Resources and Fire & Rescue Overview and Scrutiny Committee

25 September 2024

Treasury Management Quarter 1 Update Report

1. Recommendation

That the Resources and Fire & Rescue Overview and Scrutiny Committee receives and comments upon the update on Treasury Management activity and performance for the first quarter of the 2024/25 financial year.

2. Executive Summary

2.1 This quarterly report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and includes coverage of the following:

i.) a review of the Treasury Management Strategy Statement (TMSS);

ii.) a review of the Council's investment portfolio for 2024/25 (Section 3 & Appendix 1);

iii.) a review of the Council's borrowing strategy for 2024/25, including comments on any debt rescheduling undertaken during 2024/25 (Section 5 & Appendix 1);

iv.) the Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators (Section 6 & Appendix 2); and

v.) an economic update for the first quarter of the 2024/25 financial year (Appendix 3).

2.2 The following highlights are detailed in this report and annexes:

i.) Treasury operations, balances and investments during the quarter aligned with the Council approved Treasury Management Strategy's security, liquidity, and yield prioritisation.

ii.) Total treasury investments were £319m at the end of Q1 and £27m lower than at the beginning of 2024/25.

iii.) Liquid funds (*funds that can be accessed quickly*) averaged £93m during the quarter, sufficient liquidity has been retained to meet the expected calls on the Council's cash balances to fund service and capital spending.

iv.) Investments interest rates remained stable throughout the quarter with the Bank of England (BOE)'s decision to keep the base rate unchanged at 5.25%.

v.) The average interest rates earned on the Council's treasury deposits increased to 5.20% rising from the previous quarter's 4.88%. This growth is driven by the lag between the underlying increase in interest rates feeding into actual rates of return.

vi.) Interest income on treasury investments of £4.4m was achieved during the first quarter, against a year-to-date budget of £1.2m. At the end of Q1, the full year revenue surplus from interest income is forecast to be £8.3m. It is important to note that while the additional income contributes towards in year revenue budget pressures, this income is treated as windfall and cannot be relied upon to be achieved indefinitely as it is impacted by the level of deposits earmarked required for the delivery of the capital programme. Furthermore, this income stream is highly sensitive to fluctuations in interest rates, which may affect its overall yield and stability.

3. Annual Investment Strategy update as at Q1

3.1 The Treasury Management Strategy Statement (TMSS) for 2024/25, which includes the Annual Investment Strategy, was approved by the Council on 8 February 2024. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being: Security of capital, Liquidity, and Yield.

3.2 This section of the report gives a view of how the Council's treasury operations, investments and performance aligned to these priorities and the overall TMSS.

Investment balances

3.3 Throughout the quarter, the level of funds available for investment purposes averaged £356m, with a total of £319m at the end of Q1. These funds were temporarily available, with their levels primarily influenced by the timing of cashflows such as precept payments, grant receipts, payments due, payroll, and progress in the capital programme. It's important to note that cash balances tend to decrease towards the end of the month due to larger payment runs, such as payroll, but recover as we receive income and grants throughout the month. Based on the Q1 revenue forecast and the use of reserves to fund the MTFS, we expect our cash balances to reduce as we utilise our reserves. The in year deficit on the DSG of £34m and the cumulative balance of £67m DSG deficit, subject to statutory override, are also impacting our cash balances. The timing of cash flow fluctuations is temporary, while the use of reserves is permanent.

3.4 The total investments balance reduced by £27m from the £346m at the beginning of the year to £319m at the end of Q1. About 76% (£243m) of total treasury investments were managed in-house through fixed term lending to local authorities and housing associations together with a bank call account, while 24% (£77m) was externally managed through money market funds and special purpose variable net asset value funds.

Table 1 Investment Balances movements during the quarter

Investment Type in £ Millions	Balance at 31 March 2024	Movement	Balance at 30 June 2024
	£m	£m	£m
Housing Association Loans	40	00	40
Local Authority Loans	180	05	185
Bank Deposits*	16	01	17
Managed In House	**236**	**06**	**242**
Money Market Funds*	70	-33	37
VNAV Funds	40	00	40
Externally Managed	**110**	**-33**	**77**
Total Funds	**346**	**-27**	**319**
***Highly liquid (funds that can be accessed quickly).**			

3.5 Loans to Local Authorities and Housing Associations are on fixed term basis with varying remaining maturities averaging 278 days. Local Authorities in which the bulk (82%) of these investments are in, are one of the safest investment destinations due to statutory protection.

