

## CABINET

19 February 2024

<b>Title:</b> Treasury Management Strategy Statement 2024/25 and Capital Strategy 2024/25 to 2026/27	
<b>Report of the Cabinet Member for Finance, Performance and Core Services</b>	
<b>Open Report</b>	<b>For Decision</b>
<b>Wards Affected:</b> None	<b>Key Decision:</b> Yes
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<b>Accountable Director:</b> N/A	
<b>Accountable Strategic Director:</b> Jo Moore, Interim Strategic Director Finance and Investment (S151 Officer)	
<b>Summary</b>	
<p>This report presents the annual Treasury Management Strategy Statement (TMSS), Treasury and Prudential Indicators, Annual Investment Strategy (AIS) and Capital Strategy for approval, in compliance with Section 15(1)(a) of the Local Government Act 2003 (LGA 2003).</p>	
<p>The production and approval each year of a TMSS, AIS and Capital Strategy are requirements of the Council under Section 15(1) of the Local Government Act 2003. It is also a requirement of the Act to set an authorised borrowing limit for the forthcoming financial year. The LGA 2003 also requires the Council to have regard to the Prudential Code and to set prudential indicators which consider the Council's capital investment plans and borrowing requirements for the next three years.</p>	
<p>CIPFA published the updated Treasury Management and Prudential Codes on 20 December 2021 and stated that Local Authorities are expected to fully implement the required reporting changes within their TMSS/AIS reports from 2023/24. This report complies with these reporting requirements.</p>	
<p>The Capital Strategy sets out an overview of how the Council's capital investment contributes to the provision of local public services and considers the financing of that and whether it is prudent, affordable and sustainable.</p>	
<p>The Annual Investment Strategy sets out the Council's plans and approach to non-treasury and commercial investments. This is currently largely driven by the Council's Investment and Acquisition Strategy, (IAS) which will be revised and presented to Cabinet in April 2024. The Capital Strategy is included as Appendix 4 to this report.</p>	

The Treasury Management Strategy includes the Council's borrowing strategy. As at 30 November 2023, the Council had an external debt balance of £1.260bn, split into £296m for the HRA, £689m of long-term borrowing and £275m of short-term borrowing. Most of the long-term borrowing is for the IAS. Without any asset disposals and related capital receipts, then the total external debt is forecast to increase to £1.55bn by 2025/26 to fund the approved IAS schemes, with a total debt position of £1.81bn if leases and PFI schemes are added. Currently £190.3m of this debt is serviced by on-lending to Reside.

The Council's Capital Financing Requirement (CFR), which is the measure of the Council's level of underlying need to borrow to fund past and proposed capital expenditure. This is forecast to increase to over £2bn by 31 March 2025, with a peak of £2.11bn by 31 March 2026 unless additional capital schemes are agreed. The difference between the CFR and actual external debt is due to the use of internal cash resources known as "internal borrowing".

This report sets out the Council's treasury and debt position, borrowing strategy and CFR, as well as the risks related to the IAS and the General Fund.

### **Recommendation(s)**

The Cabinet is asked to recommend the Assembly to approve and adopt the Treasury Management Strategy Statement for 2024/25 and, in doing so, to:

- (i) Note the current treasury position for 2024/25 and prospects for interest rates, as referred to in sections 4 and 8 of the report;
- (ii) Approve the Annual Investment Strategy 2024/25 outlining the investments that the Council may use for the prudent management of its investment balances, as set out in Appendix 1 to the report;
- (iii) Approve the Council's Borrowing Strategy 2024/25 to 2026/27, as set out in Appendix 2 to the report;
- (iv) Approve the Capital Prudential and Treasury Indicators 2024/25 to 2026/27, as set out in Appendix 3 to the report;
- (v) Approve the Operational Boundary Limit of £1.9bn and the Authorised Borrowing Limit of £2.0bn for 2024/25, representing the statutory limit determined by the Council pursuant to section 3(1) of the Local Government Act 2003, as referred to in Appendix 3 to the report;
- (vi) Approve the Capital Strategy, including the Capital Programme for 2024/25 to 2026/27, as set out in Appendix 4 to the report;
- (vii) Approve the revised Minimum Revenue Provision Policy Statement for 2024/25, the Council's policy on repayment of debt, as set out in Appendix 5 to the report;
- (viii) Note that changes made to the Prudential Code and Treasury Management code, published in December 2021, have been fully implemented for the 2024/25 TMSS;

- (ix) Approve the Liability Benchmark data in section 11, including the impact of schemes agreed in 2022 but also the impact of pipeline schemes on the amount of borrowing required by the Council;
- (x) Delegate authority to the Section 151 Officer, in consultation with the Cabinet Member for Finance, Growth and Core Services, to proportionally amend the counterparty lending limits agreed within the Treasury Management Strategy Statement to consider the increase in short-term cash held from borrowing;
- (xi) Note the economic, development and operational risks for the IAS schemes as outlined in section 8 and within the IAS and Borrowing reports;
- (xii) Note the Council's total borrowing is £1.260bn, split into £296m for the HRA, £689m of long-term borrowing and £275m of Short-term borrowing;
- (xiii) Approve the CFR projections of £2.022bn for 2024/25, £2.11bn for 2025/26 and £2.02bn for 2026/27; and
- (xiii) Note that the Investment and Acquisitions Strategy shall be updated and presented for approval in April 2024.

