

Report to Cabinet

Subject: Prudential Code Indicator Monitoring 2024/25 and Treasury Activity Report for the Period April 2024 to July 2024

Date: 5 September 2024

Author: Financial Services Manager

Wards Affected

Borough wide

Purpose

To inform Members of the performance monitoring of the 2024/25 Prudential Code Indicators, and to advise Members of the Treasury activity as required by the Treasury Management Strategy.

Key Decision

This is **not** a key decision.

Recommendation(s)

Cabinet are recommended to:

1. Note the report, together with the Treasury Activity Report 2024/25 for Period 4 at Appendix 1, and the Prudential and Treasury Indicator Monitoring 2024/25 for the period April to July 2024, at Appendix 2.
2. Approve the changes to Prudential Indicators detailed at paragraph 2.7 to align with the latest revenue and capital budgets being reported to members as part of the Budget Monitoring and Virement Report for the period April 2024 to July 2024.

1 Background

- 1.1 The Council is required by regulations issued under the Local Government Act 2003 to report on its Prudential Code indicators and treasury activity. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).
- 1.2 For 2024/25 the minimum reporting requirements are that the Full Council should receive the following reports:
- An annual Treasury Strategy in advance of the year (the TMSS, considered by Cabinet on 21 February 2024 and subsequently approved by Full Council on 6 March 2024);
 - A mid-year treasury update report;
 - An annual review following the end of the year describing the activity compared to the Strategy.

In previous years we have brought a Prudential Code Indicator Monitoring and Treasury Activity Report to Cabinet each quarter however, due to changes to Cabinet dates for 2024/25 reporting for Quarter 1 April to June in September would not have been timely for reporting purposes.

Therefore, for 2024/25 reporting to Cabinet & Full Council will be carried out in three four monthly periods (April 24 - July 24. August 24- November 24 and December 24 to March 25) this will be on a trial basis to assess the resource benefits of only providing 3 periods of monitoring, allowing offices more time to address concerns and consider remedial action.

Whilst this is a reduction in the number of reports being presented it should be noted that this still exceeds the minimum requirements.

- 1.3 The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. This report provides details of the position at 31 July 2024 and highlights compliance with the Council's policies.

2 Proposal

2.1 Economic Update

The news that the economy grew by 0.7% in quarter 4 of 2023/24 confirmed that it moved out of its very mild technical recession that prevailed at the back end of 2023. However, data released for April and May so far shows a slight stalling in the recovery.

Consumer price inflation (CPI) is a measure of the cost of living for the typical person. Core CPI is a similar measure but removes energy and food prices as they have a tendency to be highly volatile.

CPI fell to 2.0% in June. Core CPI also fell to 3.5% in June. The fall in CPI inflation resulted in the Bank of England's 2% target being achieved for the first time since July 2021. A further easing in food inflation from 2.8% in April to 1.6% in May played a part in the fall in overall CPI inflation and with food producer price inflation at just 0.2% in May, food price inflation will probably soon fall to zero.

Despite the stickiness of wage growth in April, sharp falls in employment and a move up in unemployment suggests that wage growth will soon be back on a downward path. The 139,000 fall in employment in the three months to April was accompanied by a rise in the unemployment rate from 4.3% to 4.4%. This was the fourth increase in a row and took it to its highest level since September 2021. The rise would have been larger were it not for the 132,000 increase in inactivity in the three months to April as the UK's disappointing labour market participation performance since the pandemic continued. The vacancies data also paint a picture of a slowly cooling labour market. The number of job vacancies fell from an upwardly revised 908,000 to 904,000, leaving vacancies 31% below the peak in May 2022, but 11% above the pre-pandemic level

There was little chance that the Monetary Policy Committee (MPC) would cut rates at its June meeting, given upside surprises on services CPI inflation and wage growth. But several developments implied a rate was getting closer. The Monetary Policy Committee (MPC) subsequently reduced Bank rates by 25 basis points to 5.0% on 1 August 2024.