3.6 Further information on the council's liquidity, yields, and performance of our Variable Net Asset Value (VNAV) Funds can be found in Appendix 1 of this report.

Creditworthiness

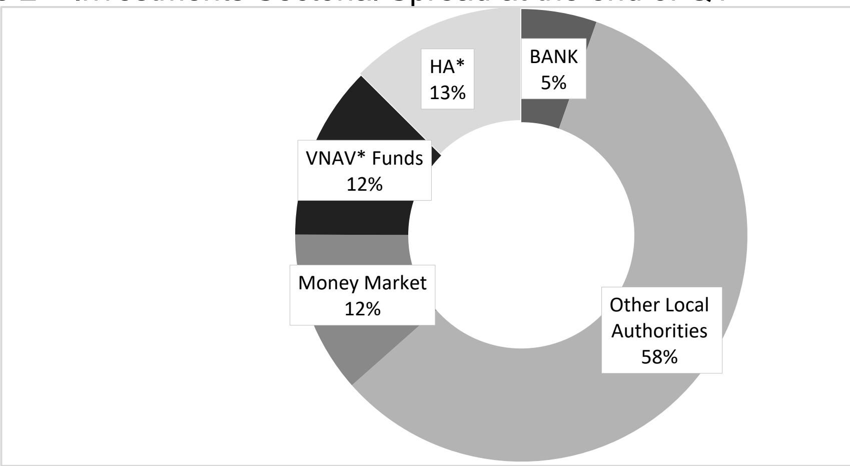
3.7 During the quarter, no changes occurred in the credit ratings of investment counterparties and countries. The Council relies on Fitch, S&P, and Moody's ratings to evaluate the creditworthiness of Treasury investment counterparties. As per the Treasury Management Strategy Statement (TMSS), investments are made in UK-based banks, rated building societies with a minimum A- Fitch credit rating, and UK local authorities.

3.8 In recent times, several local authorities have faced significant financial challenges, with some issuing Section 114 notices. Despite these difficulties, the local government sector, where 58% of the Council's deposits are invested, remains a secure option due to legal protections (Local Government Act 2003).

__Investment Counterparty Criteria__

3.9 In accordance with the TMSS, we have maintained our emphasis on security and liquidity while considering yield as a secondary factor. This approach results in the Council's treasury investments being spread across diverse sectors which exhibit strong security and liquidity features. The graph below (*Figure 2*) illustrates the sectors and proportions the treasury funds were invested in at the end of Q1.

Figure 2 – Investments Sectorial Spread at the end of Q1

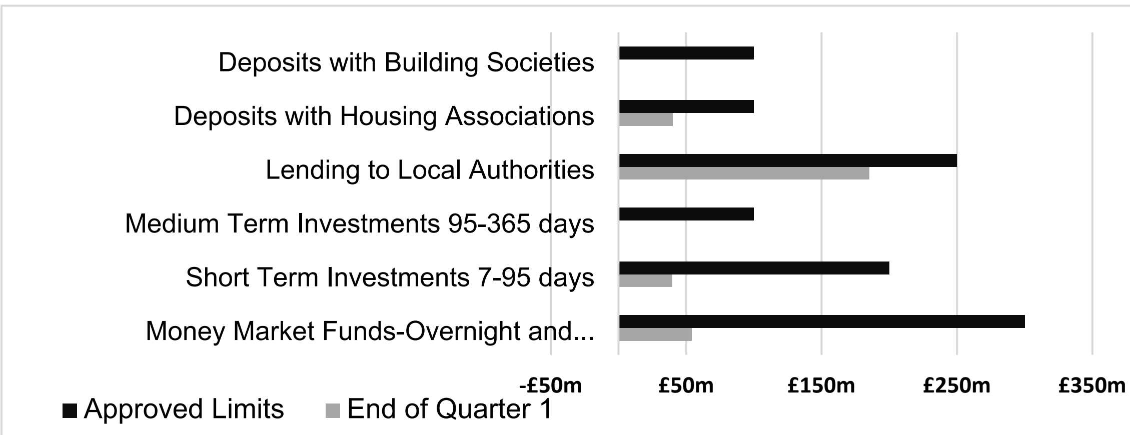


(*VNAV- Variable Net Asset Value & HA - Housing Association)

3.10 Local authorities and housing associations together held 71% of the Council's treasury funds on fixed term loans with varying repayment dates, the latest being March 2027. Investments held with local authorities alone amounted to £185m, equivalent to 58% of the total investment portfolio.