**Reason(s)**

To enable the Council to accord with the requirements of the Local Government Act 2003

## **1. Introduction and Background**

- 1.1 The Council is required to operate a balanced budget, with cash raised during the year sufficient to meet the Council's cash expenditure. Treasury management supports the Council by seeking to ensure its cash flow is adequately planned, with cash being available when it is needed. Surplus cash is invested in counterparties or instruments commensurate with the Council's risk appetite, providing adequate security and liquidity while also considering the investment return.
- 1.2 A second function of treasury management is funding the Council's capital plans and investment requirements and to ensure that investments are affordable and sustainable. The capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans or using longer term cash flow surpluses.
- 1.3 The Council is responsible for its treasury decisions, activity, and risk appetite. The successful identification, monitoring and control of risk are integral elements of treasury management, including credit and counterparty risk, liquidity risk, market risk, interest risk, refinancing risk and legal and regulatory risk. The Council is statutorily required to approve the Treasury Management Strategy Statement (TMSS) prior to the new financial year.
- 1.4 CIPFA published the updated Treasury Management and Prudential Codes on 20 December 2021 and stated that Local Authorities are expected to fully implement the required reporting changes within their TMSS/AIS reports from 2023/24. The main objective of the Codes was to respond to the expansion of local authority

investment activity over the past few years into the purchase of non-financial investments, particularly property. The Codes require an authority to ensure that it:

- defines its risk appetite and its governance processes for managing risk.
- sets out its investment policy in relation to environmental, social and governance.
- adopts a liability benchmark treasury indicator to support the financing risk management of the capital financing requirement; with material differences between the liability benchmark and actual loans to be explained.
- does not borrow to finance capital spend to invest primarily for commercial return
- increases in the CFR and borrowing are solely for purposes directly and primarily related to the functions of the authority. Where any financial returns are related to the financial viability of the project, they should be incidental to its primary purpose.
- has an annual review conducted to evaluate if commercial investments should be sold to release funds to finance new capital expenditure or refinance or repay maturing debt.
- capital plans and investment plans are affordable and proportionate.
- all borrowing/other long-term liabilities are within prudent and sustainable levels.
- commercial investments risks are proportionate to overall financial capacity.
- treasury management decisions are in accordance with good professional practice.
- reporting to members is monthly through the budget monitoring process, including updates of prudential indicators.
- should assess the risks and rewards of significant investments over the long term, to ensure the long-term financial sustainability of the authority.
- has access to the appropriate level of expertise to be able to operate safely in all areas of investment and capital expenditure, and to involve members adequately in making properly informed decisions on such investments.

1.5 This report covers the above points, outlining the key risks, borrowing requirement, assets invested in and the pipeline schemes. The Council's IAS has a long-term view of over 50 years and this report will outline the forecast income and expenditure over this time frame. However, there will be a focus on the next three years as the likely performance and cashflows are more relevant and are more accurate and to align with the Council's Medium Term Financial Strategy. Longer term forecasts based on several assumptions and estimates have an inherent risk of uncertainty.

## 2. Treasury Management Reporting Requirements

2.1 The Council is required to receive and approve at least three main treasury reports each year. These reports are required to be adequately scrutinised by Cabinet before being recommended to the Council. In addition, monthly treasury and IAS monitoring is taken to Cabinet as part of the budget monitoring report. The three main treasury reports are:

- i. **The Treasury Management Strategy Statement (TMSS)** is the most important report and considers the impact of the Council's proposed Revenue Budget and Capital Programme on the Balance Sheet position, the current and projected treasury position, the Prudential Indicators (PIs), the outlook for interest rates and current market conditions.

- ii. **A Mid-Year Treasury Management Report** to update Members on the progress of the capital position, amending PIs and investment strategy as necessary.
- iii. **An Annual Treasury Report** - outlines the actual Prudential Indicators, treasury indicators and treasury operations compared to the estimates within the strategy.

2.2 The Council is responsible for social and affordable housing within the HRA so PIs for capital expenditure, financing costs and the Capital Financing Requirement (CFR) are split between the HRA and the General Fund (GF). The impact of new capital investment decisions on housing rents is also considered. This report provides an explanation of the key elements of the Council's TMSS, its Minimum Revenue Provision (MRP) Policy, Annual Investment Strategy (AIS), Capital Strategy and Borrowing Strategy, as set out in detail in the appendices attached to this report.

### **3. Treasury Management Strategy Statement for 2024/25**

3.1 The strategy for 2024/25 covers two main areas, including Treasury Management and Capital Strategy Reporting issues. These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the Ministry of Housing, Communities and Local Government's (MHCLG)[Now DLUHC] MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

#### **3.2 Treasury Management Matters**

- Current portfolio position at 30 November 2023 (section 4);
- Medium Term Capital Finance Programme to 2026/27 and capital budget for 2024/25 (section 5);
- Treasury position as at 30 November 2023 together with forward projections 2024/25 (section 6);
- Economic update (Appendix 6) and interest rates forecast (section 7);
- Investment and borrowing rates (section 8);
- The Council's Capital Expenditure Programme 2024/25 to 2026/27 (section 9);
- Liability Benchmarks and loan repayments (section 10)
- Treasury Management Advisors report(section 11);
- Minimum Revenue Provision Policy Statement (section 12);
- Appendix 1 – Annual Investment Strategy 2024/25;
- Appendix 2 - Borrowing Strategy 2024/25 to 2026/27;
- Appendix 3 – The Capital Prudential and Treasury Indicators 2024/25 to 2026/27;
- Appendix 4 – Capital Strategy and Capital Programme 2024/25 to 2026/27
- Appendix 5 – Minimum Revenue Provision Policy Statement 2024/25;
- Appendix 6 - Economic Background; and
- Appendix 7 – Scheme of Delegation and Section 151 Officer Responsibilities

#### **3.3 Capital Strategy Reporting Requirements**

3.3.1 The CIPFA revised 2017 and 2021 Prudential and TM Codes require all local authorities to prepare an additional report, a Capital Strategy Report (CSR), which provides: a high-level long-term overview of how capital expenditure, capital financing and TM activity contribute to the provision of services; an overview of how

the associated risk is managed; and the implications for future financial sustainability.

