) and interest on external borrowing.
- The affordability limit advised by the s151 Officer is for revenue costs of capital financing to be contained within 10% of the net revenue budget.
- The cost of capital financing in future years rises markedly over the medium-term financial plan to be just over 9% by 2026/27 See Table 5.
- The long-term forecast shows costs approaching 10% by 2029. This will limit the availability of borrowing as a source of funding future capital investment and more reliance will be required on external funding and capital receipts and/ or projects for which investment will reduce operating costs or increase operating income of the Council.

The work of the Corporate and Strategic Capital Boards will bring focus to improving the effectiveness of capital programme management in the future.

1. Purpose

1.1 This report provides an important update to the Executive on performance in relation to the Council's borrowing, investments, and cash-flow for the 2024/25 financial year to meet the requirements of the CIPFA Treasury Management Code of Practice and the Local Government Act 2003. It should be read in conjunction with the Council's revenue and capital quarter two budget monitoring report for 2024/25 to understand the full financial position of the Council.

1.2 The report also provides the mid-year Prudential Indicators results for 2024/25 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 mid-year Prudential Indicator results for 2024/25 as the Council's current 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 2024/25 financial year to date. (Para 4.33 – 4.38)

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 2024/25 (including prudential indicators) was approved at the annual budget setting meeting on 8 March 2024. 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 operational purposes and investments. As a result, the timing of capital financing decisions has a significant impact on the overall treasury strategy within the Council, the total cost involved and how risk is managed.

4.3 The structure of this report to assess performance against the 2024/25 approved treasury strategy for the financial year to date is as follows:

- Capital expenditure and financing for 2024/25.
- The Council's overall borrowing need.
- Prudential indicators and any compliance issues.
- Treasury position on 30 September 2024.
- The economic background for the 2024/25 financial year so far.
- A summary of the Treasury Management Strategy approved for 2024/25.
- Treasury Management activity and compliance to date.

Capital Expenditure and Financing 2024/25

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 forecast capital expenditure for the year and how this is expected to be financed. Further information on the capital variances at directorate level from the original budget and what impact this has had on the overall financing of the programme can be found in the 2024/25 quarter two revenue and capital budget monitoring report.

Table 1: Capital expenditure and financing: 2023-24 FY to 2026-27 FY

	2023/24 actual (£m)		**2024/25 original budget (£m)**	**2024/25 forecast outturn (£m)**	**2024/25 variance (£m)**		**2025/26 original budget (£m)**	**2025/26 revised budget (£m)**	**2025/26 variance (£m)**		**2026/27 original budget (£m)**	**2026/27 revised budget (£m)**	**2026/27 variance (£m)**
Prudential Borrowing	18.469		23.037	11.694	(11.343)		28.009	28.803	0.794		1.913	8.282	6.369
EFS Borrowing	-		13.400	8.200	(5.200)		-	-	-		-	-	-
Capital Receipts	-		6.000	6.000	-		6.000	6.000	-		6.000	6.000	-

Flexible Use of Capital Receipts	2.399		13.700	6.544	(7.156)		7.700	14.856	7.156		5.300	5.300	-
Grants	26.375		29.897	38.813	8.916		27.931	44.241	16.310		-	3.404	3.404
Contributions	0.471		2.515	1.295	(1.220)		3.578	2.638	(0.940)		-	4.865	4.865
TOTAL	**47.714**		**88.549**	**72.546**	**(16.003)**		**73.218**	**96.538**	**23.320**		**13.213**	**27.851**	**14.638**

The Council's overall borrowing requirement

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 2024/25 and prior years' net capital expenditure which has not yet been paid for from 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 next three financial years is shown in Table 2 and represent a key prudential indicator for the Council. The CFR position at the mid-year position for 2024/25 is expected to be £305.707m which is £26.156m lower than forecast at the start of the financial year. This is due to:

- a rebasing of the CFR calculation at the 2023/24 year-end of £9.613m to take into third party loan repayments.
- a reduction in the borrowing requirement for the capital programme of £16.543m including
    - a reduction of £5.2m in the expected need to rely upon exceptional financial support due to achievement of planned capital receipts from asset sales.

- o Slippage in the capital programme and large reductions in the CFR carry forward to the two subsequent years of £11.343m.

Table 2: expected change in the Capital Financing Requirement 2024/25 to 2026/27 FY

	2024/25 (£m)	2025/26 (£m)	2026/27 (£m)
Opening CFR at 1 April	**290.159**	**305.707**	**329.810**
Add: Capital expenditure financed by borrowing	19.894	28.803	8.282
Less: Minimum Revenue Provision	(4.316)	(4.700)	(5.323)
Forecast closing CFR at 31 March	**305.707**	**329.810**	**332.769**
Approved CFR 2024/25 – budget setting	**331.863**	**355.426**	**352.332**
Variance on CFR since budget set	(26.156)	(25.616)	(19.563)

Mid-year Treasury Position for 2024/25

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 a Treasury Management 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/liquidity needs of the organisation. It also mitigates the Council's risk exposure on investments with external counterparties.

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 spending needs, 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. These practice statements are available for officers, members, auditors, regulators, and members of the public to review if required.