2.2 Interest rate forecast

Our Treasury Management advisors Link provided its latest forecast of interest rates on 1 August 2024 these are shown in the table below. PWLB rates in the table are based on the Certainty Rate which include a 0.2% reduction on the standard rates. This shows that the bank rate is estimated to peak at 5.0% in September 2024 and then fall to 3.25% from September 2025 to June 2026.

Interest Rate Forecasts								
Bank Rate	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26
Link	5.00%	4.50%	4.00%	3.50%	3.25%	3.25%	3.25%	3.25%
Cap Econ	5.00%	4.50%	4.00%	3.50%	3.00%	3.00%	3.00%	3.00%
5Y PWLB RATE								
Link	4.70%	4.50%	4.30%	4.10%	4.00%	3.90%	3.90%	3.90%
Cap Econ	4.50%	4.20%	4.10%	4.00%	4.00%	3.90%	3.80%	3.80%
10Y PWLB RATE								
Link	4.80%	4.60%	4.40%	4.30%	4.10%	4.10%	4.10%	4.00%
Cap Econ	4.60%	4.30%	4.30%	4.20%	4.10%	4.10%	4.00%	3.90%
25Y PWLB RATE								
Link	5.20%	5.00%	4.80%	4.70%	4.50%	4.50%	4.40%	4.40%
Cap Econ	5.00%	4.60%	4.50%	4.40%	4.40%	4.30%	4.20%	4.10%
50Y PWLB RATE								
Link	5.00%	4.80%	4.60%	4.50%	4.30%	4.30%	4.20%	4.20%
Cap Econ	4.80%	4.60%	4.60%	4.50%	4.40%	4.30%	4.30%	4.20%

2.3 Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2024/25, which includes the Annual Investment Strategy, was approved by Council on 6 March 2024, and sets out the Council's investment priorities as:

- Security of capital;
- Liquidity;
- Yield.

Whilst the Council will always seek to obtain the optimum return (yield) on its investments, this will at all times be commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate either to keep investments short term to cover cash flow needs, or to extend the period up to 12 months with highly rated financial institutions, selected by the use of the Link creditworthiness methodology (see below) which includes consideration of sovereign ratings.

Investment counterparty limits for 2024/25 are generally **£3m** per individual counterparty, however a higher limit of **£4m** per Money Market Fund is considered prudent since such funds are already by definition highly diversified investment vehicles. There is no limit on Investment with the Debt Management Office (DMO) since this represents lending to central government. The Chief Financial Officer has delegated authority to vary these limits as appropriate, and then to report any change to Cabinet as part of the next report.

Members are advised that no new variations have been made during period 1 to period 4 of 2024/25.

Limits with investment counterparties have not exceeded the prevailing levels approved by the CFO during the period 1 April to 31 July 2024.

Credit ratings advice is taken from LAS and the Chief Financial Officer has adopted the Link credit rating methodology for the selection of investment counterparties. This employs a sophisticated modelling approach utilising credit ratings from all three of the main rating agencies to give a suggested maximum duration for investments. Accordingly it does not place undue reliance on any one agency's ratings.

The methodology subsequently applies an "overlay" to take account of positive and negative credit watches and/or credit outlook information, which may increase or decrease the suggested duration of investments. It then applies a second overlay based on the credit default swap spreads for institutions, the monitoring of which has been shown to give an early warning of likely changes in credit ratings. It also incorporates sovereign ratings to ensure selection of counterparties from only the most creditworthy countries. The current Treasury

Strategy permits the use of any UK counterparties subject to their individual credit ratings under the LAS methodology. It also permits the use of counterparties from other countries with a minimum sovereign rating of AA minus. For information, the UK currently has a rating of AA minus.

