North Somerset Council

Report to the Audit Committee

Date of Meeting: 25 April 2024

Subject of Report: Treasury Management Indicators 2023/24 - Quarter 3 update

Town or Parish: All

Officer Presenting: Mark Anderson, Principal Accountant, Resources & Financial Planning

Key Decision: No

Reason:
Not an Executive decision

Recommendations

The Audit Committee is asked to note the treasury management prudential indicators and the treasury indicators for Quarter 3 of 2023/24.

1. Summary of Report

The 2021 editions of the Prudential Code and the Treasury Management Code (adopted by the council for 2023/24) introduced a requirement that monitoring of both the prudential and treasury management indicators should be reported to Members on a quarterly basis.

This is the third treasury report for 2023/24 presented to the Audit Committee;

- Quarter 1 was incorporated in the 2022/23 out-turn report in September 2023,
- Quarter 2 (or the mid-year report) was reported in November 2023,
- Due to the 2024/25 Strategy report being taken to the January 2024 Audit Committee, the 2023/24 Quarter 3 update is being taken to this, the next available Audit Committee meeting in April 2024,
- The final 2023/24 out-turn report will be reported to the Audit Committee in September 2024.

2. Policy

The council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the council to consider and approve a series of reports throughout the year on treasury, investment and capital financing strategy, governance and in-year performance monitoring related issues.

3. Details

3 Prudential Indicators

3.1 The Prudential Code aims to improve the transparency and consistency of capital investment decisions and so has developed a series of defined **prudential indicators** which ensures that those charged with governance all receive information in a clear and consistent way. The indicators defined within the Code, which are listed in Appendix 2, are focused on being able to understand a forecast of the council's overall debt levels, in conjunction with the capital programme and investment decisions, and how and when this external borrowing will be repaid.

3.2 It should be noted that all of the values presented below currently exclude the potential impact of the adoption of IFRS16 – Leases, which is due to impact on the council's 2024/25 Accounts. The adoption of this accounting standard is likely to result in new "right of use" assets being created on the council's balance sheet following a review of the council's lease arrangements. Assets, lease liabilities and capital financing requirement values will be restated once this work has been completed.

<u>Quarter 3 monitoring of Prudential Indicators</u>

3.3 The council measures and manages its capital expenditure, borrowing and commercial and service investments with references to the following indicators.

3.4 **Capital Expenditure:** The council has developed and approved a multi-year capital programme and the latest forecast of planned capital expenditure is summarised below:

Table 1.1 Capital Expenditure

	Actual 2022/23 £m	Forecast 2023/24 £m	Estimate 2024/25 * £m	Estimate 2025/26 £m
Capital investments (£m)	66.5	105.0	171.0	127.6

3.5 The council has incurred £33.9m of spend on capital projects to date. Investment in year includes £14.5m on the completion of two new schools, £2.6m on housing related projects as well as £15.9m on Place-related schemes, which include planning and design stages of Banwell Bypass, design and implementation of Bus Service Improvement Plan projects, and investment in numerous other highways schemes. The council has not incurred any capital expenditure on its commercial investments.

3.6 **Capital Financing Requirement:** The council's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with repayments of principal (minimum revenue provision, known as MRP) and capital receipts used to replace debt. The CFR is expected to increase by £21m during 2023/24. Based on the forecast figures for expenditure and financing, the council's estimated CFR is as follows:

3.7 The actual CFR is calculated on an annual basis and is included in each year's statutory accounts. The relationship between total CFR, which includes historic ex-Avon debt and finance leases, and Loans CFR is shown in the table below.

Table 1.2: Estimates of Capital Financing Requirement in £ millions

	Actual 2022/23 £m	Forecast 2023/24 £m	Estimate 2024/25 * £m	Estimate 2025/26 £m
CFR	182.2	190.2	206.9	230.3
Less: CFR re finance leases	22.1	21.3	20.9	20.5
Less: CFR re ex Avon debt	11.3	10.8	10.4	10.0
Loans CFR	**148.8**	**158.1**	**175.6**	**199.8**

Projected levels of the council's total outstanding debt (which comprises borrowing, leases and transferred debt) are shown below, compared with the capital financing requirement (see above).

