MIDDLESBROUGH COUNCIL	

Report of:	Director of Finance and Transformation (S151 Officer)
Submitted to:	Audit Committee
Date:	13 March 2025
Title:	Prudential Indicators & Annual Treasury Management Strategy – 2025/26
Report for:	Discussion
Status:	Public
Council Plan priority:	Delivering Best Value

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.

Whilst the Executive is responsible for the setting and monitoring of the annual strategy, the CIPFA Code requires a separate body within the organisation to be responsible for the scrutiny of treasury management activities and any decision-making undertaking. Given its governance role, Audit Committee is seen as best placed to undertake this role and ensure officers and the Executive are held to account so that the Council complies with best practice.

This report sets out the 2025/26 Annual Treasury Management Strategy and Prudential Indicators approved by Council on 19 February 2025 and gives an analysis of the key matters in the report. The key points for Members to note on this are as follows:

<u>Borrowing</u>

- The capital programme for 2025/26 contains total expenditure of £74.798m.
- The amount of borrowing required during the year is expected to be £17.085m

- 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 £310.197m on 31 March 2026.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 is expected to be £270.303m on 31/3/2025, rising to £292.388m at 31/3/2026.
- The Council is expected to be 'under borrowed' by £17.809m or 5.7% at the 2025/26 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.

<u>Investments</u>

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

<u>Affordability</u>

- 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 expected to be £12.060m or 8.4% of the net revenue budget at 31/3/2026. 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 and is expected to breach this level this in 2028/29. See Table 5.
- The long-term forecast shows capital financing costs breaching the 10% nominal threshold by 2029. This will limit the availability of external borrowing as a source of funding future capital investment and more reliance needs to be placed on external funding and capital receipts and/ or projects for which investment will reduce operating costs or increase operating income of the Council. The S151 officer will advise what is affordable going forwards, in terms of the Council's overall financial position, and affordability, in terms of the medium-term financial plan.

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

The main body of the report gives more details for Audit Committee on the framework used to manage treasury management and the capital financing position of the Council. The CIPFA Treasury Management Code of Practice. Effective scrutiny in this context involves publicly examining and challenging the leadership of the Council to help shape future strategies and policies to ensure that good governance is in place and that resources are used effectively and value for money is achieved.

1. Purpose

1.1 This report provides an important update to the Audit Committee on the strategic approach in relation to the Council's borrowing, investments, and cash-flow for the 2025/26 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 Treasury Management mid-year review 2024/25, reported to Members on 12 December 2024.

1.2 The report also provides the Prudential Indicators approved by Council for the 2025/26 financial year 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.

1.3 The report gives Audit Committee information on the treasury management strategy, position on capital financing and prudential indicators, and whether these are contributing to the effective management of the capital programme and the resources allocated to pay for these, as part of the revenue budget process.

2. Recommendations

2.1 That the Audit Committee

- Note the Prudential Indicator amounts for 2025/26 as the Council's forecast position in relation to capital finance activities and overall indebtedness. (Tables 1- 5)
- Note the overall approach expected for this financial year in relation to external borrowing, investment of cash balances, and management of the debt portfolio.
- Review the Treasury Management Strategy and ask for any further details or explanation as they require either from the Executive or Officers.

3. Background and relevant information

3.1 The Council's annual treasury management strategy for 2025/26 (including prudential indicators) was approved at the annual budget setting meeting on 19 February 2025. 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.

3.2 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.

Capital Expenditure and Financing 2025/26

3.3 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.

3.4 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.

3.5 Capital Expenditure forms one of the prudential indicators that are used to regulate treasury activity. Table 1 shows total forecast capital expenditure for the next three financial years and how this is expected to be financed.

Table 1: Capital expenditure and financing: 2024-25 FY to 2028-29 FY

	2024/25	**2025/26**	**2026/27**	**2027/28**
FUNDED BY:	£m	£m	£m	£m
Prudential Borrowing	12.003	17.085	28.180	-
Capital Receipts	6.000	6.000	6.000	11.613
Flexible Receipts	9.850	7.500	6.750	6.250
Grants	35.713	43.230	15.558	-
Contributions	1.592	0.983	6.520	-
Total Capital Expenditure	**65.158**	**74.798**	**63.008**	**17.863**

The Council's overall borrowing requirement

3.6 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 2025/26 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.

3.7 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.

3.8 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).

3.9 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.

