

**Blaby District Council
Council**

Date of Meeting	22 November 2022
Title of Report	Recommendations of the Cabinet Executive: Treasury Management Mid-Year Monitoring Report 2022/23 This is not a Key Decision and is on the Forward Plan
Lead Member	Cllr. Maggie Wright - Finance, People & Performance (Deputy Leader)
Report Author	Finance Group Manager
Corporate Priority	Medium Term Financial Strategy (MTFS)

1. What is this report about?

- 1.1 To provide members with an update on the Council's treasury activities for the half year ended 30th September 2022, and the economic factors which have affected those activities.
- 1.2 To demonstrate compliance with the Council's prudential indicators which were approved in February 2022.

2. Recommendation(s) to Cabinet Executive and Council

- 2.1 That the latest position in respect of treasury activities, and the prudential indicators, are accepted.
- 2.2 That the increase in the Capital Financing Requirement from £14.446m to £18.037m is approved.

3. Reason for Decisions Recommended

- 3.1 The regulatory framework governing treasury management activities includes a requirement that the Council should, as a minimum, receive a mid-year treasury monitoring report in addition to the forward-looking annual treasury strategy and the backward-looking annual treasury report.
- 3.2 This report fulfils the requirement above and incorporates the needs of the Prudential Code to ensure adequate monitoring of capital expenditure plans and the Council's prudential indicators. The treasury strategy and prudential indicators for 2022/23 were contained in the report approved by Council on 24th February 2022.

4. Matters to consider

4.1 Background

The Annual Treasury Management Strategy for 2022/23, including the Annual Investment Strategy, was approved by Council on 24th February 2022. There have been no policy changes to the strategy to date this financial year, and so the details in this report are an update to the original plans based on the latest economic position and budgetary changes which have already been approved.

As part of the February strategy report Council also approved a range of Prudential Indicators for 2022/23 which are designed to ensure that the Council's capital expenditure plans are prudent, affordable and sustainable. Officers monitor performance against these indicators on a quarterly basis, and the results are shown at Appendix A, compared with the original estimate and the forecast outturn position. As well as reviewing treasury activity to date, this report provides an explanation for any divergence from the original estimates.

4.2 Capital Expenditure & Financing

The Council's capital expenditure plans and sources of finance is the first Prudential Indicator appearing at Appendix A. The original approved programme for 2022/23 was £2.452m of which it was planned that £1.168m would be financed through borrowing.

Since February further additions have been made to the programme, including £2.847m unspent budgets brought forward from the previous financial year, and £2.512m of other additions including strategic property investment. The other additions are covered in more detail in the quarterly Capital Programme Review Reports (Quarter 1 – 5th September 2022, Quarter 2 - elsewhere on this agenda).

As a result of these changes, the latest Capital Programme for 2022/23 is now £8.040m with a borrowing requirement of £4.461m.

4.3 Impact on Prudential Indicators

Another key Prudential Indicator is the Capital Financing Requirement (CFR) which is a measure of the Council's underlying need to borrow for capital purposes. If the latest Capital Programme, as at 30th September, is fully spent the CFR will rise to £18.037m by 31st March 2023, compared with the original estimate of £14.446m. It is probable that the CFR will continue to exceed actual debt for the foreseeable future due to the Council's ongoing practice of borrowing internally to finance capital investment. However, over time, the gap between the CFR and external debt will gradually close as reserves and balances are utilised, and further borrowing is undertaken. There are two main reasons for the projected increase in the CFR to 31st March 2023.

1. The inclusion of £2.5m for potential regeneration property investment in the capital programme. If this investment doesn't materialise then the CFR will not be affected.
2. The change in Minimum Revenue Provision (MRP) policy from a straight-line method to an annuity method. Under the new method, MRP will be lower, unless the Council sets aside any voluntary provision, meaning that the CFR will not reduce by as much on an annual basis.

It is proposed that Council be recommended to formally approve the increase in the CFR.

4.4 Economic Update

Gross domestic product rose by 0.2% in quarter 1, meaning that the economy had, for the time being, avoided moving into recession. However, the impact of high inflation means that GDP is at risk of contracting during the autumn and winter months.

Consumer Price Index (CPI) inflation eased slightly between July and August from 10.1% to 9.9%, although inflation has not yet peaked. The easing in August was mainly due to a fall in oil prices. However, utility price inflation is expected to add 0.7% to CPI in October when the Ofgem unit price cap increases to, typically, £2,500 per household. Since the government's original plan to freeze prices at that level for two years has now been reversed, it remains to be seen what the impact on inflation will be.

There is an expectation that the Monetary Policy Committee (MPC) will increase interest rates further and faster, from the current 2.25% to a peak of 5.00% in February 2023. Market expectations for what the MPC will do are volatile but if the bank rate does climb to predicted levels it could cause vulnerability in the housing market. Link Group's interest rate forecast is included with this report at Appendix B.

4.5 Borrowing

The Council's current and forecast year end portfolio position is shown at Appendix A. It is compared with the CFR to demonstrate that the Council is currently using internal resources in lieu of borrowing, as mentioned above. The Council is permitted to borrow up to its CFR and may even, in the short term, exceed the CFR. However, there is a limit to the amount by which borrowing may exceed the CFR and this is described in Appendix A (no. 3, the Portfolio Position). This allows authorities some flexibility to borrow in advance of need where it is financially beneficial to do so.

The Council's actual debt is still lower than its CFR because it is continuing to borrow internally. Whilst reserves and balances remain relatively healthy and borrowing rates are higher than investment rates this remains a prudent and cost-effective approach but will require ongoing monitoring in the event of rising interest rates.

