BRIEFING PAPER

REPORT to :	Audit and Governance Committee
LEAD OFFICER:	Director of Finance
DATE:	2nd March 2023

WARD/S AFFECTED: All

TREASURY MANAGEMENT REPORT – 2022/23

Based on monitoring information for the period 1st October 2022 – 31st December 2022

1. PURPOSE
To allow scrutiny of the Treasury Management function.

2. RECOMMENDATIONS

It is recommended that Audit and Governance Committee:

2.1. Notes the Treasury Management position for the period
2.2. Notes the Treasury Management Strategy for 2023/24 which is due to be presented to Executive Board for approval on 9th March 2023

3. BACKGROUND

3.1 The Treasury Management Strategy for 2022/23, approved at Executive Board in March 2022, complies with the CIPFA Code and with Ministry for Housing Communities and Local Government (MHCLG) Guidance on Investments.

The CIPFA Code, the Investment Guidance issued by MHCLG, and the Internal Audit & Assurance reviews of Treasury Management activities, all recommend a strong role for elected members in scrutinising the Treasury Management function of the Council.

3.2 An update to the Treasury Management indicators was approved at Executive Board in September 2022 and Council in October 2022.

3.3 This report summarises the interest rate environment for the period and the borrowing and lending transactions undertaken, together with the Council’s overall debt position. It also reports on the position against Treasury and Prudential Indicators established by the Council.

3.4 A glossary of Treasury Management Terms is appended to this paper.

4. KEY ISSUES

4.1. Bank of England Bank Rate

4.1.1. The Bank of England Bank Rate was increased twice during the period. The Bank Rate at the start of the period was 2.25%, rising firstly to 3.0% on 3rd November 2022 and increasing further to 3.5% on 15th December 2022.

4.2. Investments Made and Interest Earned

4.2.1. The graph in Appendix 1 shows the weekly movement in the totals available for investment, both actuals to date and projections for the rest of the year (adjusted for anticipated borrowing). These balances have fluctuated across the period, ranging between £52M and £71M. Investment balances continued to be unusually high during this period, largely due to funds received from central government and grants received in advance of spend being incurred, including Darwen Town Deal funding of £8.15M. It is expected that investment balances will ultimately reduce in future to between £10M and £20M.

4.2.2. Investments made in the period were mainly in “liquid” (instant access) deposits, either bank “call accounts” or Money Market Funds (MMFs). Returns on MMF holdings have continued to rise over the period, following the Bank Rate increases, averaging around 2.64% throughout the period. Bank deposit account rates have also increased during the period, rising to 0.80% by the end of December 2022.

4.2.3. For limited periods, funds were also placed with the Government’s Debt Management Account Deposit Facility (at 1.80 – 3.50%). The other fixed term investments made were:

Start Date	End Date	Counterparty	Amount £	Rate
20-Sep-22	18-Sep-23	Moray Council	£5,000,000	2.00%
12-Aug-22	14-Nov-22	Cornwall Council	£5,000,000	1.68%
14-Nov-22	14-Feb-23	Cornwall Council	£5,000,000	2.95%
22-Aug-22	21-Aug-23	West Dunbartonshire Council	£5,000,000	2.10%

4.2.4. At 30th December, the Council had approximately £63.1M invested, compared to £57.9M at the start of the period. Appendix 2 shows the breakdown of the closing investment balance. The Council’s investment return over the period was approximately 2.45%. For comparison, the Sterling Over Night Rate (SONIA) increased over the period, averaging 2.75%.

4.3. Borrowing Rates

4.3.1. The cost of long-term borrowing through the PWLB (Public Works Loan Board) is linked to central government's own borrowing costs.

4.3.2. The cost of short-term borrowing, based on loans from other councils, has risen during the period, following the Bank Rate rises. Interest rates on loans from 3 months out to a year were priced at rates between 3.44% and 4.35% by the end of the period.

4.3.3. The Council has not needed to replace short term borrowing and has therefore repaid those loans as they have matured, resulting in balances falling over the period. Short term borrowing rates have remained below those of long term borrowings, therefore should we need to borrow over the longer term this may be more expensive. Should the need arise, we will review the options available.

4.4. Short Term Borrowing in the 3 Month Period

4.4.1. The Council's CFR (Capital Financing Requirement) is the key measure of the Council's borrowing **need** in the long term. It is

(a) the accumulated need to borrow **to finance capital spend** (not funded from grants, etc.)
less
(b) the accumulated Minimum Revenue Provision (MRP) charges already made - councils must make a prudent MRP charge in their accounts each year, to finance their debt -
less
(c) any capital receipts applied to finance outstanding debt.

and therefore tends to increase if capital spend financed from borrowing exceeds MRP.

