Item No: 6.1	Classification: Open	Date: 22 November 2023	Meeting Name: Council Assembly
Report title:		Treasury Management – Mid-year Update 2023-24	
Wards or Groups affected:		All	
From:		Strategic Director of Finance	

RECOMMENDATION

1. That council assembly note the 2023-24 mid-year treasury management update report and in particular:

   - the update on the economic background and implications for the Treasury Management Strategy in 2023-24 (paragraphs 10-22).

   - that all treasury management activity was undertaken in compliance with the approved treasury management strategy and within the council's prudential indicators, attached as Appendix A.

   - that the balance outstanding on all external debt as at 30 September 2023 was £965m (£888m at 30 September 2022, paragraph 23).

   - that the balance of investments at 30 September 2023 stood at £148m (£198m at 30 September 2022, paragraph 30).

2. That council assembly approve the intention to add Green Bonds (Community Municipal Investments) as a source of debt financing in relation to climate-related activities (paragraph 21)

BACKGROUND INFORMATION

3. In compliance with the Local Government Act 2003, the council has adopted the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice (the Code). The Code requires local authorities to determine an annual treasury management strategy and, as a minimum, formally report on their treasury activities and arrangements to Council Assembly mid-year and after the year-end.

4. The Code provides the following objective with regard to treasury management:

   "It is important that treasury management policies adequately reflect risk and in particular security, liquidity and yield, in that order of importance. No treasury management transaction is without risk and management of risks is the key purpose of the treasury management strategy."

5. The council is exposed to financial risks from its investments, existing external debt, as well as future borrowing requirements arising from the council's capital programme. The risks include potential losses from investments and increased borrowing costs from changing interest rates. The successful identification, monitoring and control of risk remain central to the Authority's treasury management strategy.

6. The 2023-24 treasury management strategy was approved by Council Assembly in February 2023. Under financial delegation, all executive, managerial and operational decisions are the responsibility of the Strategic Director of Finance.

7. This mid-year Treasury Management Report covers the treasury management activity and compliance with the treasury management strategy for the period from April to September 2023.

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

9. The council's treasury management function is conducted within the framework of the Treasury Management Code. The code now also excludes extensive additional requirements for service and commercial investments.

KEY ISSUES FOR CONSIDERATION

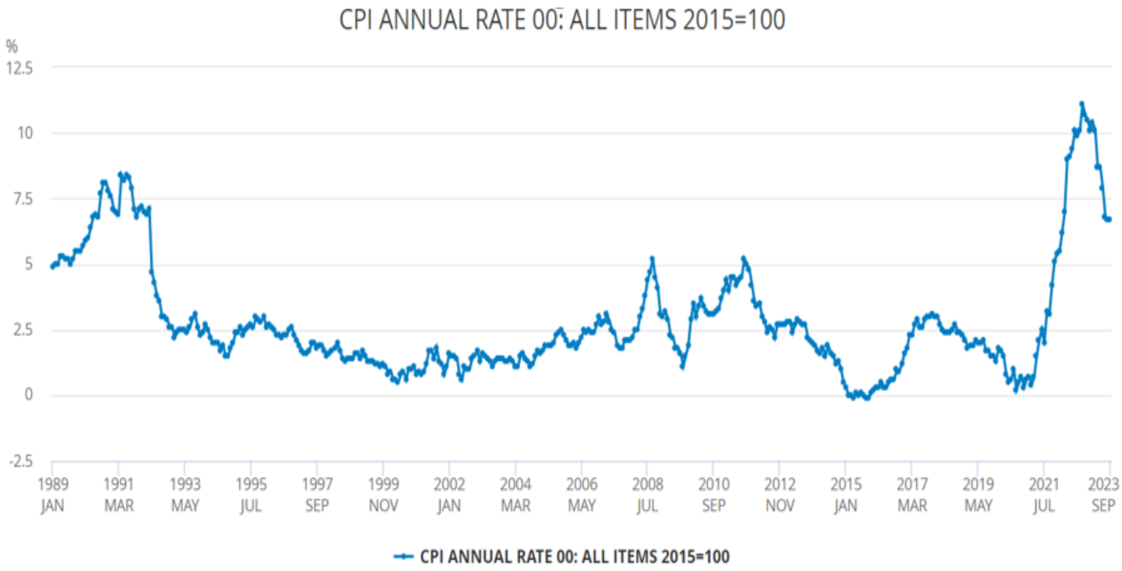
Economic Background: April 2023 to September 2023

10. The Bank of England's Monetary Policy Committee continued tightening monetary policy over most of the period and have reiterated their commitment to tightening policy further, if deemed necessary.