3.11 At the end of Q1 17% of the Council's liquid funds (funds that can be quickly accessed) were held in Money Market funds (12%) or an instant access bank account (5%). All the money market funds in place are rated at the highest form of credit worthiness by all the major three credit rating companies.

Figure 3 – Sectorial Investments Compared to Approved Limits



3.12 The counterparty and sectoral total investments were all within the limits set in the Treasury Management Strategy approved by the Council. The graph above (*Figure 3*) illustrates how the sectorial exposures compared to the approved sector limits.

3.13 Further information on the Annual Investment Strategy update at the end of Q1 can be found in Appendix 1, which provides an analysis of liquidity, investment maturity profiles, and yield performance throughout the quarter.

4. Borrowing

4.1 The TMSS states that the Council will aim to maintain efficient cash levels by running down external investment balances and utilising available cash to finance a portion of the Capital Financing Requirement, which is referred to as internal borrowing. As of Q1, the internal borrowing forecast has decreased from £179m to £76m compared to the TMSS as shown in table 2.

4.2 This change is largely attributed to the increased use of reserves, which has risen from £20m at budget setting as reported in the TMSS 24/25 to £71m at Q1. The increase in use of reserves is primarily required to cover the revenue outturn impact and accommodate adjustments to the Medium-Term Financial Strategy (MTFS) in future years.

4.3 In addition, slippage in the capital programme has resulted in expenditure being pushed to future years, reducing the internal borrowing requirements for the current year. Additional details regarding reserve movements and revisions to capital forecasts can be found in the 2024/25 Monitoring report Q1, which was presented to Cabinet on 5th September.

4.4 Total external borrowing has remained unchanged at £273m at the end of Q1. Updated forecasts are consistent with the TMSS, and it is expected that the authority will be required to start external borrowing from 2025/26

Table 2 – External and internal borrowing forecast as at Q1

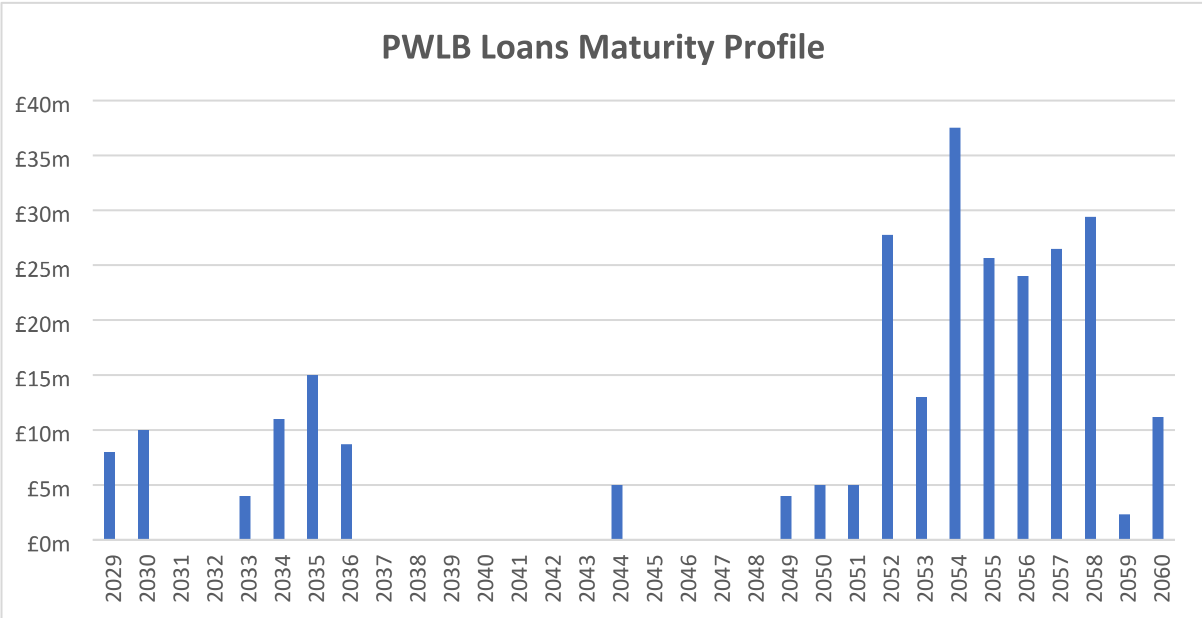
	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate	2027/28 Estimate	2028/29 Estimate
Current Debt*	272,975	272,975	284,399	372,024	425,396
New Debt (Forecast at Q1)	0	11,424	85,000	61,372	0
Gross External Borrowing	272,975	284,399	369,399	433,396	425,396
Capital Financing Requirement	348,950	453,178	540,610	607,910	593,982
Gross Internal Borrowing	75,975	168,779	171,211	174,514	168,586
Gross Internal Borrowing (TMSS 24/25)	179,366	179,366	179,366	179,366	179,366
Change from TMSS to Q1	-103,391	-10,587	-8,155	-4,851	-10,780