4.4.2. The Council's **actual** long-term debt is significantly below the CFR – the gap has widened as long-term debt has been repaid. We have been using "internal borrowing" from available revenue cash balances to partly cover this gap. The remaining gap has been covered by taking enough short term borrowing to ensure that the Council has sufficient funds to pay its liabilities and commitments, and to anticipate future borrowing needs. This has resulted in net interest savings.

4.4.3. Up to the end of December 2022, there was a decrease in short-term borrowing of £5M, as loans of £5M were repaid and no new loans were taken.

4.5. Current Debt Outstanding

	30th September 2022		31st December 2022	
	£'000	£'000	£'000	£'000
TEMPORARY DEBT				
Less than 3 months	5,000		5,000	
Greater than 3 months (full duration)	5,000		-	
		10,000		5,000
LONGER TERM DEBT				
Bonds	18,000		18,000	
PWLB	121,754		121,754	
Stock & Other Minor Loans	22		22	
		139,776		139,776
Lancashire Council County – Transferred Debt		12,768		12,631
Recognition of Debt re PFI Arrangements		58,635		58,081
TOTAL DEBT		**221,179**		**215,488**
LESS: TEMPORARY LENDING				
Fixed Term		(39,300)		(38,750)
Instant Access		(18,636)		(24,302)
NET DEBT		**163,243**		**152,436**

4.5.1. The key elements of long term borrowing set out above are:

(a) £18M classed as bonds, borrowed from the money markets, largely in the form of "LOBO" (Lender Option, Borrower Option) debt. LOBO loans are where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. The individual loans remaining range from 4.35% to 4.75%, at an average of around 4.4%. Given recent movements in interest rates, the likelihood of options being exercised on these loans is increasing. The Council holds £8M of LOBO loans with option dates within the next 6 months. The Council continues to review these loans and the opportunities available, should the options be exercised.

(b) £121.8M borrowed from the PWLB at fixed rates, at an overall average rate of around 4%. Loans repayable on maturity range from 3.06% to 7.875%, and EIP (Equal Instalment of Principal) loans from 1.7% to 3.35%.

(c) Debt managed by Lancashire County Council after Local Government Reorganisation, which is repaid in quarterly instalments across the year, charged provisionally at 2.20%.

(d) Debt recognised on the balance sheet as a result of accounting adjustments in respect of bringing into use school buildings financed through Public Finance Initiative (PFI) arrangements. The Council's effective control over, and use of these assets is thereby shown "on balance sheet", with corresponding adjustments to the debt. This does not add to the costs faced by the Council Tax Payer as these payments made to the PFI contractor are largely offset by PFI grant funding from the Government.

4.6. <u>Performance against Prudential and Treasury Indicators</u>

4.6.1. Appendix 3 shows the current position against the Prudential and Treasury Indicators set by the Council for the current year.

4.6.2. With regard to the movement in the key indicator, **Total Borrowing against the Authorised Borrowing Limit**, this is shown as the first graph in Appendix 4. Total borrowing at 31st December 2022 was £215.5M, which is below both our revised Operational Boundary (£319.4M) and our revised Authorised Borrowing Limit (£329.4M) for 2022/23.

4.6.3. This year we have remained within both our Operational Boundary – which is set for management guidance – and the (higher) Authorised Borrowing Limit. The Authorised Limit is the key Prudential Indicator – any borrowing cannot be taken if this Limit is (or would be caused to be) breached.

4.6.4. This total debt includes the impact on the balance sheet of the recognition of assets that have been financed through PFI. The accounting adjustments are designed to show our effective long-term control over the assets concerned, and the "indebtedness" arising from financing the cost of them. They do not add to the "bottom line" cost met by the Council Tax Payer.

4.6.5. The Council still holds part of its debt portfolio in loans of less than a year's duration – short-term loans currently still represent a cheaper way to fund marginal changes in the Councils debt. This remains under review, with regular updates from the Council's treasury management advisors, Arlingclose.

Interest Risk Exposures

4.6.6. Our **Variable Interest Rate Exposure** (see second graph at Appendix 4) ended the period at -£45.1M, against the revised **limit** set for this year of £100.5M.

4.6.7. This indicator exists to ensure that the Council does not become over-exposed to changes in interest rates impacting adversely on its revenue budget. The limit is set to allow for short as well as long term borrowing, and takes account of:
(a) all variable elements of borrowing (including short term borrowing – up to 364 days – and any LOBO debt at risk of being called in the year), which is then offset by
(b) any lending (up to 364 days).