11. UK inflation has remained high. Consumer Price Index (CPI) rose by 6.7% in the 12 months to September 2023, the same rate as in August (the lowest rate since February 2022). On a monthly basis, CPI rose by 0.5% in September 2023, the same rate as in September 2022. The central bank has stated that CPI inflation is expected to decline significantly in the near term.

12. The economy grew marginally by 0.2% in August following the sharp fall in July. Analysts stated that higher borrowing costs and the higher cost of living was weighing on consumers and businesses.

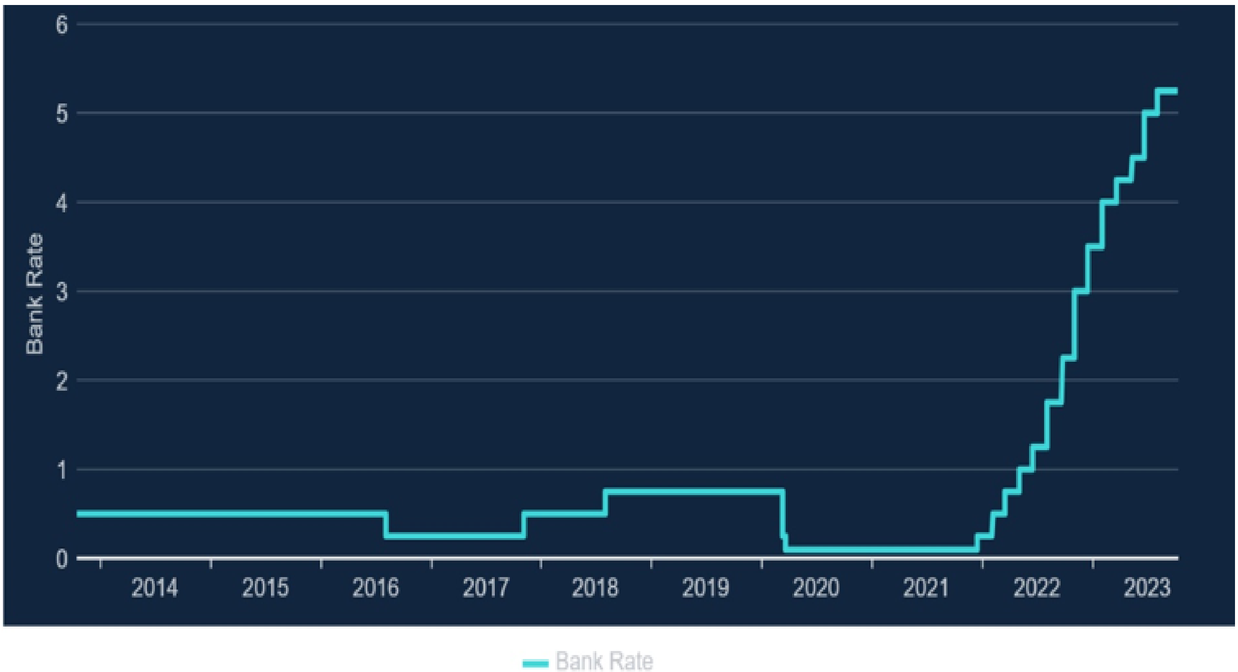
CPI Inflation 1989 – 2023



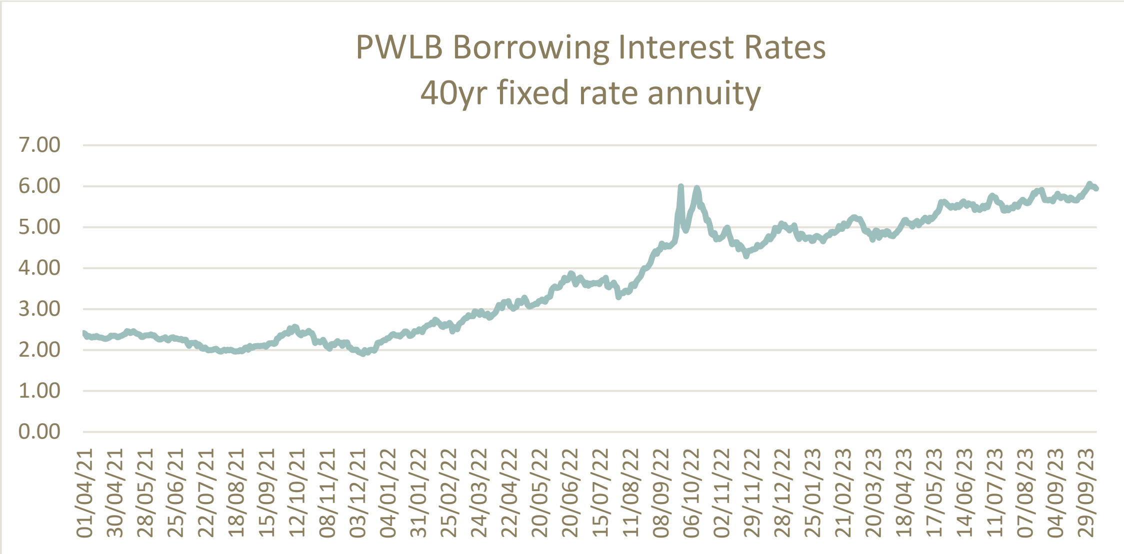
13. The Bank of England base rate rose from 0.75% in April 2022 to 5.25% in September 2023. Rates were held at 5.25%, ending a run of 14 consecutive rises after inflation started to slow down.

14. The UK economy returning to growth in August has fuelled expectations that interest rates will be left unchanged again in October. Market expectation is that interest rate will peak at this level.

Bank of England Base Rate 2013 – 2023



15. The increases in both the BOE base rate and UK Gilts are driving up the cost of external borrowing significantly. Whilst the Public Works Loan Board (PWLB) remains the cheapest option; the cost of new borrowing (and refinancing maturing debt) has increased from 1.9% in December 2021 to 5.86% as at 29 September 2023 – an increase of over 308% in the space of 21 months. Rates briefly touched 6% during the peak of the political crisis in October 2022.



Implications for ongoing Treasury Management Strategy

16. The council has an ambitious capital programme, to support both the wide range of services it offers and to build new council homes. In the past, revenue balances have been utilised to forestall the need to borrow externally. This approach is commonly known as internal borrowing. Internal borrowing is cheaper than external borrowing and remains the preferred source of financing in the short term whilst sufficient funds are available.