- 3.3.2 The aim of this CSR (Appendix 4) is to ensure that Members fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.
- 3.3.3 In November 2016, Cabinet approved the establishment of an Investment and Acquisition Strategy (IAS). The purpose of the IAS is to support the Borough's growth opportunities and to ensure the Council, and future generations, benefit by increasing the Council's ownership of long-term income producing assets. The IAS is reviewed annually by Cabinet, with the next review due to be presented to Cabinet in April 2024. Given the length of time since the IAS was approved and the significant amount of borrowing that the Council has undertaken under this strategy, external advisors have been commissioned to undertake a review of the IAS and associated asset portfolio.
- 3.3.4 The IAS had an annual income target of delivering £5.2m for 2024/25 to 2026/27, including hotel deals. The IAS is delivered primarily by the Council's development vehicle, Be First, and through its property companies, Reside. The strategy has resulted in the delivery of around 1,300 homes with another 2,000 in construction. It has also helped progress the land assembly and subsequent sale of the Film Studio at Dagenham East, letting of Welbeck Wharf Studios and the sale of the Muller site.
- 3.3.5 The CSR references the Borrowing Strategy (Appendix 2) and MRP Policy (Appendix 5) that include additional details on the borrowing and debt repayment. These documents provide details of the CSR and includes:
- The corporate governance arrangements for these types of activities;
  - Any service objectives relating to the investments;
  - The expected income, costs and resulting contribution;
  - The debt related to the activity and the associated interest costs;
  - The payback period (MRP policy);
  - For non-loan type investments, the cost against the current market value;
  - The risks associated with each activity.
- 3.3.6 Where a physical asset is bought, details of market research, advisers used, (and their monitoring), ongoing costs, investment requirements and credit information will be disclosed, including the ability to sell the asset and realise the investment cash.
- 3.3.7 Where the Council has borrowed to fund any non-treasury investment, there should also be an explanation of why borrowing was required and why the MHCLG (now DLUHC) Investment Guidance and CIPFA Prudential Code have not been adhered to. In addition, Investment Management Practices (IMPs) for non-treasury investments are required by the 2021 CIPFA Codes.
- 3.3.8 If any non-treasury investment sustains a loss during the final accounts and audit process, the strategy and revenue implications will be reported through the same procedure as the Capital Strategy. To demonstrate the proportionality between the treasury operations and the non-treasury operation, high-level comparators are shown throughout this report.

3.3.9 On 20 December 2021, updates to the Prudential Code and Treasury Code were published, effective from the publication date, and includes borrowing purely for yield (profit), which is now no longer allowed. The implementation of the changes is incorporated in the 2024/25 TMSS. Overall, the impact of the changes will require additional reporting but the impact on the Council will be limited as the Council does not invest purely for yield, with commercial purchases part of in-borough regeneration.

#### 4. Current portfolio position at 30 November 2023

4.1 Table 1 shows the Council's investments, loans and borrowing at 31/12/2022 and 30/11/2023 to show annual comparators, including average life and average return.

**Table 1: Treasury Position at 31 December 2022 and 30 November 2023**

	As at 31 December 2022			As at 30 November 2023		
	Principal	Return	Average	Principal	Return	Average
	£000s	%	Life (yr)	£000s	%	Life (yr)
<b>General Fund Fixed Rate Long Term Borrowing</b>						
PWLB	617,887	1.91%	28.59	600,692	1.91%	28.00
European Invest. Bank	74,220	2.21%	20.35	71,563	2.21%	20.35
L1 RENEWABLES	6,752	3.44%	22.85	6,711	3.44%	22.85
DEXIA BANK LOBO	10,000	3.98%	53.62	10,000	3.98%	53.62
<b>Total GF Debt</b>	<b>708,859</b>	<b>1.99%</b>	<b>28.02</b>	<b>688,967</b>	<b>1.99%</b>	<b>27.53</b>
<b>General Fund Fixed Rate ST Borrowing</b>						
Local Authority ST	146,228	2.99%	0.79	254,980	4.77%	0.19
GF Medium Term Borrowing	30,000	0.77%	0.72	20,000	2.43%	1.46
<b>Total GF ST / MT Borrowing</b>	<b>176,228</b>	<b>2.61%</b>	<b>0.38</b>	<b>274,980</b>	<b>4.60%</b>	<b>0.28</b>
<b>Total GF Debt</b>	<b>784,382</b>	<b>1.85%</b>	<b>26.83</b>	<b>963,946</b>	<b>2.73%</b>	<b>19.75</b>
<b>HRA Borrowing</b>						
PWLB Fixed Rate	265,912	3.50%	32.14	265,912	3.50%	32.14
Market Loans Fixed Rate	30,000	4.03%	42.07	30,000	4.03%	42.07
HRA Internal Borrowing Variable Rate				10,704	4.73%	-
<b>Total HRA Debt</b>	<b>295,912</b>	<b>3.55%</b>	<b>33.15</b>	<b>306,616</b>	<b>3.43%</b>	<b>31.99</b>
<b>Total Borrowing</b>	<b>1,180,999</b>	<b>2.47%</b>	<b>25.04</b>	<b>1,270,562</b>	<b>2.90%</b>	<b>22.71</b>
<b>General Investments</b>						
MMF / Cash	9,600	2.80%	0.11	3,200	5.39%	-
Local Authority Deposit	45,250	1.63%	0.59	10,000	1.00%	0.11
Bank Deposit	12,000	1.69%	0.15	2,000	5.14%	-
Loans	177,223	3.93%	29.17	251,956	3.74%	41.33
HRA Internal Borrowing Variable Rate				10,704	4.73%	
<b>Total Treasury Investments and Loans</b>	<b>244,073</b>	<b>3.35%</b>	<b>21.08</b>			
<b>HRA Cash</b>	<b>18,386</b>	<b>3.50%</b>	<b>32.14</b>	<b>18,386</b>	<b>3.65%</b>	<b>-</b>
<b>Total Investments and Cash</b>	<b>244,073</b>	<b>3.35%</b>	<b>21.08</b>	<b>277,860</b>	<b>3.66%</b>	<b>35.84</b>
Muller Equity	23,349			23,349		
<b>Total Investments with Equity</b>	<b>267,422</b>			<b>290,505</b>		