4.6.8. Our **Fixed Interest Rate Exposure** was around £126.8M, against the revised **limit** of £228.3M. This indicator effectively mirrors the previous indicator, tracking the Council's position in terms of how much of the debt will **not** vary as interest rates move. The historically low interest rates prevailing over recent decades led the Council to hold a large part of its debt in this way.

4.6.9. This limit was set to allow for the possibility of much higher levels of new long-term, fixed rate borrowing.

4.7. Codes of Practice and MRP – Consultation and Proposed Changes

4.7.1. CIPFA published its revised Prudential Code for Capital Finance and Treasury Management Code on 20th December 2021. The key changes in the two codes are around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments.

4.7.2. The principles of the Prudential Code took immediate effect although local authorities could defer introducing the revised reporting requirements until the 2023/24 financial year if they wish. The Council has taken advantage of the option to defer introducing the revised reporting requirements until the 2023/24 year.

4.7.3. To comply with the Prudential Code, authorities must not borrow to invest primarily for financial return. This Code also states that it is not prudent for local authorities to make investment or spending decision that will increase the CFR unless directly and primarily related to the functions of the authority. Existing commercial investments are not required to be sold; however, authorities with existing commercial investments who expect to need to borrow should review the options for exiting these investments.

4.7.4. Borrowing is permitted for cash flow management, interest rate risk management, to refinance current borrowing and to adjust levels of internal borrowing. Borrowing to refinance capital expenditure primarily related to the delivery of a local authority's function but where a financial return is also expected is allowed, provided that financial return is not the primary reason for the expenditure. The changes align the CIPFA Prudential Code with the PWLB lending rules.

4.7.5. Unlike the Prudential Code, there is no mention of the date of initial application in the Treasury Management Code. The TM Code now includes extensive additional requirements for service and commercial investments, far beyond those in the 2017 version. The Authority will follow the same process as the Prudential Code, i.e. delaying changes in reporting requirements to the 2023/24 financial year.

4.7.6. Government have recently consulted on changes to the capital framework: Minimum Revenue Provision. The outcome of this consultation is unlikely to have an impact on the Council, this will be reviewed in detail once the outcome of the consultation is issued and an update will be provided in due course.

5. POLICY IMPLICATIONS

None

6. FINANCIAL IMPLICATIONS

The financial implications arising from Treasury Management activities are reflected in the Council's overall Budget Strategy, and in ongoing budget monitoring throughout the year.

7. LEGAL IMPLICATIONS

The report is in accordance with the CIPFA code and therefore is in accordance with the Financial Procedure Rules under the Council's Constitution.

