MIDDLESBROUGH COUNCIL	

Report of:	Director of Finance & Transformation (S151 Officer)
Relevant Executive Member:	Executive Member for Finance
Submitted to:	Executive
Date:	5 February 2025
Title:	Prudential Indicators and Treasury Management Strategy Report - 2025/26
Report for:	Decision
Status:	Public
Council Plan 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

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 any decisions made. 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 four years, how this has been financed, the maximum level of external debt and the cost to the revenue budget.

The Minimum Revenue Provision (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 current MRP policy is based on a 2% annuity model in line with many other local authorities. The Council took this decision during the 2022/23 financial year to review the MRP policy, the effect of which is to achieve improved affordability on an annual basis over the short to medium term, although there are higher revenue charges in 25 – 50 years' time.

The Council's underlying need to borrow is measured by the Capital Financing Requirement which is forecast to be £310.197m during 2025/26 rising to £333.295m by the end of 2026/27 and decreasing slightly thereafter. This results in the revenue cost of borrowing as shown below.

	2023/24 actual	**2024/25 forecast**	**2025/26 forecast**	**2026/27 forecast**	**2027/28 forecast**	**2028/29 forecast**
Financing costs (£m)	9.376	11.154	**12.060**	13.732	14.685	15.404
Net Revenue Budget (£m)	126.354	143.190	**143.362**	144.356	148.595	152.947
Proportion of net revenue budget (%)	7.4%	7.8%	**8.4%**	9.5%	9.9%	10.1%

Whilst the Council is not an outlier in terms of its level of total debt (see the graph below), it is reaching 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 minimise future borrowing.

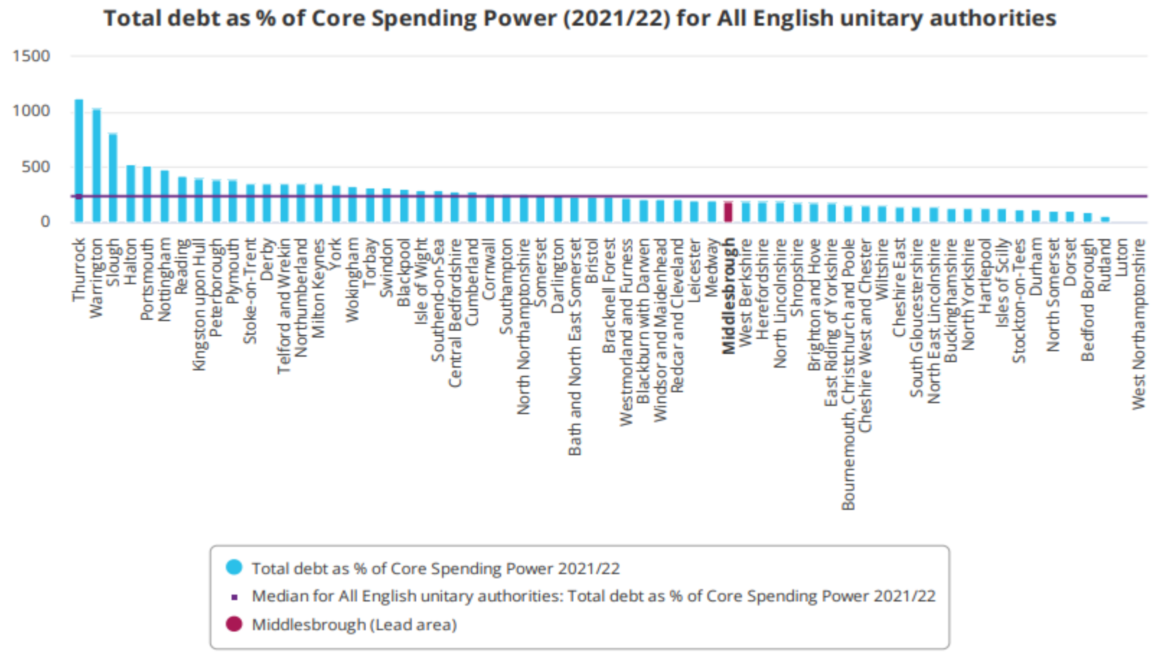
Total debt as percentage of core spending power

'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.



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

1. **Purpose**

This report outlines the Council's prudential indicators for the financial years 2025/26 – 2028/29 and sets the framework and approves the limits within which the treasury management operations for this period will work. It fulfils key legislative and guidance requirements as follows:

(a) The setting of the prudential indicators setting out 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 historic capital debt for the financial year.

(d) The Authorised Limit for External Debt for the financial year. This is the maximum amount of borrowing that the Council can enter into, with any amount above this limit being deemed illegal.

(e) The Annual 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 from the perspective of the S151 Officer.
- An integral part of the Council's Revenue and Capital Medium Term Financial Plans.

2. Recommendations

That the Executive is requested **to approve that the following are forwarded to Council for approval** as set out below.

- The Prudential Indicators and Limits for 2025/26 to 2028/29 relating to capital expenditure and treasury management activity set out in tables 1 to 10 of Appendix 1.
- The Treasury Management Strategy for 2025/26, which includes the Annual Investment Strategy for that financial year.
- The Minimum Revenue Provision (MRP) Policy for the 2025/26 financial year.
- An Authorised Limit for External Debt of £331 million for the 2025/26 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**

5. The PI & TMS report for the Council for 2025/26 covers the following areas:

- How the capital programme for the MTFP period is financed.
- 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 financed by prudential borrowing.
- 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 – This determines how much the Council accounts for in terms of the revenue costs of historical capital debt. These costs have been incurred in relation to historical and future capital investment in its asset base to support the operational delivery of services.

6. 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.

7. 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).