The Link modelling approach combines all the various factors in a weighted scoring system and results in a series of colour coded bands which indicate the creditworthiness of counterparties. The colour bandings are as follows:

- Yellow 5 years (UK Government debt or its equivalent)
- Dark pink 5 years for Ultra Short Dated Bond Funds (credit score 1.25)
- Light pink 5 years for Ultra Short Dated Bond Funds (credit score 1.50)
- Purple 2 years
- Blue 1 year (nationalised or semi nationalised UK banks only)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

Significant downgrades by the Ratings agencies have not materialised since the beginning of the Covid-19 crisis in March 2020. Where changes were made these were generally limited to "outlooks". However, as economies re-opened some instances of previous reductions were reversed.

Credit ratings are monitored weekly and the Council is also alerted to interim changes by its use of the Link creditworthiness service, however ratings under the methodology, including sovereign ratings, will not necessarily be the sole determinant of the quality of an institution. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

The ultimate decision on what is prudent and manageable for the Council will be taken by the Chief Financial Officer under the approved scheme of delegation.

2.4 Treasury Activity during Period 1 to 4 of 2024/25

The Treasury Activity Report for the period ended 31 July 2024 is attached at Appendix 1, in accordance with the Treasury Management Strategy.

Members will note that investment interest of £374,600 was generated from MMF activity, term deposits with banks and building societies, and the property fund, during the period from 1 April to 31 July 2024. This represents an overall equated rate for the Council of 5.42% which is slightly higher than the compounded Sterling Overnight Index Average (SONIA) rate, which averaged 5.15%.

During the period from 1 April to 31 July 2024, significant use was made of the Council's three Money Market Funds (MMFs). These are AAA rated investment vehicles which allow the pooling of many billions of pounds into highly diversified funds, thus reducing risk. The current rates of return on these funds are between 5.18% and 5.22%, which remain generally higher than overnight treasury deposit rates, and slightly higher than the rate obtainable from the Debt Management Office (DMO).

The Council made an investment of £1m in the CCLA Local Authority Property Fund (LAPF) on 1 December 2017. The LAPF is a local government investment scheme approved by the Treasury under the Trustee Investments Act 1961 (section 11). Dividends are treated as revenue income and have in previous years averaged around 4%.

The fund reduced slightly by £4,445 between 1st April 2024 and 30 June 2024. However, a dividend of £11,453 was received in the first quarter of the year.

This investment allows the Council to introduce a property element into its investment portfolio without the risks associated with the direct purchase of assets. It should be noted however that the capital value is **not** guaranteed and can fall as well as rise. The certificated value of the investment at 30 June 2024 was £872,674 which was lower than the original investment of £1m, this represents a £127,326 loss. However, this investment is regarded as a long-term commitment and fluctuations should be expected. A recent meeting with the CCLA suggested that the investment is expected to increase over the course of the next few years and dividends continue to be received of approximately £45k per annum.

Interest rates in the market are significantly higher than they have been in previous years in response to the rise in the bank rate. As loans mature every effort is made to replace them at favourable rates. As regards investments, security and liquidity will always be the overriding factors in the Council's treasury management. As stated in 2.2 above, Link currently forecast that the Bank Rate will peak at 5.0% in September 2024 and then fall back to 3.25% by September 2025 to June 2026.

It is currently anticipated that the outturn for investment interest will achieve the current approved estimate of £1.1m for 2024/25.

2.5 New borrowing

At 31 July 2024 no new borrowing had been undertaken.

Advice will be taken from Link with regard to the amount and timing of any additional borrowing, and should conditions become advantageous, some borrowing in advance of need will also be considered by the Chief Financial

Officer. The Council's Capital Financing Requirement (CFR) represents its underlying need to borrow to finance capital investment. Due to favourable interest rates, borrowing in advance of need is sometimes desirable, with the result that the CFR can differ to the actual borrowing planned in the year.

Councils may not borrow in advance of need purely to profit from the investment of the extra sums borrowed. However, prudent early borrowing for a demonstrable service objective is permitted. Serious consideration must be given to the cost of carrying any additional borrowing during the period prior to it being required for the financing of capital expenditure since this places a further burden on the General Fund.