*Current Debt is cumulative includes the new debt forecast from 2025/26 and in future years.

Debt Maturity Profile

4.5 The table below illustrates the existing maturity profile of the Council's borrowings. There are no scheduled repayment in the next three financial years. The next scheduled repayment will be due in the 2029 financial year with the last repayment in 2060.

Figure 8 – Debt Maturity Profile



Debt Rescheduling

4.6 Debt rescheduling opportunities increased in the periods where gilt yields, which underpin PWLB rates and market loans, have risen materially. However, during the quarter under review, no viable opportunity was identified to reschedule the Council's PWLB debt. Treasury Officers continue to monitor the debt market developments and review opportunities for debt rescheduling.

PWLB maturity Certainty Rates 2nd April 2024 to 28th June 2024

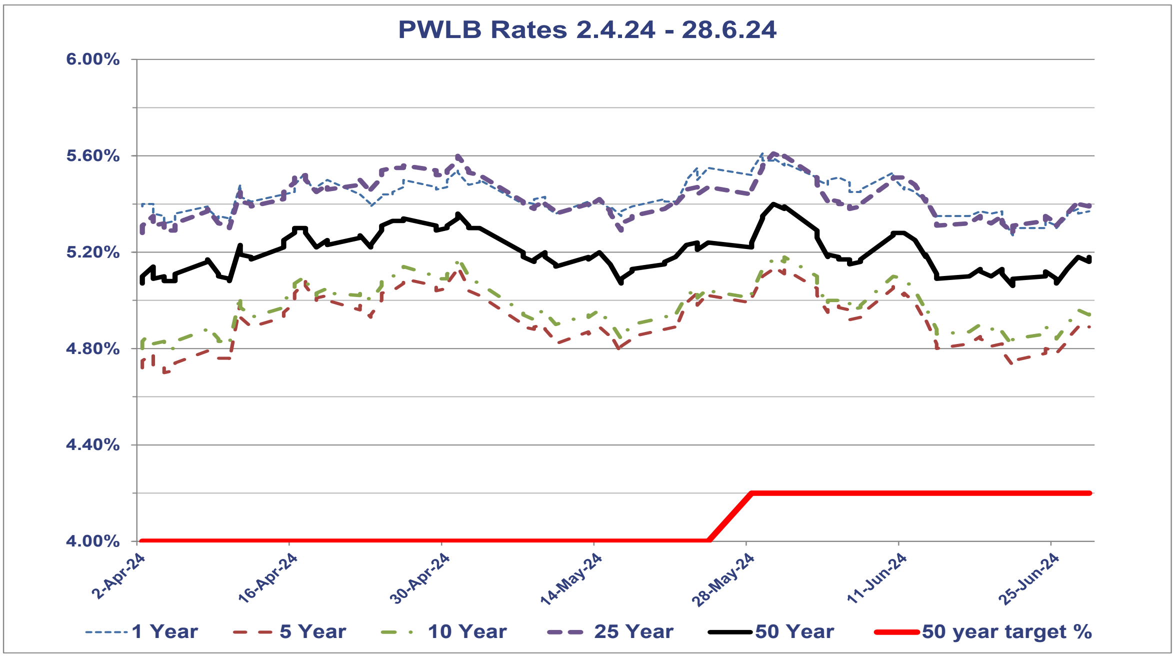
4.7 Gilt yields and PWLB rates remained relatively stable between 1st April and 30th June.