17. However, in September 2017, officers reported to cabinet that from 2017-18 onwards there would be an increasing need to borrow externally. Since then, external borrowing has gradually increased - both as a proportion of capital funding and in absolute terms. This has been necessary because of the scale of the capital programme.

18. Southwark has one of the highest outstanding PWLB debt of all English councils. This is largely a consequence of the size of Southwark's council housing estate and its position as the 4th largest social landlord in the country. This ranking is likely to rise based on the additional borrowing that will be required in coming years to fund the capital programme.

19. The most significant part of the capital programme remains the new homes. To date, approximately £285m of external borrowing has funded the New Homes Programme and a further £706m has been previously earmarked as the sum that could be borrowed within the prudential code and

affordability limits. This amounts to £991m in total for new homes. This provision is being constantly reviewed, especially in the context of interest rate rises, rent caps and inflation.

20. The need to borrow externally has a revenue impact. This is accounted for annually in the council's budget setting process, both for the Housing Revenue Account and the General Fund.

21. The council could borrow from the Public Works Loans Board (PWLB), financial institutions and banks or directly from other local authorities. In the context of its efforts to address climate change, the council's strategy may include raising capital via the issuance of Green Bonds (Community Municipal Investments) or other similar peer-to-peer (P2P) loan agreements. Alternative sources of borrowing to the PWLB will be considered to ensure the lowest available rates are achieved and value for money is achieved for taxpayers. Officers will continue to seek to ensure that the entire cost of borrowing is taken into account and that best value for money is achieved for taxpayers.