3.10 The Council's capital financing requirement for the next three financial years is shown in Table 2 and represents a key prudential indicator for the Council. The CFR position at the 31/3/2026 is expected to be £310.197m which is £12.381m higher than at the start of the financial year. This is due to capital expenditure funded by borrowing offset by debt repayment via minimum revenue provision as follows:

Table 2: expected change in the Capital Financing Requirement 2025/26 to 2027/28 FY

	2025/26 (£m)	2026/27 (£m)	2027/28 (£m)
Opening CFR at 1 April	**297.816**	**310.197**	**333.295**
Add: Capital expenditure financed by borrowing	17.085	28.180	-
Less: Minimum Revenue Provision	(4.704)	(5.082)	(5.366)
Forecast closing CFR at 31 March	**310.197**	**333.295**	**327.929**

<u>Treasury Position at the start of 2025/26</u>

3.11 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").

3.12 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.

3.13 The Council's treasury management debt and investment position is organised internally by the Corporate Finance 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.

3.14 A summary of outstanding balances is shown below.

Table 3 – summary of borrowing and investments as at 31 December 2024

Treasury Position	2024/25 mid-year Principal (£m)	Avg Rate %
Public Works Loan Board	201.418	3.63
LOBO loans	18.000	6.26
Bank loans	18.582	7.00
Short term borrowing	11.300	3.63
Total Debt	**249.300**	
Cash Investments	(22.213)	4.56
Net Debt	**227.087**	

3.15 Around 85% of the Council's total debt is with central government via the PWLB on 31 December 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.

3.16 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.

3.17 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. Around £1.000m in interest is forecast to be earned during 2024/25 on these balances at an average rate of around 4.7%.

3.18 The Council's total debt outstanding on 31st March 2026 is expected to be £292.388m. The Council's CFR position at the same date is estimated to be £310.197m. This means that the Council is expected to be "under borrowed by £17.809m or 5.7%.

3.19 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 financial institutions.

3.20 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 (2024/25) plus the estimates of any additional capital financing requirement for the current (2025/26) 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 2025/26, if required.

3.21 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

	2024/25 Outturn	2025/26 Budget	2026/27 Forecast	2027/28 Forecast
Gross External Borrowing	270.133	292.388	320.568	320.568
Capital Financing Requirement	297.816	310.197	333.295	327.929
(Under)/Over borrowing	**(27.683)**	**(17.809)**	**(12.727)**	**(7.361)**
% of CFR	9.3	5.7	3.8	2.2

3.22 **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.

3.23 **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.

3.24 **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

	2024/25 Outturn	**2025/26 Budget**	**2026/27 forecast**	**2027/28 forecast**
Authorised Limit (£m)	318.000	**331.000**	354.000	348.000
Operational Boundary (£m)	308.000	**321.000**	344.000	338.000
Capital Financing Requirement (£m)	297.816	**310.197**	333.295	327.929
Financing costs (£m)	11.154	**12.060**	13.732	14.685
Net Revenue Budget (£m)	143.190	**143.304**	144.382	148.621
Proportion of net revenue budget (%)	7.8%	**8.4%**	9.5%	9.9%

3.25 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 £333.295m 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, and any additional cash flow demands in each financial year due to the use of reserves and debt refinancing.

3.26 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 2026/27 and 2027/28 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.

3.27 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.

Summary of the Treasury Management Strategy agreed for 2025/26.

3.28 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.

3.29 The borrowing approach outlined in the treasury strategy is to achieve the optimum value for money from revenue budget resources, 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 do not exist when cash balances fall below £10.000m, then short term borrowing will be considered for the minimum period possible, given that interest rates are expected to remain stable over the period. Additionally short-term borrowing is capped at a maximum of 20% of the total of the Council's gross external debt balance to limit volatility.

3.30 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. Cash investments should not fall below a minimum limit of £10.000m, in line with the strategic approach outlined above for external borrowing.

3.31 The Council's Treasury Management function will comply with all the relevant statutory and regulatory requirements to date during the 2025/26 financial year, which limits the level 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.

3.32 Officers of the Council are aware of the risks of passive management in relation to the treasury portfolio and, with the support of Arlingclose, the Council's advisers, will proactively manage the debt and investments over the financial year.

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

4.1 Not relevant as the report is for discussion and scrutiny purposes only.

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

Topic	Impact
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.

Appendices

1	Prudential Indicators & Annual Treasury Management Strategy – 2025/26

Background papers

Body	Report title	Date
Council	Revenue Budget, Capital Programme, MTFS and Prudential Indicators – Budget Setting Report	19 February 2025
Audit Committee	Treasury Management Strategy – Mid Year Review – 2024/25	12 December 2024

Contact: Justin Weston, Head of Corporate Finance
Email: justin_weston@middlesbrough.gov.uk