AUDIT COMMITTEE
27 SEPTEMBER 2023

ITEM NO. ....

MID YEAR PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT MONITORING REPORT 2023/24

SUMMARY REPORT

Purpose of the Report

1. This report seeks approval of the revised Treasury Management Strategy, Prudential Indicators and provides a mid–yearly review of the Council's borrowing and investment activities. Audit Committee are requested to forward the revised Strategy and indicators to Cabinet and Council for their approval and note changes to the MTFP with regard to the Treasury Management Budget (Financing Costs).

Summary

2. The mandatory Prudential Code, which governs Council's borrowing, requires Council approval of controls, called Prudential Indicators, relating to capital spending and borrowing. Prudential Indicators are set in three statutory annual reports, a forward looking annual treasury management strategy, a backward looking annual treasury management report and this mid-year update. The mid-year update follows Council's approval in February 2023 of the 2023/24 Prudential Indicators and Treasury Management Strategy.

3. The key objectives of the three annual reports are:

(a) to ensure the governance of the large amounts of public money under the Council's Treasury Management activities:

  (i) Complies with legislation.
  (ii) Meets high standards set out in codes of practice

(b) To ensure that borrowing is affordable,
(c) To report performance of the key activities of borrowing and investments.

4. The key proposed revisions to Prudential Indicators relate to:

(a) The Operational Boundary will reduce to £148.025m and the Authorised Limit to £245.331m which will allow for any additional cashflow requirement.

Recommendation

5. It is recommended that:

(a) The revised prudential indicators and limits within the report in Tables 1 to 6, 8, 10 and 12 to 17 are examined.

(b) The Treasury Management Budget (Financing Costs) projected outturn shown in Table 11 is noted.

(c) That this report is forwarded to Council via Cabinet with comments from this committee, in order for the updated prudential indicators to be approved.

Reasons

6. The recommendations are supported by the following reasons :-

(a) In order to comply with the Prudential Code for Capital Finance in Local Authorities;
(b) To inform Members of the performance of the Treasury Management function;
(c) To comply with the Local Government Act 2003;
(d) To enable further improvements to be made in the Council's Treasury Management function.

Elizabeth Davison
Group Director of Operations

Background Papers

(i) Capital Medium Term Financial Plan 2023/24
(ii) Prudential Indicators & Treasury Management Strategy 2023/24
(iii) Accounting records
(iv) The Prudential Code for Capital Finance in Local Authorities

Judith Murray: Extension 5204

S17 Crime and Disorder	This report has no implications for S17 Crime and Disorder.
Health and Well Being	This report has no implications for the Council's Health and Well Being agenda.
Carbon Impact	There are no carbon impact implications in this report.
Diversity	There are no specific implications for the Council's diversity agenda.
Wards Affected	All Wards.
Groups Affected	All Groups.
Budget and Policy Framework	This report must be considered by Council.
Key Decision	This is not an executive decision.
Urgent Decision	For the purposes of call in this report is not an urgent decision.
Council Plan	This report has no particular implications for the Council Plan.
Efficiency	The report refers to actions taken to reduce costs and manage risks.
Impact on Looked After Children and Care Leavers	This report does not impact on Looked After Children or Care Leavers

MAIN REPORT

Information and Analysis

7. This mid-year review report meets the regulatory framework requirement of treasury management. It also incorporates the needs of the Prudential Code to ensure monitoring of the capital expenditure plans and the Council's prudential indicators (PIs). The Treasury Strategy and the PIs were previously reported to Council on 16 February 2023.

8. This report concentrates on the revised positions for 2023/24. Future year's indicators will be revised when the impact of the MTFP 2024/25 onwards is known.

9. A summary of the revised headline indicators for 2023/24 is presented in **Table 1** below**.** More detailed explanations of each indicator and any proposed changes are contained in the report. The revised indicators reflect the movement in the Capital MTFP since its approval in February 2023 and the means by which it is financed.

Table 1 Headline Indicators

	2023/24 Original Estimate	**2023/24 Revised Estimate**
	£m	£m
Capital Expenditure (Tables 2 and 3)	45.493	80.296
Capital Financing Requirement (Table 4)	235.933	233.649
Operational Boundary for External Debt (Table 4)	181.077	148.025
Authorised Limit for External Debt (Table 6)	247.730	245.331
Ratio of Financing Costs to net revenue stream- General Fund (Table 14)	3.82%	4.47%
Ratio of Financing Costs to net revenue stream- Housing Revenue Account (HRA)(Table 14)	12.78%	12.78%

10. The capital expenditure plans and prudential indicators for capital expenditure are set out initially, as these provide the framework for the subsequent treasury management activity. The actual treasury management activity follows the capital framework and the position against the treasury management indicators is shown at the end.

