DECISION-MAKER:		GOVERNANCE COMMITTEE		
SUBJECT:		REVIEW OF PRUDENTIAL LIMITS AND TREASURY MANAGEMENT MIDYEAR 2022/23		
DATE OF DECISION:		14 NOVEMBER 2022		
REPORT OF:		**EXECUTIVE DIRECTOR FINANCE & COMMERCIALISATION (S151 Officer)**		
CONTACT DETAILS				
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STATEMENT OF CONFIDENTIALITY

NOT APPLICABLE

BRIEF SUMMARY

The purpose of this report is to inform Governance Committee of the Treasury Management activities and performance for 2022/23 to date against the approved Prudential Indicators for External Debt and Treasury Management.

This report:

a) is prepared in accordance with the revised CIPFA Treasury Management Code and the revised Prudential Code;
b) presents details of capital financing, borrowing, debt rescheduling and investment transactions;
c) reports on the risk implications of treasury decisions and transactions;
d) gives details of the midyear position on treasury management transactions in 2022/23; and
e) confirms compliance with treasury limits and Prudential Indicators.

The report highlights the increasingly difficult economic climate being operated in, with record high levels of inflation and rising interest rates. The Bank of England increased the official Bank Rate to 2.25% over the period, up from 0.75% in March. The Monetary Policy Committee (MPC) has noted that domestic inflationary pressures are expected to remain strong and so given ongoing strong rhetoric around tackling inflation further Bank Rate rises should be expected. These factors are reflected in the borrowing strategy detailed within the report.

RECOMMENDATIONS:

It is recommended that Governance committee:

	(i)	Notes the Treasury Management (TM) activities for 2022/23 and performance against Prudential Indicators.
	(ii)	Notes that the continued proactive approach to TM has led to reductions in borrowing costs and safeguarded investment income during the year.

	(iii)	Continues to delegate authority to the S151 Officer to make any future changes which benefit the authority and to report back at the next Treasury update.
REASONS FOR REPORT RECOMMENDATIONS		
1.	The Treasury Management Code requires public sector authorities to determine an annual TM Strategy and formally report on their treasury activities and arrangements to Governance Committee mid-year and after the year-end. These reports enable those tasked with implementing policies and undertaking transactions to demonstrate they have properly fulfilled their responsibilities and enable those with ultimate responsibility/governance of the TM function to scrutinise and assess its effectiveness and compliance with policies and objectives.	
ALTERNATIVE OPTIONS CONSIDERED AND REJECTED		
2.	No alternative options are relevant to this report.	
DETAIL (Including consultation carried out)		
CONSULTATION		
3.	Not applicable.	
BACKGROUND		
4.	The Local Government Act 2003 introduced a system for borrowing based largely on self-regulation by local authorities. The basic principle is that local authorities are free to borrow as long as their capital spending plans are affordable, prudent and sustainable.	
5.	The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that authorities report on the performance of the treasury management function at least twice a year (mid-year and at year end).	
6.	The Authority's TM Strategy for 2022/23 was approved at Governance Committee on 14 February 2022. The 2017 Prudential Code includes a requirement for local authorities to produce a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 23 February 2022.	
7.	Overall responsibility for treasury management remains with the Council. No TM activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. This report covers treasury activity and the associated monitoring and control of risk.	
8.	The report and appendices highlight that:	
	a)	Borrowing activities have been undertaken within the borrowing limits approved by Governance Committee on 14 February 2022.