8. RESOURCE IMPLICATIONS

None

9. CONSULTATIONS

None

10. STATEMENT OF COMPLIANCE

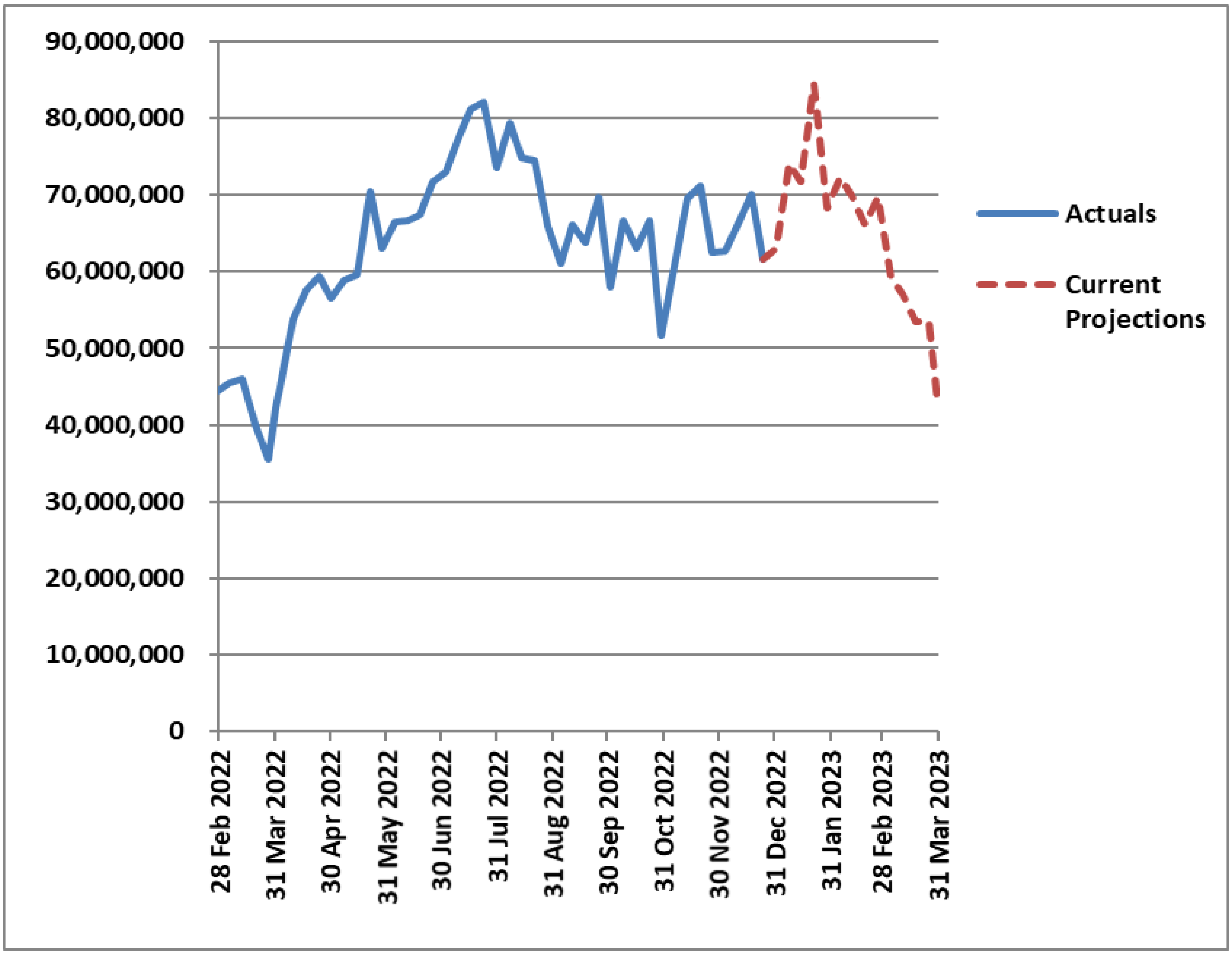
The recommendations are made further to advice from the Monitoring Officer and the Section 151 Officer has confirmed that they do not incur unlawful expenditure. They are also compliant with equality legislation and an equality analysis and impact assessment has been considered. The recommendations reflect the core principles of good governance set out in the Council's Code of Corporate Governance.