4.2 The Council holds cash balances from its income from operational activities, which are offset by expenditure to run services. If the timing of these cash flows results in surplus cash this is then invested and conversely, if it results in a deficit, borrowing will be required. Cash balances are also affected by working capital, the short-term funding required to maintain sufficient cash to meet short term debts arising from operational activities. These balances are made up of the following sources of cash:

- Capital grants and Section 106 funds received in advance of expenditure;
- General Fund, HRA and School cash balances;
- Earmarked reserves, provisions, capital receipts and working capital;
- Borrowing (financial Institutions and Publics Works Loan Board - PWLB).

4.3 Over the past year the key changes in the treasury position were:

- i. Short and medium-term borrowing increased by £98m to £275m to fund the Council's commercial holdings but also new developments.
- ii. Interest rates increased significantly, with the average short-term borrowing rate increasing from 2.99% to 4.77%, with short-term borrowing rates in December 2023 between 5.3% to 5.7%.
- iii. Long-term borrowing rates remained the same, but the Council's long-term debt decreased by £20m as annuity and equal Instalment repayments reduced the balance.
- iv. Cash holdings continued to reduce, from £67m at 31 December 2022 to £15m at 30 November 2023.
- v. Loans, especially loans to Reside, increased from £177m to £252m.

## 5. Medium Term Capital Finance Programme and 2024/25 Capital Budget

5.1 A key part of the Council's medium term financial strategy is the medium-term capital finance budget shown in Table 2. It is a statutory requirement that the level of borrowing is kept under review and is affordable.

5.2 The **interest payable** forecast and budget shows a significant increase to 2026/27. This increase reflects the increased borrowing required and increased interest rates. Interest rates are currently around 5% for borrowing and therefore **for each additional £100m of borrowing required, £5m of interest will be required**. The interest payable largely covers the current IAS and GF borrowing requirement.

5.3 **Interest Receivable** also increases significantly as several schemes become operational and start to pay interest to the Council from Reside. The interest rates are largely fixed and reflect the agreed rate at the time of construction. Assumptions for new schemes such as Roxwell, Beam and Gascoigne East 3b include higher on-lending rates to reflect the current higher borrowing costs. MRP will also start to increase against the IAS schemes, but this is covered by principal repayments from Reside and from commercial schemes as part of the debt repayment.

5.4 Surpluses from Residential schemes could be higher than currently forecast but most schemes are either still under construction or only recently become operational. Improvement in returns could come from reducing operational costs, improved lettings and from increased rents. Deficits from commercial are based on

a medium-term hold position and based on current lettings forecast. Potentially lettings, including the rates, could improve.

- 5.5 Borrowing costs for the IAS are capitalised against each project during the construction phase. Capitalisation of interest costs aligns with the CIPFA's Code of Practice to charge borrowing costs towards from the time an asset is at practical completion. As schemes are completed, capitalised interest stops and is replaced by a loan to Reside or through net operational surpluses from the asset class: commercial or residential schemes. As a result, the capitalised interest amount will reduce over time and the interest receivable will increase, with interest receivable ending up higher than the interest payable for the IAS. Overall the IAS is self-financing based on current interest rate forecasts, borrowing to date and for the schemes that have currently been agreed.
- 5.6 Table 2 below includes the MRP budget, IAS and HRA interest costs, including splitting the budgets into Residential and Commercial.

**Table 2: Medium Term Capital and Treasury Budget 2024/25 to 2026/27**

	2024/25	2025/26	2026/27
	Budget	Budget	Budget
	£'000	£'000	£'000
<b>General Fund</b>			
Interest Payable	10,139	10,139	10,139
Interest Receivable	-6,503	-6,503	-6,503
Property Charges Income	-600	-600	-600
MRP	10,792	10,792	11,192
<b>GF Sub-total</b>	<b>13,828</b>	<b>13,828</b>	<b>14,228</b>
<b>IAS</b>			
Residential Interest Payable	9,870	13,736	20,550
Residential Interest Receivable	-18,346	-19,166	-25,748
IAS Residential MRP	825	2,859	2,938
Reside principal repayments	-2,000	-4,340	-4,692
<b>IAS Residential Sub-total</b>	<b>-9,651</b>	<b>-6,911</b>	<b>-6,952</b>
Commercial Interest Payable	10,840	10,028	7,872
Commercial Interest Receivable	-780	-3,669	-2,029
IAS Commercial MRP	1,438	1,481	1,755
Commercial	-5,908	-4,990	-4,707
<b>IAS Commercial Sub-total</b>	<b>5,590</b>	<b>2,850</b>	<b>2,891</b>
<b>Net IAS Budget</b>	<b>-4,061</b>	<b>-4,061</b>	<b>-4,061</b>
Hotel Lease and Lease Back	-1,176	-1,176	-1,176
<b>Net IAS Budget Including Hotels</b>	<b>-5,237</b>	<b>-5,237</b>	<b>-5,237</b>
<b>HRA</b>			
<b>HRA Interest Payable</b>	<b>10,059</b>	<b>10,059</b>	<b>10,059</b>