2.6 Debt rescheduling

When the current day PWLB rate for the same term is higher than that being paid on an existing loan there is the potential for a discount to be receivable if the loan is repaid prematurely.

However, debt rescheduling opportunities are limited in the current economic climate, and due to the structure of PWLB interest rates. Advice in this regard will continue to be taken from LAS. No debt rescheduling has been undertaken during the period from 1 April to 31 July 2024.

2.7 Compliance with Prudential and treasury indicators

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limit. The Council's approved Prudential and Treasury Indicators (affordability limits) are included in the Treasury Management Strategy Statement (TMSS) approved by Full Council on 6 March 2024.

During the financial year to date the Council has at all times operated within the majority treasury limits and Prudential Indicators set out in the Council's TMSS, and in compliance with the Council's Treasury Management Practices. The Prudential and Treasury Indicators as at 31 July 2024 are shown at Appendix 2.

The Prudential Indicator relating to Capital Expenditure has been exceeded due to the carry forward of budget from 2023/24 which was approved by members as part of the Budget Outturn and Budget Carry Forwards 2023/24 report. The changes in the Capital Programme for 2024/25 are being reported to members via the Budget Monitoring and Virement Report for the period April 2024 to July 2024, it is proposed that this indicator is increased from £9,388,100 to £9,872,500.

The Prudential Indicator relating to the ratio of financing costs to net revenue stream has been exceeded due to an increase in the original budget of the Minimum Revenue Provision (MRP), the change in the MRP budget is being reported to members as part of the Budget Monitoring and Virement Report for

the period April 2024 to July 2024, it is proposed that the indicator is increased from 2.21% to 3.85%.

All other treasury limits and Prudential Indicators have been achieved for the period April to July 2024

A) Prudential Indicators:

These indicators are based on estimates of expected outcomes, and are key indicators of “affordability”. They are monitored on a regular basis, and Appendix 2 compares the approved indicators with the projected outturn for 2024/25, and shows variances on the indicators, as described below:

a. Capital Expenditure

The latest projected outturn shows that total capital expenditure is expected to be £9,872,500. This differs to the approved indicator of £9,388,100 due to the inclusion of approved carry-forward requests from 2023/24 and variations on the current year’s capital programme.

b. Capital Financing Requirement (CFR)

The CFR represents the historic outstanding capital expenditure which has not yet been paid for from capital or revenue resources, and is essentially a measure of the Council’s underlying borrowing need. The CFR does not increase indefinitely since the minimum revenue provision (MRP) is a statutory annual revenue charge for the economic consumption of capital assets.

At 31 July the projected closing CFR for 2024/25 is £19,193,531. This differs to the approved indicator of £19,795,200 due to savings and deferrals on the 2023/24 capital programme.

c. Gearing ratio

The concept of “gearing” compares the total underlying borrowing need (the CFR) to the Council’s total fixed assets and the gearing ratio can provide an early indication where debt levels are rising relative to long term assets held.

The projected gearing ratio at 31 July 2024 is 42%, which is in line with the approved indicator and is broadly comparable with the average gearing ratio for councils of a similar size.

d. Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of borrowing net of investment income against the net revenue stream. Financing costs represent the element

of the Council's budget to which it is committed even before providing any services.

The projected outturn of 3.85% for service related expenditure is higher than the approved indicator of 2.21% due to increased Minimum Revenue Provision (MRP) costs for 2024/25.

e. Maximum gross debt

The Council must ensure that its gross debt does not, except in the short term, exceed the opening capital financing requirement, plus estimates of any additional CFR for 2024/25 and the following two financial years. This allows flexibility for early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. The Council's gross debt at 31 July 2024 was £10.812m, which was within the approved indicator.

g. Ratio of internal borrowing to CFR

The Council is currently maintaining an "internal borrowing" position, i.e. the underlying borrowing need (CFR) has not yet been fully funded with loan debt as cash supporting the Council's reserves and balances is being used as a temporary measure.