	b)	With an increasing borrowing requirement, our overall treasury strategy is to minimise both external borrowing and investments and to only borrow to the level of the net borrowing requirement. This will reduce credit risk, take pressure off the Council's lending list, and avoid the cost of carry existing in the current interest rate environment. Throughout the year, capital expenditure levels, market conditions and interest rate levels are monitored to minimise borrowing costs over the medium to longer term and to maintain stability.
	c)	For longer term investments the Council will continue to hold assets in more secure and/or higher yielding asset classes. Total investment returns are estimated to be £1.7M during 2022/23 which is £0.6M higher than budgeted and reflects the current financial environment of increased interest rates.
	d)	The differential between debt costs and investment earnings continued to be acute, resulting in the use of internal resources in lieu of borrowing often being the most cost effective means of financing capital expenditure. The average rate for repayment of debt, (the Consolidated Loans & Investment Account Rate – CLIA), is 2.88%, in line with budget. We do not currently have any short-term debt, but it is the intention to borrow in the short-term markets during 2022/23.
	e)	Since 2012, the Council has pursued a strategy of internal borrowing – minimising external borrowing by running down its own investment balances and only borrowing short term to cover cash flow requirements. This has both reduced the credit risk exposure and saved the Council money in terms of net interest costs. Rates are monitored and if opportunities arise long term borrowing is considered in consultation with our treasury advisors. In order to add more certainty a £10M, 25 year PWLB maturity loan was taken May. Rates have continued to rise since then as can be seen in Appendix 2, paragraphs 11 to 17.
	f)	In achieving interest rate savings, the Council is exposed to interest rate risk by taking out variable debt. This was and continues to be very financially favourable but does mean that close monitoring of the markets is required to ensure that the Council can act quickly should the situation change.
	g)	Net loan debt is expected to increase during 2022/23 from £209M to £299M (£90M) as detailed in Appendix 2, paragraph 5. As at September 2022 the balance is £254M, due to higher than expected cash balances at this point in year and deferral of majority of new borrowing to later in year.
	h)	As part of the creation of the authority, assets and liabilities were transferred from Hampshire as the predecessor authority. This forms part of the net loan debt and was £13M at end of quarter 2.
	i)	The forecast cost of financing the council's loan debt is £16.71M at an average interest rate of 2.82%, of which £5.49M relates to the HRA.

		This will be subject to movement as the need for further borrowing for the remainder of the year becomes more certain.
	j)	During the first half of the financial year PWLB rates have risen dramatically, particular in late September after the Chancellor's 'mini-budget' prompted a fall in sterling and rise in market interest rate expectations. Interest rates rose by over 2%. As a result, a review of the capital programme was undertaken during quarter 2, which has resulted in a reduction in borrowing overall and a re-profiling of schemes to move borrowing into later years.
	k)	The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves. During the year investment balances have ranged between £109.37M and £66.45M and are currently £67.27M but are expected to reduce to £48M by year end. Appendix 2, paragraphs 21 to 26, gives further detail. Forecast income is now £1.63M, £0.61M higher than originally budgeted, reflecting higher market rates on interest.
9.	Appendix 1 summarises the economic outlook and events in the context of which the Council operated its treasury function during 2022/23.	
10.	Appendix 2 summarises treasury activity during the year and covers: • Borrowing Requirement and Debt Management • Investment Activity • Non – Treasury Investments	
11.	Appendix 3 summarises quarterly benchmarking produced by our advisors, showing the breakdown of our investments and how we compare to their other clients and other English Unitary authorities. It shows the average return on our internal investments at 1.91% is higher than the unitary average of 1.74% and our overall return including the Local Authority Property Fund (income only) is 2.74% as opposed to the average of 2.13%. This has been achieved without impacting on our average credit rating which at AA- is in line with than both other Local Authorities and Unitary Authorities.	
COMPLIANCE WITH PRUDENTIAL INDICATORS AND AMENDMENT TO 2022/23 TREASURY STRATEGY		
12.	It can be confirmed that the Council has complied with its Prudential Indicators for 2022/23, approved by Governance Committee on 14 February 2022.	
13.	In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of TM activity during 2022/23. None of the Prudential Indicators has been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield. The table below summarises the Key Indicators, further details can be seen in appendix 4.	