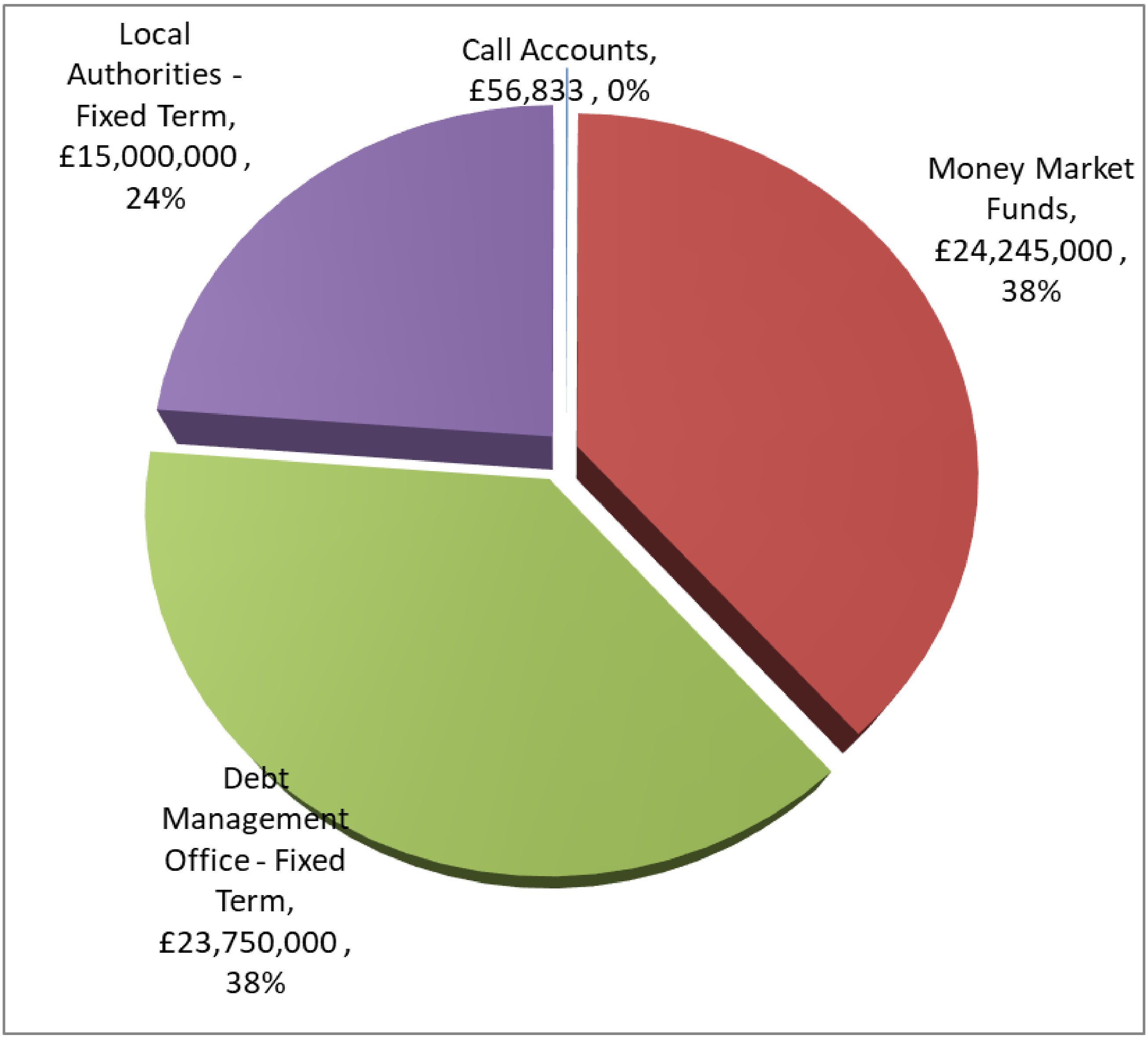
VERSION:	**0.01**

CONTACT OFFICER:	Jenny Bradley – Finance Manager extn 267681 Dean Langton – Director of Finance extn 666703
DATE:	February 2023
BACKGROUND PAPERS:	CIPFA Guidance - CLG Investment Guidance - Council Treasury Management Strategy for 2022/23 approved by Executive Board 10th March 2022 – Review of the Policy for Minimum Revenue Provision and Prudential and Treasury Management Indicators approved by Executive Board 8th September 2022 and Council on 6th October 2022 – Treasury Management Strategy for 2023/24 to be presented for approval to Executive Board on the 9th March 2023

Weekly Investment Balances **Appendix 1**

2022/23 (Feb 22 to Mar 23)




Local Authorities - Fixed Term, £15,000,000 , 24%
Call Accounts, £56,833 , 0%
Money Market Funds, £24,245,000 , 38%
Debt Management Office - Fixed Term, £23,750,000 , 38%

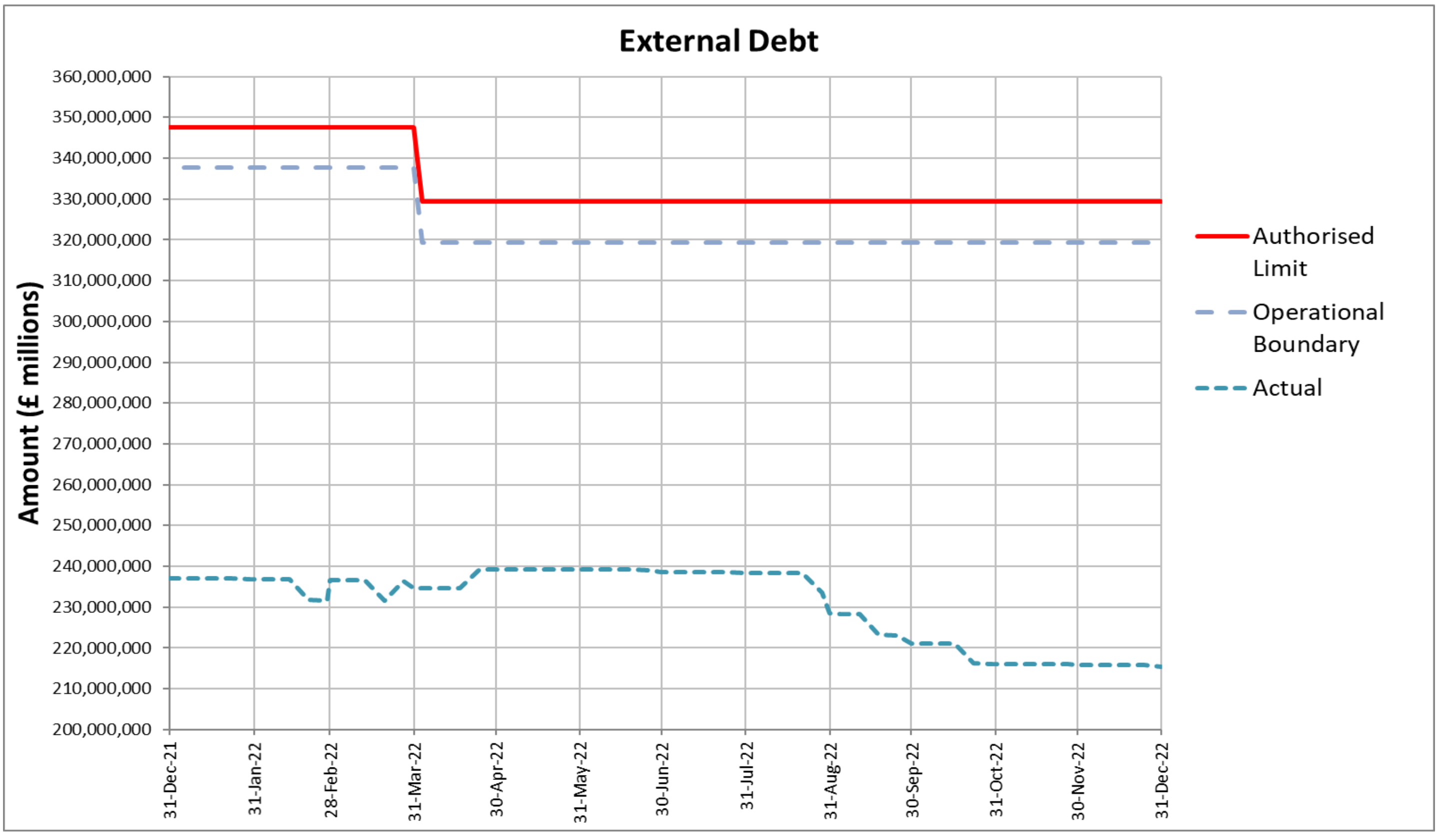
Performance against Treasury & Prudential Indicators 2022/23 (approved by Council 28th February 2022 / Executive Board 10th March 2022) **Appendix 3**