11. The purpose of the report supports the objective in the revised CIPFA Code of Practice on Treasury Management and the Department for Levelling Up, Housing & Communities Investment Guidance which state that Members receive and adequately scrutinise the treasury service.

12. The underlying economic environment remains difficult for Councils. It is essential that the Council continues to monitor its cashflow in these times of high inflation and interest rates. Borrowing rates are higher than investment returns and this background encourages the Council to continue investing over the shorter term and

with high quality counterparties but also limit any borrowing to only that which is essential and for the shorter term where possible until interest rates start to fall.

Key Prudential Indicators

13. This part of the report is structured to update:

(a) The Council's capital expenditure plans
(b) How these plans are financed
(c) The impact of the changes in the capital expenditure plans on the PI's and the underlying need to borrow
(d) Compliance and limits in place for borrowing activity
(e) Changes to the Annual Investment Strategy
(f) The revised financing costs budget for 2023/24

Capital Expenditure PI

14. **Table 2** shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the budget.

Table 2

Capital Expenditure by Service	2023/24 Original Estimate	2023/24 Revised Estimate
	£m	£m
General Fund	20.874	56.727
HRA	24.585	24.535
Total Estimated Capital Expenditure	**45.459**	**81.262**
Loans to Joint Ventures	0.034	(0.966)
Total	**45.493**	**80.296**

15. The changes to the 2023/24 capital expenditure estimates have been notified to Cabinet as part of the Capital Budget monitoring process (Quarterly Project Position Statement Report).

16. The current capital programme that has not already been financed now stands at £156.697m but this includes a number of schemes that will be spent over a number of years not just in 2023/24. A reduction of £76.401m has been allowed for schemes which are known will be finalised in future years, but it is likely that other schemes will also slip into future years.

Impact of Capital Expenditure Plans

Changes to the financing of the Capital Programme

17. **Table 3** draws together the main strategy elements of the capital expenditure plans shown above, highlighting the original elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element (Borrowing Need) increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR). Borrowing need has reduced for 2023/24 due to schemes that have been estimated to have slipped into future years. This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Table 3

Capital Expenditure	2023/24 Original Estimate	2023/24 Revised Estimate
	£m	£m
General Fund	20.874	56.727
HRA	24.585	24.535
Loans to Joint Ventures	0.034	0.034
Total Capital expenditure	45.493	81.296
Financed By:		
Capital Receipts - Housing	0.303	0.433
Capital Receipts –General Fund	2.950	5.158
Capital grants	7.890	32.851
JV Repayments	2.260	1.000
HRA Revenue Contributions	12.609	24.077
GF Revenue Contributions	0.000	0.403
Self-Financing - GF	6.400	16.036
Total Financing	32.412	79.958
Borrowing Need	**13.081**	**1.338**

The Capital Financing Requirement (PI), External Debt (PI) and the Operational Boundary

18. **Table 4** shows the Capital Financing Requirement (CFR), which is the underlying external need to borrow for capital purposes. It shows the expected actual debt position over the period. This is called the Operational Boundary. The reduction in Borrowing Need (Table 3) is around £11.7m and currently actual borrowing for the Council is £148.014m. The reduction is due to slippage in the Housing programme. It is proposed to set an actual borrowing figure of £141.014m this will accommodate the additional borrowing need and any debt requirements for cash flow purposes. Other Long-term liabilities (the PFI scheme) will be added to give the revised operational boundary for 2023/24.

Prudential Indicator- External Debt/ Operational Boundary

Table 4

	2023/24 Original Estimate	2023/24 Revised Estimate
	£m	£m
Prudential Indicator- Capital Financing Requirement		
Opening CFR- Post Audit of Accounts	**230.542**	**228.660**
CFR General Fund	128.723	147.259
CFR General Fund PFI/Leasing IFRS	21.051	7.011
CFR – Housing	76.798	76.631
CFR – Loans to Joint Ventures	9.361	2.748
Total Closing CFR	**235.933**	**233.649**
Net Movement in CFR	5.391	4.989
Borrowing	160.026	141.014
Other long-Term Liabilities	21.051	7.011
Total Debt 31 March- Operational Boundary	**181.077**	**148.025**

Limits to Borrowing Activity

19. The first key control over the treasury activity is a PI to ensure that over the medium term gross borrowing should not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2023/24 and the next two financial years. As shown in **Table 5** below.