4.8 The 50-year PWLB Certainty Rate target for new long-term borrowing (the low point of our forecast on a two-year timeline) started 2024/25 at 4.00% and increased to 4.20% on 28th May. As can be seen, with rates remaining elevated, it would be advisable to not borrow long-term unless the Authority wants certainty of rate and judges the cost to be affordable.

HIGH/LOW/AVERAGE PWLB RATES FOR 02.04.24 – 28.06.24

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	5.27%	4.70%	4.80%	5.28%	5.06%
Date	21/06/2024	04/04/2024	02/04/2024	02/04/2024	21/06/2024
High	5.61%	5.14%	5.18%	5.61%	5.40%
Date	29/05/2024	01/05/2024	01/05/2024	30/05/2024	30/05/2024
Average	5.43%	4.92%	4.98%	5.42%	5.20%
Spread	0.34%	0.44%	0.38%	0.33%	0.34%

PWLB RATES 02.04.24 - 28.06.24 (note: the 1st April & 29th and 30th June were bank holidays/weekends)



5. Liability Benchmark

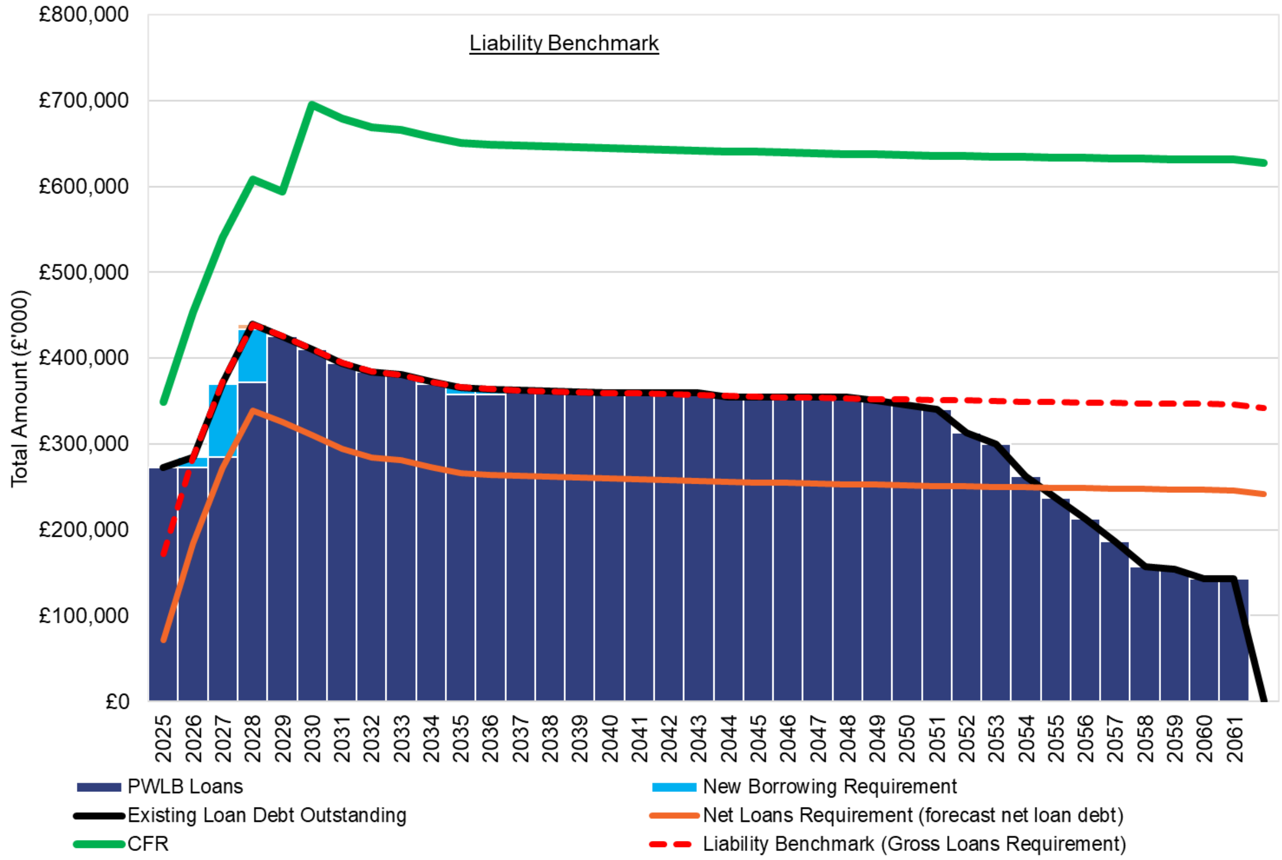
5.1 The purpose of this prudential indicator is to compare the Authority's existing loans outstanding against a standardised assessment of the need for external loan debt, referred to as the liability benchmark. The benchmark reflects the borrowing required to finance capital spending, whilst taking into account the ability to utilise cash balances instead of borrowing externally and maintaining a certain level of cash liquidity. If the existing external loans outstanding are below the debt required, the authority may need to borrow more to cover the shortfall. Conversely, if the existing external loans outstanding exceed the necessary amount, the resulting excess cash may need to be invested or external borrowing may be reduced. Therefore, the chart provides the authority with insights into how much it needs to borrow, when, and at what maturities to match its planned borrowing needs.