3.8 **Gross Debt and the Capital Financing Requirement:**

In this indicator, projected levels of the council's total outstanding external debt (which comprises borrowing and leases) are compared with the Capital Financing Requirement. The Capital Financing Requirement measures the council's underlying need to borrow for a capital purpose for the current and future year. The actual Capital Financing Requirement as at the year-end is included in each year's statutory accounts.

Table 1.3: Gross Debt and the Capital Financing Requirement

	Actual 2022/23 £m	Forecast 2023/24 £m	Estimate 2024/25 * £m	Estimate 2025/26 £m	Debt at 31/12/23 £m
Debt (incl. leases)	170.3	175.7	173.8	177.3	163.1
Capital Financing Requirement	182.2	190.2	206.9	230.3	

3.9 Statutory guidance is that debt should remain below the capital financing requirement, except in the short term. As can be seen from the table above, the council expects to comply with this requirement in the medium-term.

3.10 **Debt and the Authorised Limit and Operational Boundary:** The council is legally obliged to set an affordable borrowing limit (also termed the Authorised Limit for external debt) each year and to keep it under review. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

3.11 **The authorised limit** is the 'affordable borrowing limit' which the council is required to set in section 3 of the Local Government Act 2003 and cannot be exceeded without acting ultra vires. The authorised limit is set at a higher level than the operational boundary to provide headroom for unexpected borrowing requirements.

3.12 **The operational boundary / limit** should be the council's best estimate of the most likely, prudent, maximum levels of debt to be held during the years in question. The boundary can be exceeded in the short-term should the council need to undertake temporary borrowing, or debt rescheduling, but should not be exceeded for new long-term borrowing proposals.

Table 1.4: Debt and the Authorised Limit and Operational Boundary

	Maximum debt 2023/24 £m	Debt at 31/12/23 £m	2023/24 Authorised Limit £m	2023/24 Operational Boundary £m	Complied? Yes/No
Borrowing	137.5	129.7	225.0	208.0	Yes
Other (ex-Avon debt and finance leases)	33.4	33.4	40.0	35.0	Yes
Total debt	**170.9**	**163.1**	**265.0**	**243.0**	Yes

3.13 Since the operational boundary is a management tool for in-year monitoring it is not significant if the boundary is breached.

3.14 **Net Income from Commercial and Service Investments to Net Revenue Stream:** The council's income from commercial and service investments as a proportion of its net revenue stream has been and is expected to be as indicated below. The net impact or return into the revenue budget is Nil for the year however this is after transfers to / from reserves. The latest forecast indicates that the council will contribute the net surplus of £0.3m into the commercial investment smoothing reserve at the year-end, which is part of the risk management measures surrounding these investments.

Table 1.5: Net Income from Commercial and Service Investments to Net Revenue Stream

	Actual 2022/23 £m	Forecast 2023/24 £m	Estimate 2024/25 £m	Estimate 2025/26 £m
Total **net** income from service and commercial investments	0.1	0	0	0
Proportion of net revenue stream	0%	0%	0%	0%

3.15 **Proportion of Financing Costs to Net Revenue Stream:** Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue.

3.16 The net annual charge is known as financing costs; this is compared to the net revenue stream i.e., the amount funded from council tax, business rates and general government grants.

Table 1.6: Proportion of Financing Costs to Net Revenue Stream

	Actual 2022/23 £m	Forecast 2023/24 £m	Estimate 2024/25 * £m	Estimate 2025/26 £m
Financing costs (£m)	12.7	10.6	6.8	9.9

Proportion of net revenue stream	6.9%	5.0%	3.0%	4.4%

Treasury Management Indicators:

3.17 In the same way that the Prudential Code requires the council to publish Prudential Indicators, the 2021 CIPFA Treasury Management Code of Practice requires the council to publish a series of Treasury Management Indicators, which provide information relating to how the council manages its cash-flows and investments to support the operational running of the council activities as well as finance the long-term capital investment programme.