22. The Medium Term Financial Strategy (MTFS) report to October Cabinet, discussed the short and long term pressures in the Housing Investment Programme and the need to ensure financial sustainability. Officers will also be reviewing and revising the Treasury Management Strategy with reference to this and to the rapidly changing economic environment.

Borrowing Update

23. As at 30 September 2023, the balance outstanding on all of the council's external loans portfolio was £965m. The proportion of long-term loans outstanding stood at £915m, compared to £888m as at 30 September 2022.The majority of long-term loans outstanding was borrowed from the PWLB at fixed rates of interest.

24. In the first half of 2023-24, £5.95m of long-term borrowing was repaid and no new PWLB loans were taken out.

25. Short-term borrowing outstanding as at 30 September 2023 was £50m, with a weighted average rate of 4.36% compared to £20m in September 2022 with a weighted average rate of 0.67%. All short-term borrowing was via other local authorities which are typically at lower rates compared to other sources for short-term loans.

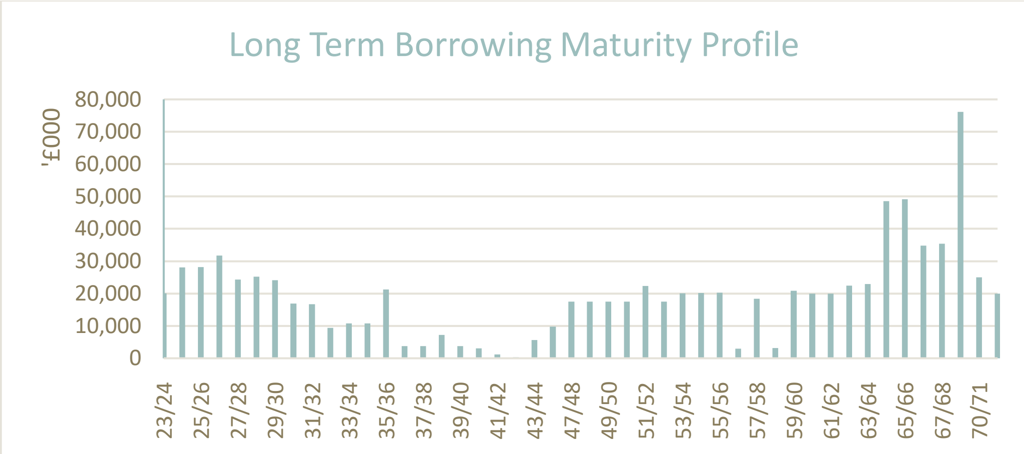
26. Borrowing short-term (less than one year) increases the council's exposure to interest rate and refinancing risks. To mitigate this risk, it is prudent to ensure that short-term borrowing as a proportion of the total debt portfolio is managed within prudential limits.

27. The benefits of internal/short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecasted to rise

modestly. This will help inform decisions on whether the council borrows additional sums at long-term fixed rates with a view to keeping future interest costs low, even if this causes additional costs in the short-term.

28. The weighted average rate of interest for the council's debt portfolio was 3.78% at 30 September 2023, 3.75% at 31 March 2023.

29. The maturity profile of outstanding long term borrowing as at 30 September 2023 is shown in the chart below:



Investment Management

30. The council holds significant cash balances, representing income received in advance of expenditure plus balances and reserves. These are invested on a daily basis to maximise the council's return on available balances. The cash balance at 30 September 2023 was £148m (compared to £198m as at 30 September 2022). The change year on year is mainly attributable to increased expenditure thereby reducing the available cash balances at 30 September 2023. However, over the reporting period, the council's cash balances ranged between £55m and £180m due to timing differences between income and expenditure.

31. The annualised rate of return for council treasury investments for the first half of 2023-24 financial year was 4.16% an improvement on the prior year performance of -0.67%, reflecting the increasing rate of return available in the market.