5.7 The IAS has an overall net income budget to achieve in the Council's General Fund revenue budgets. This overall surplus (after meeting IAS borrowing costs) is ei used as part of the Council's funding for its base budgets.

5.8 The IAS and treasury returns are currently difficult to accurately forecast as there is significant volatility within the interest rate market and currently many schemes have recently completed or will complete over the coming months. Reside now has a full-time Chief Finance Officer who is working with the Council on more accurate scheme forecasting. In the interim, the following assumptions have been used:

- New Borrowing Rate is modelled at 4.75% in 2024/25, 4.5% in 2025/26 and 4.0% in 2026/27;
- Assumed use of Council general reserves in 2024/25 is £40m and in 2025/26 it is £30m, which will reduce the amount of internal borrowing available;
- Borrowing based on current schemes, pipeline to be agreed at higher rates;
- Reside loans are agreed as per the Cabinet /IP agreement;
- No interest income assumed for loans to BDPT Group for LEUK for 2024/25 and 2025/26;
- £2m additional provision per year for interest rate risk;
- Drawdown of BD Energy loan and London Road loan as per current schedule;
- Refinancing of £22m per year requiring £580k additional borrowing costs per year at 5% in 2024/25 and 4.5% in 2026/27.

5.9 As schemes become operational, there are assumptions around how quickly schemes are let or sold that have a significant impact on the net returns from the IAS, especially where borrowing is high, such as for Private Rents (PRS) and Shared Ownership (SO), where there is no grant available to reduce borrowing. Where schemes remain unlet or unsold, interest costs are still incurred and cannot be capitalised, this puts a significant pressure on the IAS and treasury returns. The table below shows the net IAS returns since 2020/21 to 2022/23:

**Table 3: IAS and Treasury Returns 2020/21 to 2022/23**

GF Treasury and IAS Returns	Borrowing costs	Interest Income	IAS Income	Net IAS & Interest Cost
	£000s	£000s	£000s	£000s
<b>2020/21 Actual</b>	7,730	-8,817	-6,919	<b>-8,006</b>
<b>2020/21 Budget</b>	13,069	-6,503	-6,637	<b>-71</b>
<b>Variance</b>	<b>-5,339</b>	<b>-2,314</b>	<b>-282</b>	<b>-7,935</b>
<b>2021/22 Actual</b>	8,370	-9,156	-5,434	<b>-6,220</b>
<b>2021/22 Budget</b>	14,121	-6,503	-6,782	<b>836</b>
<b>Variance</b>	<b>-5,751</b>	<b>-2,653</b>	<b>1,348</b>	<b>-7,056</b>
<b>2022/23 Actual</b>	6,687	-9,111	-5,575	<b>-7,999</b>
<b>2022/23 Budget</b>	11,681	-6,503	-6,077	<b>-899</b>
<b>Variance</b>	<b>-4,994</b>	<b>-2,608</b>	<b>502</b>	<b>-7,100</b>

5.10 The above returns do not include the dividend contributions from subsidiaries or the returns from the sale of Muller and from the two hotel deals, which have contributed a further £60m to the Council. Over the past 4 years the IAS and Treasury will have contributed nearly £24m in surplus returns compared to the budget set and a total of £84m. These additional returns have been saved to the IAS reserve or contributed

to covering shortfalls in subsidiary dividend income. Given the volatility, highlighted above, in delivering the £5m net return required it is imperative that adequate IAS reserves are maintained IAS to provide protection against adverse market conditions – either increased costs of schemes, reduced net returns from non-residential asset classes or higher interest rates.

The Council has also received additional income from New Homes Bonus attributable to new housing supply under the IAS, income from the sale of land held within LEUK and from the sale of the film studio land has also contributed.

5.11 However currently there are three large pressures that are impacting both the IAS and Treasury, namely:

- i. high scheme build costs;
- ii. significant underperformance in the operational management of the recently completed schemes such as slow lets of PRS; and
- iii. high interest rates directly affecting refinancing and borrowing costs.

High interest rates have largely been contained through increasing the rates modelled for new schemes, which has restricted the number of schemes to only those that are financially viable at higher interest rates.

5.12 MRP budgets includes charges arising from the IAS but these costs are offset through loan repayments from Reside.

5.13 Based on current forecasts the IAS is self-financing, with sufficient income being generated from the property investments to cover associated costs.

## 6. Treasury Position Forward Projections to 2026/27

6.1 The Council's treasury forward projections are summarised in Table 4. The table shows the estimated external debt against the underlying Capital Financing Requirement (CFR), highlighting any over or under borrowing. The CFR and gross debt includes a significant increase in borrowing to fund the IAS. To ensure borrowing is only for a capital purpose Gross Debt should, except in the short term, be below the CFR over the period and the table shows that the Council will be compliant with this rule.