<u>Prudential Indicators and Capital Investment Plans</u>

8. 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.

9. 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 2025/26 financial year.

10. There is total outstanding debt of £245.860 million on 31 December 2024, with circa £25m of borrowing expected to be required before 31 March 2025.

11. The forecast overall total long term external debt at the end of 2024/25 of £270.303 million, should be compared with the estimated *Capital Financing Requirement* (the underlying value which the Council needs to borrow to fund capital activities) of £297.816million. The Council therefore has an expected under-borrowed position of £27.513 million, which provides some savings in interest payments as other revenue and capital cash has been used in lieu of borrowing. This is a key strategic decision each year as to whether the under-borrowing position is increased or reduced.

12. Table 6 in Appendix 1 shows the profile of outstanding debt over the whole of the medium-term financial planning period, and this will rise to a maximum of £333.295m on 31st March 2027 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, and any additional cash flow demands in each financial year.

13. The Council holds revenue budgets for repaying debt and interest (known as Capital Financing Costs). The repayment of debt costs for 2025/26 are £12.060million (8.4% of the net revenue budget for 2025/26). For comparison purposes the forecast capital financing costs in 2024/25 are expected to be £11.154 million (which represented 7.8% of the planned net revenue budget for 2024/25).

Prudential Indicator	2024/25 (£m)	2025/26 (£m)	2026/27 (£m)	2027/28 (£m)	2028/29 (£m)
Capital Financing Requirement (underlying need to borrow)	**297.816**	**310.197**	**333.295**	**327.929**	**321.994**
External Borrowing	270.303	292.388	320.568	320.568	315.568
Internal Borrowing	27.513	17.809	12.727	7.361	6.426
% of Net Revenue Budget on debt costs	7.8%	8.4%	9.5%	9.9%	10.1%
Authorised limit for External Debt	318.000	331.000	354.000	348.000	342.000

14. The table above illustrates the key figures from paragraphs 11-13 and how these change over the period to 2028/29. It also shows that the proportion of capital financing costs is increasing over the period due to the level of external debt required

for the capital programme and due to the annuity policy adopted for minimum revenue provision that unwinds over time.

15. 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, a nominal amount of 10% of the net revenue budget was suggested as being a 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, particularly given the financial position and low level of unrestricted reserves.

16. It is also 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 2024/25 is £318 million, with this increasing to £331 million for 2025/26 due to an increase in the level of borrowing required for the financial year.

17. It should be noted that the authorised limit for the Council is currently higher than either the level of external debt or the capital financing requirement. This is not uncommon within local authorities to build in extra headroom for unexpected capital investment, possible debt re-financing opportunities and the remote possibility of needing to borrow for any further exceptional revenue purposes. At present, the Council's authorised limit is set at £20m above its capital financing requirement and allows a degree of flexibility within the Council's planning processes and this legal limit. As suggested above, it is not recommended to go beyond the capital financing requirement unless this is only for temporary and defined purposes.

<u>Treasury Management</u>

18. 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.

19. 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.

20. Given that credit criteria are the most important factor when making an investment decision, the Council receives regular updates from its 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 (financial institution) and the maximum duration for any fixed term deposits made. This framework helps to protect against the loss of any sums invested (credit risk), ensuring liquidity is not compromised, and that these investments earn interest to support the revenue budget.

21. On 31 December 2024, the Council had cash balances of £35.021 million 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 £15.000 million below which the Council will look to borrow to maintain liquidity. The amount currently is higher than normal, due to asset sales that have happened during the 2024/25 financial year and have not yet been spent. This means that external borrowing has been lower as result of this additional income.

22. 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 capital programme 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).

23. Out of the £245.860 million worth of external debt on 31 December 2024, 86% is long term from the Public Works Loan Board – the government agency for local authority borrowing and 14% is long term with financial institutions (generally banks). There is also £7.4m short-term borrowing in place at present.

24. Current long term interest rates for borrowing from the PWLB are between 5.0% and 5.8% depending on the length of the loan (local authorities can borrow up to 50 years from central government) with short term rates being between 5.25% and 6.0% for up to one year in duration.

25. 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.

26. 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 outlawed any local authority applications for this type of activity from 1st April 2021 with Section 151 Officers having to confirm each year that their investment plans do not contain any of these types of activity.

27. 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, with funding from the PWLB if required.

<u>Knowledge & Skills</u>

28. 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.

29. 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.

30. 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 a new programme of activity for members of the Executive and Audit Committee will be provided over the next 12 months. This is important given the level of new members at the last election and some of the financial challenges facing the Council over the medium-term financial plan.

Minimum Revenue Provision

31. 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 2022/23 moved to an annuity basis of calculating these revenue costs. No changes are being proposed to the MRP policy for 2025/26 financial year and there is no further scope to make annual savings beyond this on a prudent basis. This policy is set out at the end of Appendix 1 for information.

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

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

Impact(s) of the recommended decision(s)

33. 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 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.

Financial (including procurement and Social Value)

34. 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 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.

35. The table between paragraphs 13 and 14 outlines the key debt metrics and the capital financing costs as a % of the net revenue budget over the medium-term financial planning period.

36. Other impact areas are considered in the table below:

Topic	Impact
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.
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
To implement and monitor the 2025/26 prudential indicators and treasury management strategy	Head of Finance & Investment	1 April 2025 (and during the 2025/26 financial year)

Appendices

1	Prudential Indicators & Treasury Management Report for 2025/26 to 2028/29

Background papers

Body	Report title	Date
Council	Prudential Indicators and Annual Treasury Management Strategy – 2024/25	08/03/24
Executive	Prudential Indicators and Treasury Management Strategy Report – Mid Year review 2024/25	04/12/24

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