32. The initial external investment portfolio totalled £100m. In July 2023 the decision was made to disinvest principal amounts on maturity, in order to reduce the council's borrowing requirement. As at 30 September 2023, the total market value of the portfolio stood at £74m.

33. To assess the external fund managers' performance, the council measures the return against a composite investment benchmark of SONIA (Sterling Over Night Indexed Average) and the one to three year gilt index. For the equivalent period of the financial year, the benchmark index annualised

return was 3.39% and the fund managers performed better with an annualised return of 3.79%.

34. The distribution of external investments by maturity and credit rating as at 30 September 2023 is set out in the table below:

Investment Maturity Profile and Credit Ratings

	A		AA		AAA		Total	
Investment Maturity	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**
Up to 1 Year	46.6	63.0	1.3	1.8	6.4	8.6	54.3	73.4
1-2 Years	3.1	4.2	1.0	1.4	7.6	10.2	11.7	15.8
2-5 Years	0.5	0.7	2.1	2.9	5.4	7.3	8.1	10.9
Total	**50.3**	**67.9**	**4.4**	**6.0**	**19.4**	**26.1**	**74.1**	**100.0**

AAA represents the highest credit quality, AA represents very high credit quality and A represents high credit quality.

35. The investment activity during the period conformed to the approved strategy and cash flow was successfully managed to maintain liquidity.

Prudential Indicators – Actuals and Estimates

36. Local authority borrowing, investment and capital finance activity is supported by the Prudential Code for Capital Finance, the Treasury Management in the Public Services Code of Practice and related guidance published by CIPFA. The codes require councils to set a series of indicators and limits each year. The 2022-23 indicators were agreed in February 2022, before the start of the financial year. Appendix A shows the outturn of the Authority against the 2022-23 prudential indicators and estimates for 2023-24.

37. The council has complied with its prudential indicators throughout the first half of 2023-24.

Community, Equalities (including socio-economic) and Health Impacts

38. This report monitors the council's compliance with the treasury management strategy and Council's prudential indicators as agreed in February 2023. This report has been judged to have no direct impact on local people and communities who are protected under the Equality Act.

Climate change implications

39. The report seeks approval for the use of Green Bonds which adds support to the council's climate change strategy.

Resource implications

40. There are no direct resource implications in this report.

Consultation

41. There has been no consultation on this report.

SUPPLEMENTAL ADVICE FROM OTHER OFFICERS

Assistant Chief Executive (Governance and Assurance) [AJW 1.11.2023]

42. The council's constitution determines that agreeing the treasury management strategy is a function of the council assembly and that the review and scrutiny of the treasury management strategy and policies is the responsibility of the audit, governance and standards committee.

43. Financial standing orders require the strategic director of finance to set out the treasury management strategy for consideration and decision by council assembly, also to report on activity on a regular basis to cabinet and at mid and year-end to council assembly. Furthermore all executive and operational decisions are delegated to the strategic director of finance.

44. The Local Government Act 2003 ("the 2003 Act") section 3 and the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 require local authorities to determine affordable borrowing limits and have regard to the Prudential Code for Capital Finance in Local Authorities, also the Treasury Management in the Public Services Code of Practice and Guidance, published by the Chartered Institute of Public Finance and Accountancy, when considering borrowing and investment strategies, determining or changing borrowing limits or prudential indicators.

45. Section 15(1) of the 2003 Act requires a local authority "to have regard (a) to such guidance as the Secretary of State may issue". This guidance includes the Ministry of Housing, Communities and Local Government Guidance on Local Authority Investments updated February 2018 and on the flexible use of capital receipts which was updated in August 2022

46. Section 12 of the 2003 Act grants local authorities the powers to invest for any purpose relevant to its functions or for the purposes of the prudent management of its financial affairs.

47. Council Assembly has to have due regard to the need to eliminate discrimination, advance equality of opportunity, and to foster good relations between people with protected characteristics and others in accordance with section 149 Equality Act 2010. Members are referred to the "Community, equalities (including socio-economic) and health impacts" section above.