**Table 4: Treasury Position for 2024/25 to 2026/27**

<b>Gross Debt Movement 2024/25 to 2026/27</b>	<b>2024/25</b>	<b>2025/26</b>	<b>2026/27</b>
	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>
<b>External Debt</b>	<b>£000s</b>	<b>£000s</b>	<b>£000s</b>
Debt at 1 April	1,350,000	1,450,000	1,550,000
Expected Change in Debt	100,000	100,000	-50,000
Finance Lease and PFI	266,444	261,557	256,333
<b>Gross Debt at 31 March</b>	<b>1,716,444</b>	<b>1,811,557</b>	<b>1,756,333</b>
<b>CFR</b>	<b>2,022,307</b>	<b>2,108,306</b>	<b>2,015,383</b>
<b>Under / (Over) Borrowing</b>	<b>305,862</b>	<b>296,748</b>	<b>259,050</b>

## 7. Interest rate forecast

7.1 The Authority has appointed Link Group (LG) as its treasury advisor and part of their service is to assist the Authority to formulate a view on interest rates. LG provided the following forecasts on 5 February 2024 following the 01 February 2024 MPC meeting. These are forecasts for Bank Rate, average earnings and PWLB certainty rates, gilt yields plus 80 bps.

Link Group Interest Rate View		05.02.24											
	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	5.25	5.25	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	4.80	4.30	3.80	3.30	3.00	3.00	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.20	5.10	4.60	4.10	3.70	3.30	3.10	3.10	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.00	4.90	4.40	3.90	3.60	3.20	3.10	3.10	3.10	3.10	3.10	3.20	3.20
5 yr PWLB	4.50	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.60	3.50	3.50	3.50
10 yr PWLB	4.70	4.50	4.40	4.30	4.20	4.10	4.00	3.90	3.80	3.70	3.70	3.70	3.70
25 yr PWLB	5.20	5.10	4.90	4.80	4.60	4.40	4.30	4.20	4.20	4.10	4.10	4.10	4.10
50 yr PWLB	5.00	4.90	4.70	4.60	4.40	4.20	4.10	4.00	4.00	3.90	3.90	3.90	3.90

- LAS central forecast for interest rates was previously updated on 7 November and reflected a view that the MPC would be keen to further demonstrate its anti-inflation credentials by keeping Bank Rate at 5.25% until at least second half of 2024. LG expect rate cuts to start when both the CPI inflation and wage/employment data are supportive of such a move, and when there is a likelihood of the overall economy enduring at least a slowdown or mild recession over the coming months (although most recent GDP releases have surprised with their on-going robustness).
- Timing will remain one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.
- In the upcoming months, LG's forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but also international factors such as policy development in the US and Europe, the provision of fresh support packages to support the faltering recovery in China as well as the on-going conflict between Russia and Ukraine, and in the Middle East.

### PWLB RATES

- The gilt curve saw significant falls in yields throughout November and December but has given up some of that ground since. Initially markets priced in several reductions in Bank Rate through 2024 and 2025, reflecting market confidence in inflation falling back swiftly. However, more recently, concern over the stickiness of services and wage inflation has seen yields rise a little. At the time of writing there is c50 basis points difference between the 5- and 50-year parts of the curve.

### The balance of risks to the UK economy: -

- The overall balance of risks to economic growth in the UK is even.

## Downside risks to current forecasts for UK gilt yields and PWLB rates include:

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, could keep gilt yields high for longer).
- **The Bank of England** has increased Bank Rate too fast and too far over recent months, and subsequently brings about a bout of weaker growth, potentially recession, than LG's currently anticipate.
- **Geopolitical risks**, for example in Ukraine/Russia, the Middle East, China/Taiwan/US, Iran and North Korea, which could lead to increasing safe-haven flows.

## Upside risks to current forecasts for UK gilt yields and PWLB rates:

- Despite the tightening in Bank Rate to 5.25%, the **Bank of England allows inflationary pressures to remain elevated** for a long period within the UK economy, which then necessitates Bank Rate staying higher for longer than LG's currently project.
- **The pound weakens** because of a lack of confidence in the UK Government's pre-election fiscal policies, which may prove inflationary, resulting in investors pricing in a risk premium for holding UK sovereign debt.
- Projected **gilt issuance, inclusive of natural maturities and QT**, could be too much for the markets to comfortably digest without higher yields compensating.

## LG FORECASTS

LAS expect the MPC will keep Bank Rate at 5.25% until the second half of 2024, to combat inflationary and wage pressures, even if they have dampened somewhat of late. LG's do not think that the MPC will increase Bank Rate above 5.25%.

### Gilt yields and PWLB rates

The overall longer-run trend is for gilt yields and PWLB rates to fall back over the timeline of LG's forecasts, as inflation continues to fall through 2024.

Our target borrowing rates are set **two years forward** (as LG's expect rates to fall back) and the current PWLB (certainty) borrowing rates are set out below: -

PWLB debt	Current borrowing rate as at 05.02.24 p.m.	Target borrowing rate now (end of Q4 2025)	Target borrowing rate previous (end of Q4 2025)
5 years	4.71%	3.70%	3.70%
10 years	4.82%	3.90%	3.90%
25 years	5.36%	4.20%	4.20%
50 years	5.16%	4.00%	4.00%

**Borrowing advice:** LG's long-term (beyond 10 years) forecast for Bank Rate remains at 3% and reflects Capital Economics' research that suggests AI and general improvements in productivity will be supportive of a higher neutral interest rate. As all PWLB certainty rates are currently significantly above this level, borrowing strategies will need to be reviewed in that context. Overall, better value can be obtained at the shorter end of the curve and short-dated fixed LA to LA

monies should be considered. Temporary borrowing rates will remain elevated for some time to come but may prove the best option whilst the market continues to factor in Bank Rate reductions for 2024 and later.