Table 5

	2023/24 Original Estimate £m	2023/24 Revised Estimate £m	2024/25 Revised Estimate £m	2025/26 Revised Estimate £m
Gross borrowing	160.026	141.014	151.014	166.014
Plus Other Long Term Liabilities	21.051	7.011	5.912	4.817
Total Gross Borrowing	**181.077**	**148.025**	**156.926**	**170.831**
CFR* (year-end position)	235.933	233.649	236.815	236.056

* includes on balance sheet PFI schemes and finance leases

20. The Group Director of Operations reports that no difficulties are envisaged for the current and future years in complying with this PI.

21. A further PI controls the overall level of borrowing, this is the Authorised Limit which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which while not desirable, could be afforded in the short term, but is not sustainable in the longer term. The

Authorised Limit is currently set 5% above the Capital Financing Requirement to allow for any additional cashflow needs, the revised figure for 2023/24 has been raised by 5% of the new CFR total. Whilst it is not expected that borrowing would be at these levels this would allow additional borrowing to take place should market conditions change suddenly and swift action was required. This is a Statutory limit determined under section 3 (1) of the Local Government Act 2003.

22. It is proposed to move the Authorised Limit in **Table 6** in line with the movement in the overall Capital Financing Requirement.

Table 6

Authorised Limit for External Debt	2023/24 Original Indicator £m	2023/24 Revised Indicator £m
Capital Financing Requirement	235.933	233.649
Additional headroom to Capital Financing Requirement	11.797	11.682
Total Authorised Limit for External Debt	**247.730**	**245.331**

Interest Rate Forecasts Provided by Link Asset Services (as at 27th June 2023)

Table 7

	Bank Rate	**PWLB rates for borrowing purposes***			
		5 year	10 year	25 year	50 year
	%	%	%	%	%
2023/24					
Sept 2023	5.25	5.60	5.20	5.40	5.10
Dec 2023	5.50	5.30	5.00	5.20	5.00
March 2024	5.50	5.10	4.90	5.10	4.90
2024/25					
June 2024	5.25	4.80	4.70	4.90	4.70
Sept 2024	4.75	4.50	4.40	4.70	4.50
Dec 2024	4.25	4.20	4.20	4.50	4.30
March 2025	3.75	3.90	3.90	4.20	4.00
2025/26					
June 2025	3.25	3.60	3.70	4.00	3.80
Sept 2025	2.75	3.40	3.50	3.90	3.60
Dec 2025	2.75	3.30	3.50	3.80	3.60
March 2026	2.50	3.30	3.50	3.80	3.50

*PWLB rates above are for certainty rates (which are provided for those authorities that have disclosed their borrowing/capital plans to the government. Darlington Borough Council will be able to access these certainty rates which are 0.2% below PWLB's normal borrowing rates.

23. Central banks in the developed economies have significantly quickened the pace of their monetary policy tightening. Although their policies are bespoke and reflect the

economic backdrop in each of their countries, that is not to say there has not been a similar approach to dampening inflationary pressures that are still spiking upwards.

24. The latest Bank Rate increase was implemented on the 3 August. After an 6-3 vote in favour, Bank Rate shifted up 25bps from 5.00% to 5.25%, but the MPC was careful to keep its options open regarding future decision-making (also note that one vote was for no increase and two voted in favour of a 50bps increase).

25. In terms of Key Assumptions and Risks past increases in Bank Rate, and the higher path of market interest rates on which the forecast is conditioned, weigh to an increasing degree on the UK economy in coming quarters. GDP growth remains below pre-pandemic rates in the medium term, reflecting relatively weak potential supply and a waning boost from fiscal policy.

26. The UK economy has been in excess demand over recent quarters but an increasing degree of economic slack is expected to emerge after the middle of next year. The second-round effects in domestic prices and wages are also likely to take longer to unwind than they did to emerge.

27. Inflation is expected to continue to fall in Q3 and Q4 to 4.9%. In the modal forecasts conditioned on market interest rates, increasing degree of slack in the economy and declining external cost pressures – the Bank sees CPI returning to 2% target by Q2 2025 and below target inflation in the medium term but this has a lesser degree of certainty than thought back in May.

28. In the aftermath of the MPC decision markets have seen some further increases in near term expectations for the peak in Bank Rate such that it is expected to hit 5.75% by November and remain at that level through the first half of 2024.