<u>Quarter 3 monitoring of Treasury Management Indicators</u>

3.18 **Liability benchmark:** To compare the Authority's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes that cash and investment balances are kept to a minimum level of £50m at each year-end. This benchmark is currently £52.6m and is forecast to rise to £128.0m over the next three years.

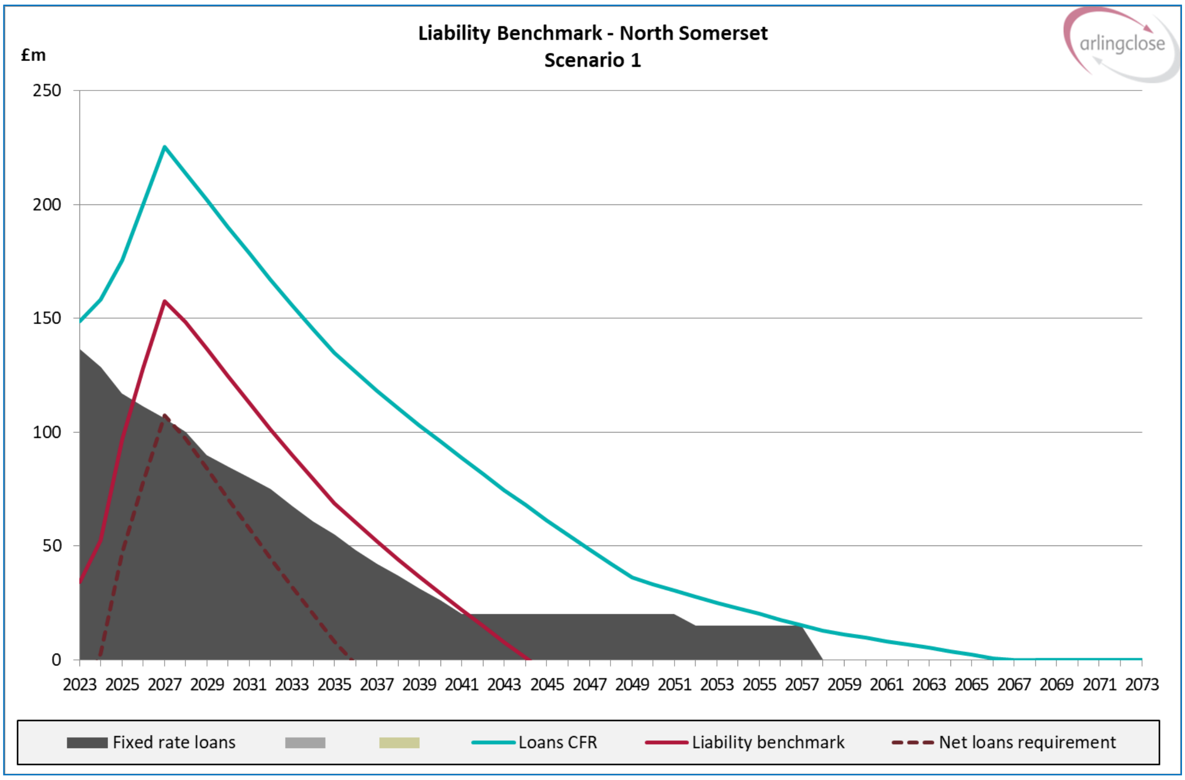
3.19 The liability benchmark is an important tool to help establish whether the council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external borrowing the council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow.