The projected outturn for internal borrowing is 44%, which is marginally lower than the approved indicator of 45%.

B) Treasury Management Indicators:

These indicators are based on limits, beyond which activities should not pass without management action. They include two key indicators of affordability and four key indicators of prudence.

Affordability:

a. Operational boundary for external debt

This is the limit which external debt is not "normally" expected to exceed. In most cases, this would be a similar figure to the CFR, but it may be lower or higher depending on the levels of actual debt, and must allow for unusual cash flow movements.

b. Authorised limit for external debt

This limit represents a control on the "maximum" level of borrowing. It is the statutory limit determined under s3 (1) of the Local Government Act 2003 and represents the limit beyond which external debt is prohibited. The Authorised Limit must be set, and revised if necessary, by Full Council. It reflects a level of

external debt which, while not desirable, could be afforded in the short term, but is not sustainable in the longer term. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

Prudence:

c. Upper limits for the maturity structure of borrowing

These are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing.

d. Maximum new principal sums to be invested during 2024/25 for periods in excess of one year (365 days)

All such investments are classified as "non-specified". This indicator is subject to the overall limit for non-specified investments set out in the TMSS, and to the overall limit per counterparty.

e. Interest rate exposure

The latest Treasury Management Code requires a statement in the TMSS explaining how interest rate exposure is managed and monitored by the Council, and this is repeated below:

The Council has a general preference for fixed rate borrowing in order to minimise uncertainty and ensure stability in the charge to revenue, however it is acknowledged that in certain circumstances, some variable rate borrowing may be prudent, for example if interest rates are expected to fall. The Council's investments are generally for cashflow purposes and accordingly a mix of fixed and variable rates will be used to maximise flexibility and liquidity. Interest rate exposure will be managed and monitored on a daily basis by the Chief Financial Officer.

Local indicators for the proportions of fixed and variable rate loans, have been retained by the Council for information purposes.

Appendix 2 shows the actual position as at 31 July 2024, and demonstrates that all activities are contained within the currently approved limits.

3 Risk Management

The CIPFA Prudential Code and Treasury Management Code (both updated in 2021) have placed greater importance on risk management. Where a local authority changes its risk appetite (for example, moving surplus cash into or out of certain types of investment funds or other investment instruments) then this change in risk appetite should be brought to Members attention in treasury management update reports.

There have been no changes in risk appetite and there are no other significant treasury management issues that have arisen since approval of the TMSS on 6 March 2024 that need to be brought to the attention of Members.

There are a number of risks inherent within any treasury management strategy, the most significant risks include:

- Reporting is not compliant with statutory guidelines
- Investment and borrowing activity is outside the approved TM framework.
- Long term borrowing is taken at rates that are not advantageous
- Investment of principal sums with insecure counterparties.
- Investment returns are volatile and may not meet budgeted amounts.
- Borrowing is not affordable.

These risks are mitigated by the controls included in the TMSS and are detailed at section 2.3 - Treasury Strategy above.

4 Alternative Options

An alternative option is to fail to present a Prudential Code Indicator Monitoring and Treasury Activity Report, however this would contravene the requirement of the Council's Treasury Management Strategy Statement (TMSS).

5 Financial Implications

No specific financial implications are attributable to this report.

6 Legal Implications

There are no legal implications arising from this report.

7 Equalities Implications

There are no equalities implications arising from this report.

8 Carbon Reduction/Environmental Sustainability Implications

There are no carbon reduction/environmental sustainability implications arising from this report.

9 Appendices

1. Treasury Activity Report 2024/25 for Period 1 to 4 (31 July 2024).
2. Prudential and Treasury Indicator Monitoring 2024/25 for Period 1 to 4 (31 July 2024).

10 Background Papers

None identified.

11 Reasons for Recommendation

To comply with the requirements of the Council's Treasury Management Strategy Statement.

Statutory Officer approval:

Approved by: Chief Financial Officer

Date: 15 August 2024

Approved by: Monitoring Officer

Date: 15 August 2024