BACKGROUND DOCUMENTS

Background Papers	Held at	Contact
Item 2.3 capital strategy and treasury management strategy, Council Assembly 22 February 2023	Southwark council 160 Tooley Street London SE1 2QH	Timothy Jones

APPENDICES

No.	Title
Appendix A	Prudential Indicators: 2022-23 Actuals & 2023-24 Estimates

AUDIT TRAIL

Lead Officer	Clive Palfreyman - Strategic Director of Finance	
Report Author	Timothy Jones – Departmental Finance Manager	
Version	Final	
Dated	6 November 2023	
Key Decision?	No	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER		
Officer Title	**Comments Sought**	**Comment included**
Assistant Chief Executive (Governance and Assurance)	Yes	Yes
Strategic Director of Finance	No	N/A
Cabinet Member	Yes	No
Date final report sent to Constitutional Team		6 November 2023

APPENDIX A

PRUDENTIAL INDICATORS: 2022-23 ACTUALS AND 2023-24 ESTIMATES

BACKGROUND

1. Capital finance, borrowing and investment arrangements are supported by a series of prudential indicators, drawn from the Prudential Code on Capital Finance for Local Authorities and the Treasury Management in the Public Services Code of Practice plus Guidance, published by CIPFA. The Local Government Act 2003 requires that councils have regard to these codes. The 2023-24 indicators were approved by Council Assembly in February 2023, and the 2022-23 outturn positon was reported in July 2023. This appendix updates 2023-2024 indicators.

2. The indicators are grouped into three broad areas: affordability and prudence, capital finance and treasury management. The indicators are of a technical nature and existing budgets take account of capital finance and treasury activities.

AFFORDABILITY AND PRUDENCE INDICATORS

2022-23 Outturn	2023-24 Estimate	
		Ratio of Financing Cost to Net Revenue Stream A measure of the cost of borrowing and long term liabilities net of interest income and set-asides, as a percentage of
4%	7%	General Fund
7%	12%	HRA

£m	**£m**	***Capital Financing Requirements (CFR) and Gross Debt*** The CFR is the balance remaining on past capital expenditure financed through debt and long term liabilities. The level of gross debt should not exceed the CFR unless prudent over the short term. Actual gross debt has
1,492	1,832	CFR
1,067	1,320	Maximum Gross Debt in the Year

CAPITAL FINANCE INDICATORS

2022-23 Outturn	2023-24 Estimate	
£m	**£m**	***Capital Expenditure***
88	147	General Fund
318	427	HRA
406	**574**	**Total**

2022-23 Outturn	2023-24 Estimate	
£m	**£m**	***Capital Financing Requirement (CFR)*** The CFR is the balance on past capital expenditure financed through borrowing and long term liabilities.
704	877	General Fund
788	955	HRA
1,492	**1,832**	**Total**

TREASURY MANAGEMENT INDICATORS

Operational Boundary and Authorised Limit for External Debt:

These are limits the council determines to accommodate borrowing and long term liabilities. The lower limit is the operational boundary and takes account of existing positions and ordinary activity. The higher limit is the authorised limit, enabling additional borrowing to be taken for very short periods, in the interest of prudence, within a risk controlled framework.

2022-23 Outturn	2023-24 Limit	2023-24 Estimate	Operational Boundary
£m	**£m**	**£m**	
991	1,519	1,249	Borrowing (maximum outstanding in year)
76	71	71	Other Long Term Liabilities
1,067	**1,590**	**1,320**	**Total**

£m	**£m**	**£m**	**Authorised Limit**
1,824	1,910	1,910	Borrowing (maximum outstanding in year)
120	120	120	Other Long Term Liabilities
1,944	**2,030**	**2,030**	**Total**

2022-23 Outturn	2023-24 Limit	2023-24 Estimate	
			Maturity Structure of Borrowing Limits accommodating existing positions with flexibility to vary exposure within a risk controlled framework.
9%	35%	8%	Under 1 year
4%	35%	3%	1 year and within 2 years
9%	50%	9%	2 years and within 5 years
10%	75%	10%	5 years and within 10 years
69%	100%	70%	10 years and over
			Limits on Investments Greater than One Year Caps on the maximum exposure to longer investments, while recognising benefits from prudent exposure within a risk controlled framework.
6%	65%	27 %	Percentage longer than one year
9.4 months	2.5 years	11.3 months	Overall maximum average maturity