Table 1.7: Liability Benchmark

	Actual 2022/23 £m	Forecast 2023/24 £m	Estimate 2024/25 * £m	Estimate 2025/26 £m
Loans CFR	148.8	158.1	175.6	199.8
Less: Balance sheet resources	-164.8	-155.5	-128.6	-121.7
Net loans requirement	**-16.0**	**2.6**	**47.0**	**78.1**
Plus: Liquidity allowance	50.0	50.0	50.0	50.0
Liability benchmark	**34.0**	**52.6**	**97.0**	**128.1**

3.20 The liquidity allowance has been calculated as the strategic pooled funds balance of £10m plus an amount that we don't want cash balances to fall below. This would therefore be around £50m.

3.21 Following on from the medium-term forecast above, the long-term liability benchmark assumes no capital expenditure funded by borrowing after 2027/28, minimum revenue provision on new capital expenditure based on asset life and income, expenditure and reserves all increasing by inflation of 2.5% p.a. This is shown in the chart below together with the maturity profile of the council's existing borrowing.



3.22 The chart is indicating that the current debt portfolio (the grey shaded area) is predominantly more than the projected borrowing requirement (the red line, liability benchmark) illustrated where the top of grey area is above the red line. The difference between the two is surplus cash. However, it also indicates that there may be a small c.£1m net borrowing requirement in 2027 (where the dotted red line moves above the grey area).

3.23 The actual net borrowing requirement will change based on many factors including, timing of delivery against the approved capital programme, the level of balance sheet resources available, (e.g., new funding from government, or changes to spending patterns.

3.24 Whilst borrowing may be above the liability benchmark, strategies involving borrowing which is significantly above the liability benchmark carry higher risk.

3.25 **Maturity Structure of Borrowing:** This indicator is set to control the council's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

Table 1.8: Maturity Structure of Borrowing

	Upper Limit	Lower Limit	31/12/23 Actual	Complied?
Under 12 months	50%	0%	2.21%	Yes
12 months and within 24 months	30%	0%	13.24%	Yes
24 months and within 5 years	40%	0%	16.13%	Yes
5 years and within 10 years	50%	0%	22.07%	Yes
10 years and above	100%	0%	46.35%	Yes

3.26 Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

3.27 **Long-term Treasury Management Investments:** The purpose of this indicator is to control the council's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury management limits are:

Table 1.9: Long-term Treasury Management Investments

	2023/24	2024/25	2025/26	No fixed date
Limit on principal invested beyond a year	£40m	£40m	£40m	£10m
Actual principal invested beyond a year	£0m	£0m	£0m	£10m
Complied?	Yes	Yes	Yes	Yes

3.28 Long-term investments with no fixed maturity date include strategic pooled funds but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

Additional indicators

3.29 **Security:** The council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Table 1.10: Security

Credit risk indicator	2023/24 Target	31/12/23 Actual	Complied?
Portfolio average credit score	6.1	5.46	Yes

3.30 **Interest Rate Exposures:** This indicator is set to control the council's exposure to interest rate risk. Bank Rate rose by 1.0% during the period, from the prevailing rate of 4.25% on 1st April to 5.25% by 31st December.

Table 1.11: Interest rate exposure

Interest rate risk indicator	2023/24 Target	31/12/23 Actual	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	£1m	£0.4m	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	£1m	£0.4m	Yes

3.31 For context, the changes in interest rates during the period were:

	31/03/23	31/12/23
Bank Rate	4.25%	5.25%
1-year PWLB certainty rate, maturity loans	4.78%	5.13%
5-year PWLB certainty rate, maturity loans	4.31%	4.19%

10-year PWLB certainty rate, maturity loans	4.33%	5.37%
20-year PWLB certainty rate, maturity loans	4.70%	4.90%
50-year PWLB certainty rate, maturity loans	4.41%	4.67%

4. Consultation

Financial information and performance details are included within the council's monthly budget monitoring processes and key messages are described within the narrative report where required.

5. Financial Implications

Financial implications are contained throughout the body of the report within the relevant sections however, an additional summary has been included to provide a high-level overview of the key components linked with capital financing and investment decisions.