29. Investors will likely remain nervous about the impact of inflation until there is unambiguous evidence it is falling materially and consistently. However, while the forecasts for 5 and 10-year PWLB rates through the next two years have increased, those for longer maturities are not materially different from that outlined in May. Accordingly, the starting point for our August forecast is somewhat higher at the short end than envisaged in May, although gilt yields are still anticipated to fall back in due course once the economy slows and labour markets loosen. Countering this will be the considerable gilt issuance required, with £240bn expected this financial year, while the central bank is also reversing out at least £80bn of quantitative tightening through this period, meaning some investors may not be overly convinced of the merit of buying UK gilts if further inflationary upside surprises emerge over the coming months.

30. Of course, what happens outside of the UK remains critical to movement in gilt yields as well. The European Central Bank has made it abundantly clear that policy tightening will continue, most likely at its meeting in July. And while the US Federal Reserve may have paused to take stock at its own meeting in June, it was a "hawkish pause" with forecasters expecting that the next meeting in July will see the tightening process

continue. Not forgetting the most recent developments in Russia and what impact on energy prices this may have in the future.

31. From a practical standpoint those looking to borrow will, most probably, need to continue to focus on optimising their cashflow forecasts, and given the elevated level of rates right across the curve at present, seek to fund either temporarily from local authorities or with short-dated loans from the PWLB. In term of borrowing advice although temporary borrowing rates will remain elevated for some time to come it may prove the best option whilst the market continues to wait for inflation and therein gilt yields to drop back later in 2023 and 2024.

Treasury Management Strategy 2023/24 and Annual Investment Strategy Update

32. The Treasury Management Strategy Statement, (TMSS), for 2023/24 was approved by Council on 16 February 2023.

33. There are no policy changes to the TMSS.

34. The details in this report update the position in the light of the updated economic position and budgetary changes already approved.

Debt Activity during 2023/24

35. The expected net borrowing need is set out in **Table 8**

Table 8

	2023/24 Original Estimate £m	**2023/24 Revised Estimate £m**
CFR (year-end position) from Table 4	235.933	233.649
Less other long term liabilities PFI and finance leases	21.051	7.011
Net adjusted CFR (net year end position)	**214.882**	**226.638**
Expected Borrowing	160.026	141.014
(Under)/ Over borrowing	**(54.856)**	**(85.624)**

36. The Council has taken on £20m of new short debt in the current year to date which will be repaid using short term maturing investments.

37. The amount borrowed by the Council now stands at £141.014m, this excludes any additional cashflow loans which may be required.

38. There will still be an element of under-borrowing by the Council at the end of March 2024.

Debt Rescheduling

39. Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

Annual Investment Strategy 2023/24

Investment Portfolio

40. In accordance with the Code, it is the Council's priority to ensure security of Capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. Successive interest rises over the past year have meant that current investment returns are much higher than we have seen in previous years and in line with the current bank rate of 5.25%. During this period of greater returns the Council are actively investing where possible.

Treasury Management Activity from 1 April 2023 to 31 August 2023

41. Current investment position – The Council held £57.339m of investments at 31/08/2023 and this is made up of the following types of investment.

Table 9

Sector	Country	Up to 1 year
		£m
Banks	UK	20.000
AAA Money Market Funds	Sterling Funds	7.340
Property Funds - CCLA	UK	10.000
Hermes		10.000
Lothbury	UK	9.999
Total		**57.339**

Short Term Cashflow Investments

42. Cash balances are invested on a daily basis to maximise the benefit of temporary surplus funds. These include investments in Money Market Funds, the Government's Debt Management Office and bank short term notice accounts. A total of 66 investments were made in the period 1 April 2023 to 31 August 2023 totalling c£105m these were for short periods of up to 180 days and earned interest of £0.526m on an average balance of £26.940m which equated to an annual average interest rate of 4.69%.

Investment returns measured against the Service Performance Indicators

43. The target for our investment returns is to better or at least match a number of external comparators, this performance indicator is also known as yield benchmarking. As can be seen from Table 10, the short term investment achievements (up to 6 months) are above market expectations.

Table 10

	Cashflow Investments %
Darlington Borough Council - Actual	**4.69%**
External Comparators	
Sterling Overnight Index Average (SONIA) – 6 months	4.63%

Treasury Management Budget

44. There are three main elements within the Treasury Management Budget:-

(a) Longer term capital investments interest earned – a cash amount of which earns interest and represents the Councils revenue balances, unused capital receipts, reserves and provisions, this will now include Property Funds.

(b) Cash flow interest earned – the authority has consistently had a positive cash flow. Unlike long term capital investments it does not represent any particular sum but it is the consequence of many different influences such as receipt of grants, the relationship between debtors and creditors, cashing of cheques and payments to suppliers.