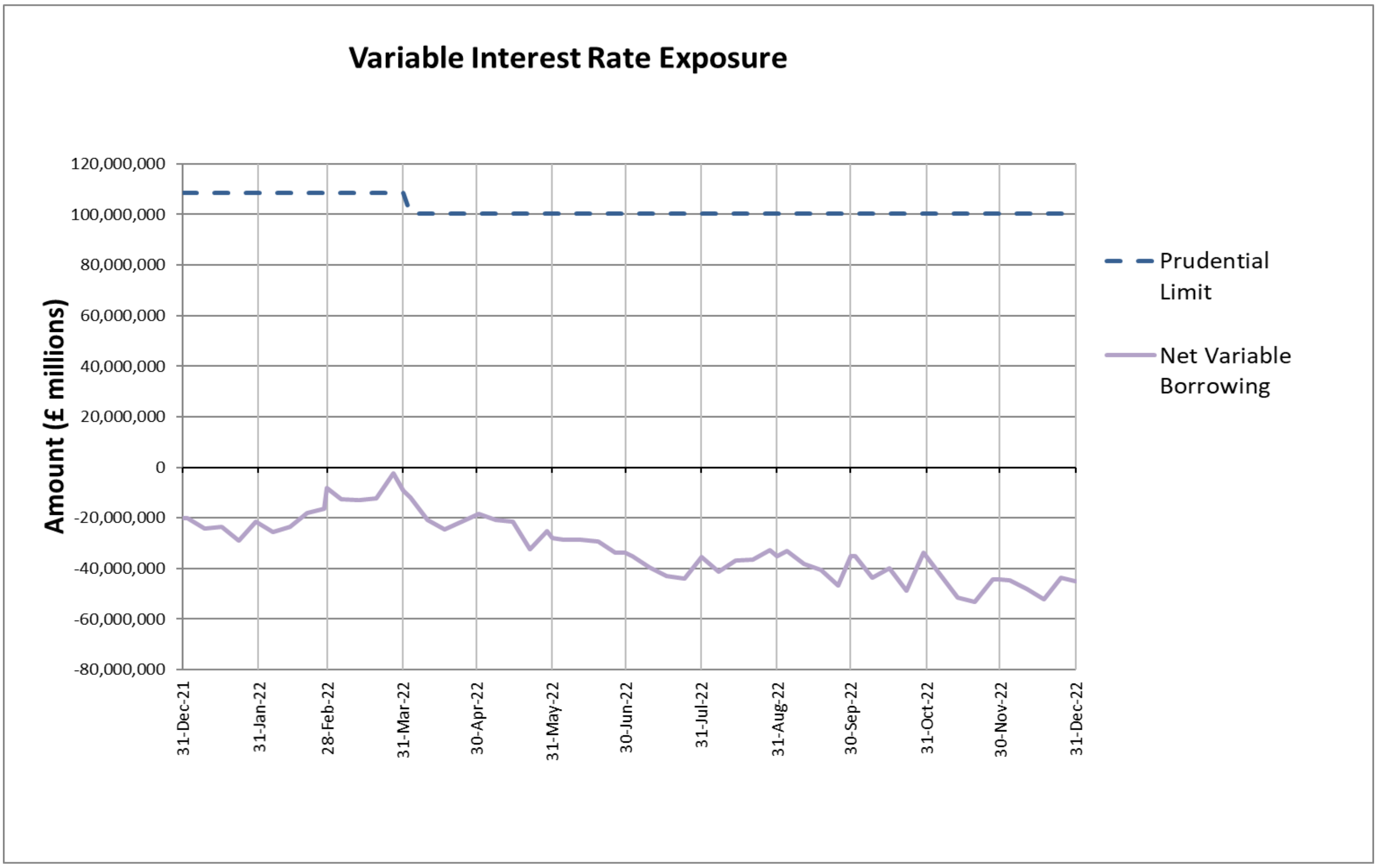
<table>
<tr><th></th><th>Indicator 2022/23</th><th>As Approved Mar 22</th><th>Current Monitoring</th><th>Commentary</th></tr>
<tr><td></td><td>Estimated Capital Expenditure</td><td>£35.7M</td><td>£28.6M</td><td></td></tr>
<tr><td></td><td>Estimated Total Capital Financing Requirement at End of Year</td><td>£296.7M
(incl projections re LCC debt £14.8M and PFI debt £68.9M)</td><td rowspan="2">These indicators are set when the Capital Programme is approved, to inform the decision making around that process, and are not, as a matter of course, updated during the financial year.</td><td></td></tr>
<tr><td></td><td>Estimated Ratio of Financing Costs to Net Revenue Stream</td><td>12.6%</td><td></td></tr>
<tr><td></td><td>Outturn External Debt Prudential Indicators</td><td><table><tr><td>LCC Debt</td><td>15.0M</td></tr><tr><td>PFI Elements (no lease)</td><td>69.2M</td></tr><tr><td>Remaining Elements</td><td>235.2M</td></tr><tr><td>Operational Boundary</td><td>319.4M</td></tr><tr><td>Authorised Borrowing Limit</td><td>329.4M</td></tr></table>These are the revised limits presented to Executive Board in September 2022</td><td><table><tr><th>Borrowing to Date</th><th>£M</th></tr><tr><td>LCC Debt</td><td>12.6</td></tr><tr><td>PFI Elements</td><td>58.1</td></tr><tr><td>BwD</td><td>144.8</td></tr><tr><td>Total</td><td>215.5</td></tr></table></td><td>The Council has chosen to delay changes to accounting for leases therefore lease borrowings will now not be included until 1 April 2024