Table 6 – Revised budget impacts – capital financing and interest – 2023/24

	Budget £000	Forecast Out-turn £000	variance £000
Interest payable on borrowing	6,135	5,745	-390
Net interest receivable on investments	-2,689	-7,243	-4,553
Minimum revenue provision	6,851	7,268	417
Total	**10,296**	**5,769**	**-4,527**
MRP analysis;			
- Supported Borrowing Minimum Revenue Provision	900	900	0
- Prudential Borrowing Minimum Revenue Provision	5,141	5,558	417
- Ex-Avon Loan Debt Minimum Revenue Provision	445	445	0
- Finance Leases Minimum Revenue Provision	365	365	0

As can be seen from the table above the council is forecast to show an underspend on these budgets during the year, which will be brought together and aggregated with other areas of council spending, some of which are experiencing significant pressures, notably those demand led services.

6. Legal Powers and Implications

This report is for information only and covers the council's required obligations.

Treasury risk management at the council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year.

The 2021 editions of the Prudential Code and the Treasury Management Code (adopted by the council for 2023/24) introduced a requirement that monitoring of both the prudential and treasury management indicators should be reported to Members on a quarterly basis.

This report fulfils the council's legal obligation under the Local Government Act 2003 to have regard to both of the above CIPFA Codes.

7. Climate Change and Environmental Implications

Until recently the council recognises that it has had limited choice or options in this area however, some degree of change is expected to happen following the emergence of Environmental, Social and Governance (ESG) policies. This is where organisations are choosing to bring other considerations into their treasury strategies and decision-making processes and also introduce new investment products or services to the market.

The development of the council's ESG investment policy during 2023/24 has not detracted from the core functions that need to take place within the existing treasury management strategy, i.e., the management of cash-flows and also meeting the requirements within the approved revenue budget, but it will provide an opportunity to ensure that climate and other environmental implications are considered and reported on in the future.

The council welcomes the introduction of ESG policies and hopes that they will provide a broader range of opportunities that can be considered within future investment decisions, particularly those that will deliver positive outcomes for climate change and the environment more generally.

8. Risk Management

Members will be aware that there is a direct link between the levels of risk and the levels of return achieved on investment, although there are many other factors which also affect the capital financing budgets.

The council's treasury management activities expose it to a variety of financial risks, notably:

a. credit risk – the risk that other parties might fail to pay amounts due to the council. Includes bail-in risk – the risk that shareholders and depositors in banks and building societies bear losses in the event of counter-party's failure or reduction in net asset value,
b. liquidity and re-financing risk – the risk that the council might not have funds available to meet its commitments to make payments as they fall due,
c. market risk (interest rate and price risks) – the risk that financial loss might arise for the council because of changes in such measures as interest rates, investment valuations, and stock market movements.

The council's Treasury Management Strategy sets out the council's approach to managing these risks.

The priority of the Treasury Management Strategy will continue to be the reduction of risk to safeguard public resources.

The risk appetite of the council is low to give priority to the security of its investments. The council will also aim to achieve the optimum return on its investments commensurate with desired levels of security and liquidity.

It should be noted that the council's Treasury Management Strategy sets out how the council manages and mitigates these risks but cannot eliminate risks completely.

9. Equality Implications

Have you undertaken an Equality Impact Assessment? N/A

10. Corporate Implications

The safeguarding of public money is critical to the council's reputation, and the measures contained within the report are intended to address member and public concerns and ensure an appropriate balance of return on investment whilst ensuring managing associated risks.

11. Options Considered

The council is required to undertake a treasury management function to support its financial affairs and there are many options within the component parts.

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Appendices:

1. Glossary of Terms
2. List of Indicators – Prudential and Treasury

Background Papers:
Treasury Management Strategy 2023/24, Executive & Council – February 2023

Other relevant guidance includes:
- CIPFA – The Prudential Code for Capital Finance in Local Authorities 2021
- CIPFA - Treasury Management in Public Services – Guidance notes for local authorities 2021
- MHCLG – Statutory Guidance on Local Government Investments (3rd edition) 2018

Authorised Limit – the maximum amount of external debt at any one time in the financial year.