14.	***Table1: Key Prudential Indicators***

Indicator	Limit	Actual at 30/9/2022
Authorised Limit for external debt	£975M	£319M
Operational Limit for external debt	£850M	£319M
Maximum external borrowing year to date	£785M	£266M
Limit of fixed interest debt	100%	83%
Limit of variable interest debt	50%	17%
Limit for long term investments	£100M	£28M

REVISION TO CIFPA CODES

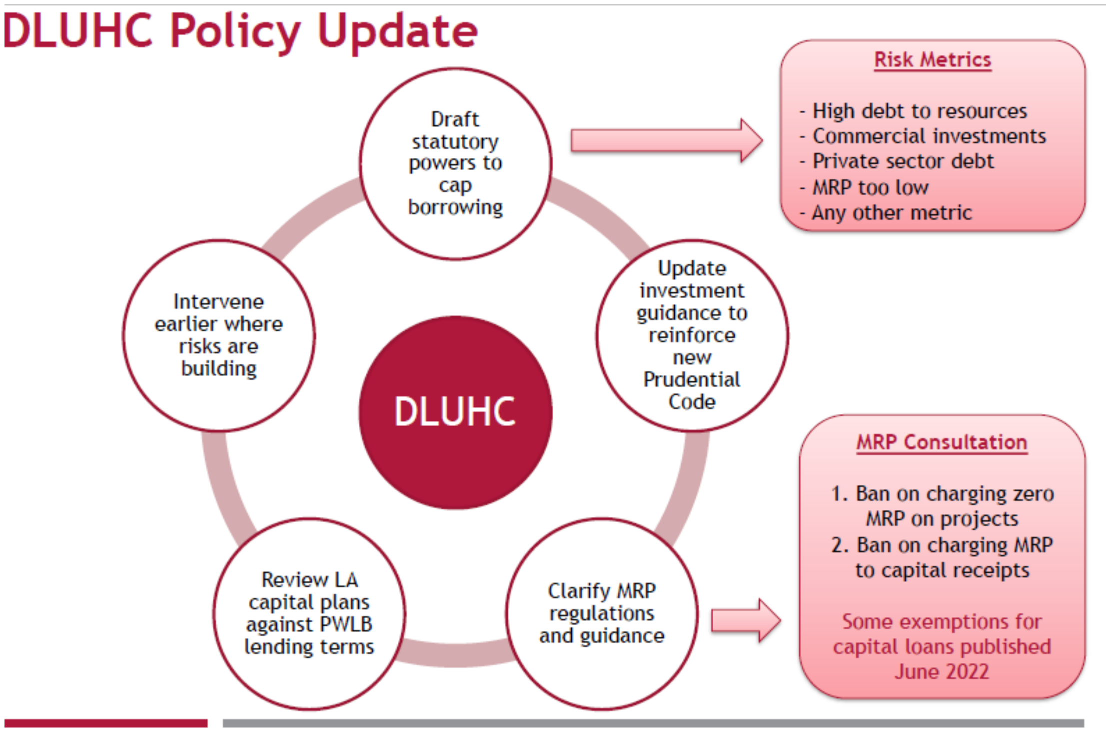
15. CIPFA published revised Prudential and Treasury Management Codes in December 2021. The Prudential Code took immediate effect although detailed reporting requirements could be deferred until the 2023/24 financial year. We are reviewing the impact of the proposed changes.

16. The main changes from previous codes include:

- Additional reporting requirements for the Capital Strategy.
- For service and commercial investments, in addition to assessments of affordability and prudence, an assessment of proportionality in respect of the Authority's overall financial capacity (i.e., whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services).
- Forward looking prudential code indicators must be monitored and reported to members at least quarterly.
- A new indicator for net income from commercial and service investments to net revenue stream.
- Inclusion of the liability benchmark as a treasury management prudential indicator. CIPFA recommends this is presented as a chart of four balances – existing loan debt outstanding; loans CFR, net loans requirement, liability benchmark – over at least 10 years and ideally cover the authority's full debt maturity profile.
- Excluding investment income from the definition of financing costs.
- Credit and counterparty policies should set out the Authority's policy and practices relating to Environmental, Social and Governance (ESG) investment considerations.
- Additional focus on the knowledge and skills of officers and elected members involved in decision making.
- Future long-term investments, such as CCLA will be prohibited as we are net borrower, but we will not need to unwind existing investments.