Operational boundary and authorised borrowing limit have not been breached during the year</td></tr>
<tr><td></td><td>Variable Interest Rate Exposure</td><td>£100.5M
This is the revised limit presented to Executive Board in September 2022</td><td>Exposure to Date -£45.1M</td><td>Limit not breached during the year</td></tr>
<tr><td></td><td>Fixed Interest Rate Exposure</td><td>£228.3M
This is the revised limit presented to Executive Board in September 2022</td><td>Exposure to Date £126.8M</td><td>Limit not breached during the year</td></tr>
<tr><td></td><td>Prudential Limits for Maturity Structure of Borrowing</td><td><table><tr><th>Lower Limit</th><th>Upper Limit</th><th>Period (Years)</th></tr><tr><td>0%</td><td>50%</td><td><1</td></tr><tr><td>0%</td><td>30%</td><td>1-2</td></tr><tr><td>0%</td><td>30%</td><td>2-5</td></tr><tr><td>0%</td><td>30%</td><td>5-10</td></tr><tr><td>25%</td><td>95%</td><td>>10</td></tr></table></td><td><table><tr><th colspan="3">Actual Maturity Structure to Date</th></tr><tr><th>Period (Years)</th><th>£M</th><th>%</th></tr><tr><td><1</td><td>16.6</td><td>11%</td></tr><tr><td>1-2</td><td>13.2</td><td>9%</td></tr><tr><td>2-5</td><td>19.6</td><td>14%</td></tr><tr><td>5-10</td><td>21.6</td><td>15%</td></tr><tr><td>>10</td><td>73.8</td><td>51%</td></tr><tr><td>Total</td><td>144.8</td><td>100%</td></tr></table></td><td></td></tr>
<tr><td></td><td>Total Investments for Longer than 364 Days</td><td>£7M</td><td>No Long Term Investments Made</td><td></td></tr>
</table>

Movements in Prudential Indicators – Total Debt and Variable Interest Exposure Year to 31st December 2022

Appendix 4





Investment Rates
The interest rates for durations of less than a year are represented by LIBID (London Interbank Bid Rate), a reference rate measuring levels at which major banks are prepared to borrow from one another. This is a potential benchmark for the return on the Council's investments, though the rates actually available are constrained by the Council's investment criteria and largely short term investment horizon, designed to ensure cash is available when required.