Bank Rate – the Bank of England base rate.

Capital Financing Requirement – financing needs of the council – i.e., the requirement to borrow.

CIPFA - the Chartered Institute of Public Finance and Accountancy. The institute is one of the leading professional accountancy bodies in the UK and the only one which specialises in the public sector. It is responsible for the education and training of professional accountants and for their regulation through the setting and monitoring of professional standards. Uniquely among the professional accountancy bodies in the UK, CIPFA has responsibility for setting accounting standards for a significant part of the economy, namely local government. CIPFA's members work, in public service bodies, in the national audit agencies and major accountancy firms.

CLG – Communities and Local Government – see MHCLG.

Counterparty – the organisation the council is investing with.

Credit Rating – an assessment of the credit worthiness of an institution.

Creditworthiness – a measure of the ability to meet debt obligations.

ESG – Environmental, Social and Governance based investment decisions.

Finance Lease - a finance lease is a lease that is primarily a method of raising finance to pay for assets, rather than a genuine rental. The latter is an operating lease. The key difference between a finance lease and an operating lease is whether the lessor (the legal owner who rents out the assets) or lessee (who uses the asset) takes on the risks of ownership of the leased assets. The classification of a lease (as an operating or finance lease) also affects how it is reported in the accounts.

Gilts – long term fixed income debt security (bond) issued by the UK Government and traded on the London Stock Exchange.

LIBID – London Interbank BID Rate – the interest rate at which London banks are willing to borrow from one another.

MHCLG – Ministry of Housing, Communities and Local Government. The Government department that sets policy on supporting local government, communities and neighbourhoods, regeneration, housing, planning building and the environment and fire. The name for this Government department has recently changed and is now known as **DLUHC**, which is the **Department for Levelling Up, Housing and Communities**.

Minimum Revenue Provision - the minimum amount which must be charged to an authority's revenue account each year and set aside towards repaying borrowing.

Money Market - the market in which institutions borrow and lend.

Money Market Rates – interest rates on money market investments.

Ninety-One – one of the council's cash managers who invest in multi-asset funds. They were previously known as Investec.

Operational Boundary – the most likely, prudent but not worst-case scenario of external debt at any one time.

Pooled Funds – investments are made with an organisation who pool together investments from other organisations and apply the same investment strategy to the portfolio. Pooled fund investments benefit from economies of scale, which allows for lower trading costs per pound, diversification, and professional money management.

Prudential Code – a governance procedure for the setting and revising of prudential indicators. Its aim is to ensure, within a clear framework, that the capital investment plans of the council are affordable, prudent, and sustainable and that treasury management decisions are taken in accordance with good practice.

Prudential Indicators – indicators set out in the Prudential Code that calculates the financial impact and sets limits for treasury management activities and capital investment.

PWLB (Public Works Loans Board) - a central government agency which provides long and medium-term loans to local authorities at interest rates only slightly higher than those at which the Government itself can borrow. Local authorities can borrow to finance capital spending from this source.

Sovereign – the countries the council can invest in.

Tradition UK Ltd – is one of the council's cash managers who manage £10m of investments on our behalf. Tradition place funds in fixed term cash deposits with a range of financial institutions.

Treasury Management – the management of the council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risk associated with those activities and the pursuit of optimum performance with those risks.

Treasury Management Practices – schedule of treasury management functions and how those functions will be carried out.

Variable Net Asset Value money market funds – the principal invested may fluctuate below that invested.

List of Indicators – Prudential and Treasury **Appendix 2**

Prudential Indicators

Capital Expenditure

Capital Financing Requirement

Gross Debt and the Capital Financing Requirement

Debt and the Authorised Limit and Operational Boundary

Net Income from Commercial and Service Investments to Net Revenue Stream

Proportion of Financing Costs to Net Revenue Stream

Treasury Management Indicators

Liability Benchmark

Maturity Structure of Borrowing

Long-term Treasury Management Investments

Additional indicators – security

Additional indicators – interest rate exposures