Our suggested budgeted earnings rates for investments up to about three months' duration in each financial year are set out below:

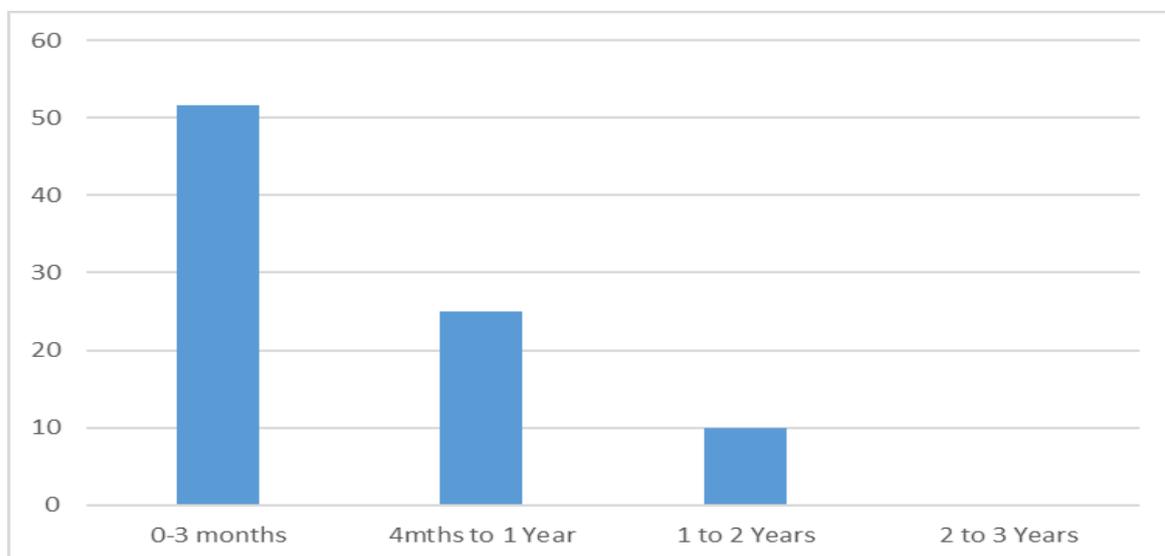
Average earnings in each year	Now	Previously
2023/24 (residual)	5.30%	5.30%
2024/25	4.55%	4.55%
2025/26	3.10%	3.10%
2026/27	3.00%	3.00%
2027/28	3.25%	3.25%
2028/29	3.25%	3.25%
Years 6 to 10	3.25%	3.25%
Years 10+	3.25%	3.25%

As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts.

Our interest rate forecast for Bank Rate is in steps of 25 bps, whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps. Naturally, LG's continue to monitor events and will update LG's forecasts as and when appropriate.

## 8. Treasury Investment Returns

Investment returns are expected to remain elevated in 2024/25, with an average return expected of around 4% but on a much-reduced cash balance of approximately £30m to £50m. The maturity profile of the Council's treasury investments is below:



## 8.1 Return Target 2024/25 to 2026/27

8.1.1 To achieve the interest receivable budget, the following returns need to be achieved:

2024/25	4.75% on an average cash balance of £30m
2025/26	4.50% on an average cash balance of £30m
2026/27	4.00% on an average cash balance of £30m

8.1.2 The return reflects the current investment positions but if opportunities are available to secure competitive rates, further investments will be made. The core treasury interest receivable budget should be achievable but there are pressures from loans to third parties, including the Council's subsidiaries but also on interest rates, however if returns from interest receivable are lower due to lower rates, then there should be reduced borrowing costs reported against the income payable budget.

## 8.2 HRA Investments

8.2.1 Cash balances held by the HRA will be invested as part of the Council's overall treasury strategy. Cash balances will generally earn the average short-term rate of the Council's investments, which will be calculated at the financial year end. Where there is agreement by the S151 Officer, individual investments can be ring-fenced for the HRA, with the allocations made within the Council's overall treasury strategy requirements. For further details please refer to the HRA Business Plan.

## 9. The Capital Expenditure Plans 2024/25 – 2026/27

9.1 The Council's HRA and GF capital expenditure plans, together with cash balances and reserves, are the key drivers of treasury management activity. The estimates for capital expenditure, and its funding based on current proposed revenue budget for 2024/25 and three-year capital programmes, are reflected in prudential indicators, which are designed to assist Member's overview and confirm capital expenditure plans. The Prudential Indicators are included in Appendix 3.

Table 5 below shows the proposed CFR to 2026/27. The Prudential Code requires Councils to ensure that capital expenditure remains within sustainable limits and to consider the impact on Council Tax and, for the HRA, housing rent levels.