5.2 The liability benchmark makes assumptions about future prudential borrowing beyond the five-year Medium Term Financial Strategy. Due to the long-term nature of these assumptions, they are broad approximations, and the resulting graph shows the liability benchmark gradually decreasing until 2050. It is important to note that the chart's representation of the Capital Financing Requirement (CFR) also decreases over time. However, in reality, a rolling program of new capital expenditures will be approved, which means the CFR is unlikely to decline as shown in the graph.

5.3 The liability benchmark is the lowest level of borrowing compared to the CFR borrowing requirement – borrowing only when cash balances reach a set minimum level. This assumes that internal resources such as reserves and working capital are utilised and that cash and investment balances are held at optimum levels over time.

5.4 As capital spending increases over the next few years and the Council utilises its reserves rather than borrowing more, and the gap between external debt (the black line) and the liability benchmark (the dotted red line) reduces until the Council does start borrowing externally again.

5.5 The cash liquidity buffer is reflected in the gap between the dotted red line (the liability benchmark) and the solid orange line (the net loans requirement). This buffer is planned to be brought down to £100m over time, representing a more efficient use of balance sheet resources, and this shows as a reduced gap between these two lines.



6. Non-Treasury Investments

6.1 In addition to managing the Council's treasury investments and borrowings, the Treasury Management Team are also responsible for managing other non-treasury investments, undertaken in pursuit of achieving the Council's economic, commercial, and social objectives. Among the ongoing non-treasury investments that the team is involved in are: loans through the Warwickshire Investment Fund, and loans to the Warwickshire Property and Development Group, and Educaterers, the schools catering local authority trading company.

6.2 The non-treasury investments activities are reported and monitored at other governance forums and are not included in this report.

7. Financial Implications

7.1 The financial implications of the treasury management performance and activity are set out in the body of the report.

8. Environmental Implications

8.1 The Council is committed to considering environmental, social, and governance (ESG) issues, and has a particular interest in terms of climate change and pursuing activities that have a positive social impact.

8.2 In the TMSS, the Council undertook to ensure an understanding of the degree to which investments may contribute towards climate change and where appropriate, move cash balances to funds that have ESG driven targets, or "green funds", to ensure our investment is contributing towards tackling ESG issues, among other undertakings, with security and liquidity of investments taking precedence.

8.3 **Environmental**: The majority (71%) of the treasury investments outstanding at the end of the quarter were fixed-term deposits with other local authorities and housing associations. Of these deposits, 58% by value were with local authorities and housing associations with a climate action plan.

9. Timescales Associated with Next Steps

9.1 This next report to update on Q2 will be presented to Resources and Fire & Rescue Overview and Scrutiny Committee on 4th December 2024.

Appendix

Appendix 1 – Investment and Borrowing Portfolio
Appendix 2 – Prudential Indicators
Appendix 3 – LINK Economic Update

Background Papers
None.

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The report was circulated to the following members prior to publication:
Local Member(s): None – this is a County wide report