DLUHC POLICY UPDATE

17. DLUHC published a policy paper in November 2021 outlining the ways it feels that the current framework is failing and potential changes that could be made. The paper found that "while many authorities are compliant with the

	framework, there remain some authorities that continue to engage in practices that push the bounds of compliance and expose themselves to excessive risk".
18.	The consultation closed on 8 February 2022 and results are yet to be published but the following diagram highlights the probable outcome. 
RESOURCE IMPLICATIONS	
Capital/Revenue	
19.	This report is a requirement of the TM Strategy, which was approved at Governance Committee on 14 February 2022 and as part of the Capital Strategy by Council on 23 February 2022.
20.	The interest cost of financing the Authority's long term and short term loan debt is charged corporately to the Income and Expenditure account. The cost is estimated at £8.7M for 2022/23, which is lower than budgeted (£9.6M), despite increased interest rates. This is as a result of a review of the capital programme, borrowing needs and deferral of most of the borrowing to the later part of the year.
21.	In addition, interest earned on temporary balances invested externally is credited to the Income and Expenditure account. The current forecast for 2022/23 is £1.6M, £0.6M higher than budgeted due to higher interest rates.
22.	The expenses of managing the Authority's loan debt consist of brokerage and internal administration charges. These are pooled and borne by the HRA and General Fund proportionately to the related loan debt. Debt management expenses are expected to be £0.2M in 2022/23 in line with budget.
Property/Other	
23.	None.

LEGAL IMPLICATIONS	
<u>Statutory power to undertake proposals in the report</u>:	
24.	Local Authority borrowing is regulated by Part 1, of the Local Government Act 2003, which introduced the new Prudential Capital Finance System. From 1 April 2004, investments are dealt with, not in secondary legislation, but through guidance. Similarly, there is guidance on prudent investment practice, issued by the Secretary of State under Section 15(1)(a) of the 2003 Act. A local authority has the power to invest for "any purpose relevant to its functions under any enactment or for the purposes of the prudent management of its financial affairs". The reference to the "prudent management of its financial affairs" is included to cover investments, which are not directly linked to identifiable statutory functions but are simply made in the course of treasury management. This also allows the temporary investment of funds borrowed for the purpose of expenditure in the reasonably near future; however, the speculative procedure of borrowing purely in order to invest and make a return remains unlawful.
<u>Other Legal Implications</u>:	
25.	None.
RISK MANAGEMENT IMPLICATIONS	
26.	Not Applicable
POLICY FRAMEWORK IMPLICATIONS	
27.	This report has been prepared in accordance with the CIPFA Code of Practice on TM.

KEY DECISION?	~~Yes~~/No
WARDS/COMMUNITIES AFFECTED:	NONE

<u>SUPPORTING DOCUMENTATION</u>	
Appendices	
1.	2022/23 Economic Background
2.	Treasury Activity during 2022/23
3.	Southampton Benchmarking 30th September 2022
4.	Compliance with Prudential Indicators
5.	Glossary of Treasury Terms
Documents In Members' Rooms	
1.	None.

Equality Impact Assessment	
Do the implications/subject of the report require an Equality and Safety Impact Assessments (ESIA) to be carried out.	~~Yes~~/No
Privacy Impact Assessment	
Do the implications/subject of the report require a Privacy Impact Assessment (PIA) to be carried out.	~~Yes~~/No

<table>
<tr><td colspan="3">Other Background Documents
Equality Impact Assessment and Other Background documents available for inspection at:</td></tr>
<tr><td colspan="2">Title of Background Paper(s)</td><td>Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)</td></tr>
<tr><td>1.</td><td>The Medium Term Financial Strategy, Budget
Capital Programme 2022/23 to 2024/25 –
reported to Council 23 February 2022</td><td></td></tr>
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