**Table 5: Proposed Capital Expenditure 2023/24 to 2026/27**

Capital Expenditure	2023/24	2024/25	2025/26	2026/27
	Estimate	Estimate	Estimate	Estimate
	£000s	£000s	£000s	£000s
Opening CFR as at 1 April	1,706,996	1,936,511	2,022,307	2,108,306
Change in Year – General Fund	229,515	85,796	85,999	-97,682
Change in Year – Housing	0	0	0	4,759
<b>Net movement in CFR</b>	<b>229,515</b>	<b>85,796</b>	<b>85,999</b>	<b>-92,923</b>
<b>Total CFR as at 31 March</b>	<b>1,936,511</b>	<b>2,022,307</b>	<b>2,108,306</b>	<b>2,015,383</b>
<b>Net financing need for the year</b>	<b>248,547</b>	<b>98,959</b>	<b>101,106</b>	<b>-77,080</b>
<b>Less: MRP*</b>	<b>-11,333</b>	<b>-13,163</b>	<b>-15,107</b>	<b>-15,843</b>
<b>Less: Capital Receipts</b>	<b>-7,700</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Movement in CFR</b>	<b>229,515</b>	<b>85,796</b>	<b>85,999</b>	<b>-92,923</b>

- 9.2 A portion of the net financing requirement has already been borrowed to fund properties held by Reside. The increased financing need reflects IAS borrowing requirement.
- 9.3 Headroom has been included within the Authorised Limit on external borrowing to ensure that any major capital investment projects resulting from the IAS are not restricted by this statutory limit. The limit also covers any short-term borrowing for cash flow purposes and long-term borrowing for capital projects, finance leases, PFI and any unforeseen incidences where expected capital receipts are not forthcoming due to unexpected economic factors.

## **10. Treasury Management Advisors**

- 10.1 The Council uses LG, Treasury solutions as its external treasury management advisors. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times. But, given the complexity and scale of the Council's debt position users external, professional advice to provide assurance to both the Council's Section 151 Officer and Members
- 10.2 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review by the Council's Section 151 Officer.

## **11. Minimum Revenue Provision Policy Statement**

- 11.1 In accordance with Statutory Instrument 2008 number 414 and new guidance issued by the Government under section 21 (1A) of the Local Government Act 2003 a statement on the Council's policy for its annual Minimum Revenue Provision (MRP) needs to be approved before the start of the financial year.
- 11.2 The Council are asked to approve the Minimum Revenue Provision Statement set out in Appendix 5.
- 11.3 However, it should be noted that the Section 151 Officer is currently seeking external assurance on the Council's MRP Statement to ensure that it remains compliance with the changes that have been to the Prudential Code in recent years. In addition, there is currently a consultation on revised MRP policies for 2024/25 that may introduce changes to the way MRP is charged. Members will be updated and presented with any proposed revisions once that work has been completed.

## **12. Environmental, Social & Governance (ESG) Considerations**

- 12.1 ESG is becoming a more and more important, with around two thirds of councils declaring a "climate emergency" to date but not translating this into the incorporation of something more formal within their treasury-related Annual Investment Strategy. Changes to the CIPFA TM Code 2021 will see ESG incorporated into Treasury Management Practice 1 (TMP), with the Code stating:

*“The organisation's credit and counterparty policies should set out its policy and practices relating to environmental, social and governance (ESG) investment considerations. This is a developing area, and it is not implied that the organisation's ESG policy will currently include ESG scoring or other real-time ESG criteria at individual investment level.” and*

*“ESG issues are increasingly significant for investors and investment managers. This is better developed in equity and bond markets than for short-term cash deposits, and there is a diversity of market approaches to ESG classification and analysis. This means that a consistent and developed approach to ESG for public service organisations is currently difficult. Organisations are therefore recommended to consider their credit and counterparty policies in light of ESG information and develop their own ESG investment policies and treasury management practices consistent with their organisation's own relevant policies, such as environmental and climate change policies.”*

- 12.2 ESG is currently not a factor in agreeing if a deposit or loan is with a certain counterparty but this will be reviewed as part of a review of the TMP.

### **13. Financial Implications**

Implications completed by: Nurul Alom, Finance Manager FPA

- 13.1 The financial implications are discussed in detail in this report.
- 13.2 The numbers within the report have been checked against the main budget report to ensure accuracy and consistency.

### **14. Legal Implications**

Implications completed by: Dr. Paul Feild, Senior Governance Solicitor

- 14.1 It is a statutory requirement under the Local Government Finance Act 1992 for the Council to set out what the Council has to base its budget calculations upon. Furthermore, it is a legal requirement for the Council to set a balanced budget with regard to the advice of its Chief Finance Officer. However, what is meant by ‘balanced’ is not defined in law and this has means that the Council must rely upon the professional judgement of its finance team to ensure that the local authority's budget is robust and sustainable.
- 14.2 The Local Government Act 2003 (the “Act”) requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. The Council must ‘have regard to’ the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities when carrying out its functions under the Act.
- 14.3 The Act requires the Council to each year set out its Treasury Management Strategy for borrowing and to prepare an Annual Investment Strategy which sets out the Council's policies for managing its investments and for giving priority to the

security and liquidity of those investments these to be approved before the next municipal financial year.

## **15. Other Implications**

- 15.1 **Risk Management:** This report has risk management issues for the Council, primarily that a counterparty could cease trading or risk that interest rates would rise adversely. The mitigation of these is contained in this report.
- 15.2 **Corporate Policy and Equality Impact** - The TMSS seeks to support the Council's investment aims to unlock regeneration and economic growth opportunities within the borough. There are no equality or diversity implications arising from this report.

**Public Background Papers Used in the Preparation of the Report:** None

### **List of appendices:**

- Appendix 1 – Annual Investment Strategy 2024/25
- Appendix 2 - Borrowing Strategy 2024/25 to 2026/27
- Appendix 3 – The Capital Prudential and Treasury Indicators 2024/25 to 2026/27
- Appendix 4 – Capital Strategy and Capital Programme 2024/25 to 2026/27
- Appendix 5 - Minimum Revenue Provision Policy Statement 2024/25
- Appendix 6 - Economic Background
- Appendix 7 – Scheme of Delegation and Section 151 Officer Responsibilities