Borrowing Rates
To indicate the potential costs of borrowing to fund the Council's capital programme, the reference point is Public Works Loans Board (PWLB) borrowing rates. The benchmark used is for "Certainty Rate" borrowing of "Maturity" Loans (loans of fixed lump sums, at fixed rates, over periods from 1 to 50 years).
The PWLB is the statutory body which lends to public bodies from Government resources – the Government has declared that it will be abolished at some point in the future, but that the facility for lending at good value will be continued - no date has been proposed for the change.

PWLB Loans - Fixed rate loans are repayable by one of three methods:
(a) **Maturity**: half-yearly payments of interest only, with a single repayment of principal at the end of the term.
(b) **Annuity**: fixed half-yearly payments to include principal and interest or
(c) **EIP (Equal Instalments of Principal)**: equal half-yearly instalments of principal together with interest on the balance outstanding at the time.

Certainty Rates - a discount - currently 0.20% - is available on new PWLB borrowing to local authorities completing an information request on borrowing intentions to Central Government.

Current PWLB rates have no impact so long as no new longer term borrowing is taken, as all the Council's existing long term debt is at fixed rates.

LOBO - LOBO stands for Lender Option, Borrower Option. It means that the lender can increase the interest rate, which gives the borrower the option to repay the loan in full without penalty fees. Public bodies used to be only able to borrow money through government Public Works Loan Board (PWLB) loans, however borrowing from banks in the form of LOBOs was permitted from the early 2000s. LOBOs were made available with low rates (cheaper than then available PWLB rates) so they appeared to be an attractive alternative.

LOBOs have provoked criticism because of high initial profits to the lender from day one, and high subsequent interest rates. It is difficult to exit LOBO loans early unless the lender is in agreement, so they are less flexible, and there is a risk that if/when they are "called", the borrower may find itself having to refinance debt at high rates.
This Council always limited the scale of LOBO borrowing taken, so that it formed part of an overall balanced debt portfolio, while bringing the advantage of initial lower rates.

PFI - The private finance initiative is a way of creating "public–private partnerships" (PPPs) by funding public infrastructure projects with private capital.

BSF - Building Schools for the Future (BSF) was the name given to Central Government's investment programme in secondary school buildings in England in the 2000s. In Blackburn with Darwen, the schools funded through this scheme are Witton Park High School, Blackburn Central High School and Pleckgate High School.

Prudential Indicators

Prudential Indicators are established mainly to allow members to be informed of the impact of capital investment decisions and to establish that the proposals are affordable, prudent and sustainable. In addressing the debt taken on by the Council, the indicators also deal with treasury issues, in particular the absolute level of debt being taken on (through the Authorised and Operational Borrowing Limits).

It should be noted that a "breach" of a prudential indicator is not necessarily a problem for the Council. Some indicators are more crucial that others, particularly in terms of their impact. If we spend more on the capital programme in total, that is not necessarily a problem if it has no adverse revenue consequences, for instance. Similarly, if we breach the indicator relating to variable interest rate exposure, this can just point to the balance of different types of debt taken up (between at fixed or variable interest rates) being significantly different from that anticipated when the indictor was set.

On the other hand, the Council's ability to borrow from the PWLB is constrained by needing to remain within the Authorised Borrowing Limit the Council has set for itself. If it became necessary to re-shape the Council's overall capital spending and borrowing strategy to the extent that the original Authorised Borrowing Limits were at risk of being breached, it would be necessary to obtain authority from full Council to change the borrowing limits.

Money Market Fund

A Money Market Fund is a type of fund investing in a diversified portfolio of short term, high quality debt instruments - provides benefit of pooled investment - assets are actively managed with very specific guidelines to offer safety of principal, liquidity and competitive returns - such funds “ring-fenced”, kept fully separate from the remainder of funds managed by the investment house running the fund.

Council only uses highly rated funds - **policy** is to limit to those with long-term credit ratings no lower than A-, but current **practice** is to only use AAA rated with daily access (like instant access bank accounts).