4.15 A summary of outstanding balances is shown below.

Table 3 – summary of borrowing and investments and movement since 2023/24-year end position

Treasury Position	2023/24 Outturn Principal (£m)	Avg Rate (%)	2024/25 mid-year Principal (£m)	Avg Rate %
Public Works Loan Board	186.404	3.61	201.418	3.63
LOBO loans	18.000	6.26	18.000	6.26
Bank loans	13.900	7.00	18.582	7.00
Short term borrowing	29.800	3.85	11.300	3.63
Total Debt	**248.104**		**249.300**	
Cash Investments	(12.723)	4.83	(22.213)	4.56
Net Debt	**235.381**		**227.087**	

4.16 Around 85% of the Council's total debt is with central government via the PWLB on 30 September 2024. These loans vary in length from between 5 – 45 years and in essence, these match the lives of the capital assets they are financing. Most of the Lender Option Borrower Option (LOBO) and Bank debt was taken out by the Council 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 type of financial instrument used is 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 longer term borrowing may not in line with the overall treasury strategy and ambitions. 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 any temporary reductions in rates caused by fluctuations in economic data (both UK and worldwide) and in 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 to borrow. Over £0.700m in interest is forecast to be earned during 2024/25 on these balances at an average rate of around 4.6%.

4.19 The Council's total debt outstanding as at 31st March 2024 was £249.300m. The Council's revised CFR position was estimated to be £305.707m at Quarter Two. This means that the Council was "under borrowed by £56.407m or 18.5%. Most borrowing to date has been to replace maturing short term debt and therefore most of the capital programme borrowing for the financial year still needs to be taken.

4.20 This “under borrowed” amount is currently 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 (2023/24) plus the estimates of any additional capital financing requirement for the current (2024/25) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure and allows the Council some flexibility to borrow in advance of its immediate capital needs in 2024/25, if required.

4.22 Table 4 sets out the Council’s gross borrowing position against the CFR and shows **compliance with this prudential indicator** as debt levels continue to be lower than required over the medium term.

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

	2023/24 Actual	2024/25 Original	2024/25 Mid-year	2025/26 Forecast	2026/27 Forecast
Gross External Borrowing	248.104	310.535	278.194	306.997	315.279
Capital Financing Requirement	292.090	331.863	305.707	329.810	332.769
(Under)/Over borrowing	**(43.986)**	**(34.203)**	**(27.513)**	**(22.813)**	**(17.490)**
% of CFR	15.1	10.3	9.0	6.9	5.3

4.23 **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.

4.24 **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.

4.25 **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

	2023/24 actual	**2024/25 mid-year**	**2025/26 forecast**	**2026/27 forecast**
Authorised Limit (£m)	328.000	**372.000**	370.000	373.000
Operational Boundary (£m)	308.000	**326.000**	350.000	353.000
Capital Financing Requirement (£m)	292.090	**305.707**	329.810	332.769
Financing costs (£m)	9.235	**11.154**	13.253	13.960
Net Revenue Budget (£m)	126.354	**143.190**	148.601	152.176
Proportion of net revenue budget (%)	7.4%	**7.8%**	8.9%	9.2%

4.26 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 £332.769m on 31st March 2027. 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 due to the use of reserves and debt refinancing.

4.27 Although the Council does not have relatively highly debt levels against its comparator authorities, the strain on the revenue budget is increasing, particularly against the 2025/26 and 2026/27 budgets. 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's advice is to contain capital expenditure financed by borrowing at a level which remains below this benchmark. This is particularly important given the Council's fragile financial position and the low level of unrestricted revenue reserves.

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

Economic Background 2024/25

4.29 A summary of the general economic conditions that have prevailed through the first six months of the 2024/25 is attached at Appendix 1 for information. This has been provided the Council's external treasury adviser and gives some context on the current economic drivers that are influencing interest and bond rates at present.

Summary of the Treasury Management Strategy agreed for 2024/25.

4.30 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.

4.31 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 4.75% 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.

4.32 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 fact that 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 2024/25

4.33 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.

4.34 All borrowing and investment activity undertaken so far during the financial year has been in line with the approved strategy agreed, with no exceptions.

4.35 A total of £20m of new long-term borrowing was undertaken from the PWLB, with £18.800m repaid on either maturity or annuity loans. The total level of external debt for the Council rose by £1.200m during the first six months of 2024/25. Significant borrowing is still required to fund the capital programme, EFS and liquidity requirements over the remainder of the financial year. A further £30m - £35m is still required. Any borrowing decisions will be undertaken in line with the Council's approved treasury management policy and via consultation with external advisers. All the costs of the above debt decisions have been factored into the medium-term financial plan and are fully funded.

4.36 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 2024/25 is expected to be £0.700m and helps to balance the overall net capital financing budget of £11.154m.

4.37 The Councils Treasury Management function has complied with all the relevant statutory and regulatory requirements to date during 2024/25, 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, financially affordable, and sustainable, and its treasury practices demonstrate a low-risk approach.

4.38 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 to maintain the 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 2003 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 – 2024/25 financial year – first six months

Background papers

Body	Report title	Date
Council	Revenue Budget, Capital Programme, MTFS and Prudential Indicators – Budget Setting Report	8 March 2024

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