(c) Debt serving costs – this is the principal and interest costs on the Council's long term debt to finance the capital programme.

Table 11 - Changes to the Financing Costs Budget 2023/24

	£m	£m
Original Financing Costs Budget 2023/24		**3.477**
Add Increased debt costs	0.207	
Less Increased returns on Investments	(0.159)	
Add increased returns on Property Funds	(0.048)	
Total adjustments		**0.000**
Revised Treasury Management Budget 2023/24		**3.477**

45. This statement concludes that the Treasury Management budget is forecast to Outturn on budget in 2023/24, this will be reflected in the current MTFP projections.

Risk Benchmarking

46. A regulatory development is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance and these are shown in Table 12. Discrete security and liquidity benchmarks are also requirements of member reporting.

47. The following reports the current position against the benchmarks originally approved.

48. **Security** – The Council's maximum security risk benchmarks for the current portfolio of investments, when compared to historic default tables were set as follows;

0.077% historic risk of default when compared to the whole portfolio

Table 12

Maximum	Benchmark 2023/24	Actual May	Actual July
Year 1	0.077%	0.013%	0.006%

N.B. this excludes Property Funds

49. The counterparties that we use are all high rated therefore our actual risk of default based on ratings attached to counterparties is very low.

50. **Liquidity** – In respect of this area the Council set liquidity facilities/ benchmark to maintain

(i) Bank overdraft - £0.100M
(ii) Liquid short term deposits of a least £3.000M available within a weeks notice
(iii) Weighted Average Life benchmark is expected to be 0.4 years with a maximum of 1 year

51. The Group Director of Operations can report that liquidity arrangements have been adequate for the year to date as shown in Table 13

Table 13

	Benchmark 2023/24	Actual May	Actual July
Weighted Average Life	0.4 – 1 year	0.45 years	0.45 years

52. The figures are for the whole portfolio of cash flow investments deposited with Money Market funds on a call basis (i.e. can be drawn on without notice) as well as call accounts that include a certain amount of notice required to recall the funds.

Treasury Management Indicators

53. **Actual and estimates of the ratio of financing costs to net revenue stream** – This indicator identifies the trend in the cost of capital (financing costs net of interest and investment income) against the net revenue stream.

Table 14

	2023/24 Original Indicator	2023/24 Revised Indicator
General Fund	**3.82%**	**4.47%**
HRA	**12.78%**	**12.78%**

Treasury Management Prudential indicators

54. **Upper Limits on Variable Rate Exposure –** This indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments.

55. **Upper Limits on Fixed Rate Exposure –** Similar to the previous indicator this cover a maximum limit on fixed interest rates

56. Historically for a number of years this Council has used these percentages; together they give flexibility to the treasury management strategy allowing the Council to take advantage of both fixed and variable rates in its portfolio whilst ensuring that its exposure to variable rates is limited.

Table 15

	2023/24 Original Indicator	2023/24 Revised Indicator
Limits on fixed interest rates	100%	100%
Limits on variable interest rates	40%	40%

57. **Maturity Structures of Borrowing -** These gross limits are set to reduce the Council's exposure to large fixed rate loans (those instruments which carry a fixed interest for the duration of the instrument) falling due for refinancing. The higher limits for longer periods reflect the fact that longer maturity periods give more stability to the debt portfolio.

Table 16 - Maturity Structures of Borrowing

	2023/24 Original indicator	2023/24 Actual to Date	2023/24 Revised Indicator
Under 12 months	40%	15%	20%
12 months to 2 years	50%	15%	40%
2 years to 5 years	60%	21%	60%
5 years to 10 years	80%	27%	80%
10 years and above	100%	100%	100%

58. **Total Principal Funds Invested –** These limits are set having regard to the amount of reserves available for longer term investment and show the limits to be placed on investments with final maturities beyond 1 year. This limit allows the authority to invest for longer periods if they give better rates than shorter periods. It also allows some stability in the interest returned to the Authority.

Table 17 - Principal Funds Invested

	2023/24 Original Indicator	2023/24 Revised Indicator
Maximum principal sums invested greater than 1 year	£50m	£50m

Conclusion

59. The prudential indicators have been produced to take account of the Council's borrowing position. The key borrowing indicator (the Operational Boundary) is £148.025m. The Council's return on investments has been good, exceeding both of the targets. Based on the first five months of 2023/24 the Council's borrowing and investments is forecast to be on target on the approved 2023/24 budget.

60. The Council's treasury management activities comply with the required legislation and meet the high standards set out in the relevant codes of practice.

Outcome of Consultation

61. No consultation was undertaken in the production of this report.