The original borrowing requirement for 2022/23 was £1.168m, and the budget allows for this being met by external borrowing. No new borrowing has been undertaken to date this financial year. Since the Council still holds a positive cash balance, and with PWLB rates rising, it is likely that any planned borrowing will be deferred.

There is provision within the revenue budget for interest payable of £202,361, which allows for the Council borrowing the £1.1m required to fund the Capital Programme, along with £2.0m of maturing debt. However, there is currently no pressing need to borrow externally. Any short-term cash deficits can be covered by taking out temporary loans, for which rates are currently lower than longer term PWLB borrowing rates. The interest payable budget will be reviewed as part of the budget setting process but may need to increase to take account of the recent inclusion of investment property acquisitions in the capital programme.

Gilt yields and PWLB rates were on a generally rising trend over the first half year. However, they rose sharply towards the end of September following the Chancellor's mini-budget announcement. The 50-year PWLB certainty rate for new long-term borrowing started the financial year at 2.20% but had risen to 4.80% by 30th September, albeit that rates are forecast to fall back to around 3.10% by the end of September 2025.

4.6 Investments

When considering the investment of surplus funds, the Council's main priority is the security of capital and liquidity, but it also seeks to achieve an appropriate level of return which is consistent with its appetite for risk.

The Council held £34.254m of investments on 30th September 2022 and the investment earned the first half year is £182,006, significantly higher than the comparable return at the same point in 2021/22 (£28,018). This means that investment income has already exceeded the budgeted return for 2022/23 which was £100,000. Although cash flow balances generally reduce during the last quarter of the financial year, with interest rates on the rise, it is now expected that investment income will reach around £400,000 for 2022/23.

There have been no instances to date where the Council has been in breach of its investment counterparty limits.

Property Fund

In addition to the internal investment portfolio, the Council has also invested £1m in the Lothbury Property Trust. Generally, property funds offer an improved rate of return, but it is recognised that higher interest rates often only come with increased risk, and, in the short term, fund values can fall as well as rise. For that reason, it is important to note that any investment in property funds must be seen as a longer-term investment.

Following the fall experienced during the pandemic, the value of the property fund rose considerably during 2021/22 and the early part of this financial year, reaching a high of £1.129m at the end of June. In light of the recent economic turmoil the fund value has fallen back to £1.075m so remains above the initial value of the deposit.

Until 31st March 2023 there is a statutory override in place that means any fluctuation in fund value does not have to be charged or credited to the General Fund. The government is currently consulting on whether the statutory override should be extended or withdrawn. In the event of a withdrawal, the Council will still have 12 months to consider options with regards to the future if the investment.

In terms of return, the Council has received rental and interest income of £13,762 up to 31st July 2022; the next quarter's results are due on 31st October and will be reported verbally at the meeting. This represents a return of around 4.12% up to the end of July.

5. What will it cost and are there opportunities for savings?

- 5.1 There are no direct costs arising from this report. However, it is expected that investment income will exceed the budget by around £300,000. Although it is likely that the Property Fund will generate around £40,000 in 2022/23 it is considered prudent to set this sum aside to mitigate any short-term reductions in the future net asset value of the fund. This is a similar principle to that adopted with the Local Authority Mortgage Scheme.

6. What are the risks and how can they be reduced?

6.1

Current Risk	Actions to reduce the risks
That external borrowing might not be undertaken at the most advantageous rate	Treasury officers maintain regular contact with the Council's advisors, Link Treasury Services, who monitor movements in interest rates on our behalf. The aim is always to drawdown loans when interest rates are at their lowest point.
Credit risk – the risk that other parties might fail to pay amounts due, e.g., deposits with banks etc.	The Annual Investment Strategy sets the criteria through which the Council decides with whom it may invest. The lending list is updated regularly to reflect changes in credit ratings.
Liquidity risk – the Council might not have sufficient funds to meet its commitments	Daily monitoring of cash flow balances. Access to the money markets to cover any short-term cash shortfall.
Refinancing and maturity risk – the risk that the Council might need to	Monitoring of the maturity profile of debt to make sure that loans do not all mature in

renew a loan or investment at disadvantageous interest rates	the same period. Monitoring the maturity profile of investments to ensure there is sufficient liquidity to meet day to day cash flow needs.
Market risk – losses may arise because of changes in interest rates etc	Maximum limits are set for exposure to fixed and variable interest rates. The Finance team will monitor market rates and forecast interest rates to limit exposure
Loss on the Property Fund investment if property values fall again.	The Lothbury Property Trust should be seen as a longer-term investment where the value of the fund can fluctuate both upwards and downwards. Historically, property prices tend to rise over time, but officers will monitor the trajectory of the fund and consider withdrawal if the valuation continues to fall.

7. Other options considered

- 7.1 None, this report is a requirement of the Treasury Management Code of Practice.

8. Environmental impact

- 8.1 There is no direct environmental impact arising from this report. However, the Council continues to utilise sustainable investment opportunities in line with its approved investment criteria.

9. Other significant issues

- 9.1 In preparing this report, the author has considered issues related to Human Rights, Legal Matters, Human Resources, Equalities, Public Health Inequalities, and Climate Local and there are no areas of concern.

10. Appendix

- 10.1 Appendix A – Prudential Indicators
- 10.2 Appendix B – Interest Rate Forecast

11. Background paper(s)

- 11.1 None.

12. Report author's contact details

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