Report to the Audit & Governance Committee

Epping Forest District Council

Date of meeting: 30th November 2023

Portfolio: **Finance & Economic Development**

Subject: **Treasury Management Quarter 2 Update 2023/24**

Responsible Officer: **Andrew Small** **(01992 564278)**

Democratic Services: **Laura Kirman** **(01992 564243)**

Recommendations/Decisions Required:

(1) To note the Treasury Management Quarter 2 Update 2023/24 ***(Appendix A)*** and pass comment for full Council.

Executive Summary:

The Council's Treasury Management Strategy (including Investment Strategy) for 2023/24 was considered at a meeting of the Audit and Governance Committee on 13th February 2023 and was subsequently agreed by full Council on 28th February 2023.

In accordance with CIPFA's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code 2021 Edition) and generally accepted good practice, the Treasury Management Quarter 2 Update for 2023/24 (presented in ***Appendix A***) sets out the Council's actual Treasury Management activity for the first six months (Quarter 2) of 2023/24 (i.e., April to September 2023).

Appendix A begins by setting the external context for Quarter 2 of 2023/24 by exploring the Economic Background, Financial Markets and Credit Ratings, including a further rise in UK interest rates, reflecting the Bank of England's response to stubborn inflation in the economy.

The Borrowing and Investment position for Epping Forest District Council as at 30th September 2023 shows the following:

- *Borrowing* – external borrowing increased by £8.7 million (from £281.6 million to £290.3 million) during the period April to September 2023; and

- *Investments* – there was a decrease in investments of £5.9 million (from £14.1 million to £8.2 million) during the same period.

The definition of investments in CIPFA's Treasury Management Code covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e., management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).

Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) also includes within the definition of investments all such assets held partially or wholly for financial return.

The report therefore also considers the Service and Commercial Investments held by the Council. This includes:

- Qualis and Home Assistance service loans (combined value of £50.890 million as at 30th September 2023)
- Commercial Property (Balance Sheet value of £148.483 million as at 31st March 2023); and a
- Qualis Investment Loan (value of £30.0 million as at 30th September 2023).

Appendix A concludes by considering compliance with CIPFA's Treasury Management Code and the Treasury Management Strategy for 2023/24, including Prudential and Other adopted indicators. Compliance with reportable indicators was achieved in almost all areas in Quarter 2, although available cash has dropped slightly below target levels recently as further borrowing has been minimised in the light of higher interest rates.

Reasons for Proposed Decision:

To enable the robust scrutiny the Council's Treasury Management performance in 2023/24 in compliance with CIPFA's Treasury Management in the Public Services: Code of Practice (the CIPFA Code 2021 Edition) and generally accepted good practice.

Legal and Governance Implications:

The Local Government Act 2003 created a framework for the financing of capital investments in local authorities which came into operation from April 2004. Alongside this, the Prudential Code was developed by CIPFA as a professional Code of Practice to support local authority decision making in capital investment and financing. Local authorities are required by regulation to have regard to the Prudential Code.

Safer, Cleaner and Greener (SCG) Implications:

None.

Background Papers:

Treasury Management in the Public Services: Code of Practice (2021 Edition) published by CIPFA December 2021.

(MHCLG) Statutory Guidance on Local Government Investments (3rd Edition). Issued under section 15(1)(a) of the Local Government Act 2003 and effective for financial years commencing on or after 1st April 2018.

Arlingclose Technical Update (revised Prudential and Treasury Management Codes) issued 22nd December 2021.

Treasury Management Strategy (including Investment Strategy) 2023/24 (Audit and Governance Committee, 13th February 2023).

Risk Management:

There are a range of inherent financial risks associated with Treasury Management activity; not least the potential for loss of interest and/or deposits. The Council therefore engages the services of external Treasury Management advisors, Arlingclose Ltd.

Borrowing and Investment decisions are made in accordance with the Council’s formally adopted Treasury Management Strategy (including Investment Strategy). The Strategy includes several Risk Management features, including – for example – the overriding priority that security of deposit takes precedence over return on investment.

Appendix A

Treasury Management Quarter 2 Update 2023/24

Introduction

The Council has previously adopted CIPFA's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Council to approve Treasury Management semi-annual ("mid-year updates") and annual reports.

This quarterly report provides an additional update and includes the new requirement in the 2021 Code, mandatory from 1st April 2023, of quarterly reporting of the Treasury Management Prudential Indicators. The Non-Treasury Prudential Indicators are incorporated within the Council's routine quarterly (revenue and capital monitoring) report.

The Council's Treasury Management Strategy (including Investment Strategy) was considered at a meeting of the Audit and Governance Committee on 13th February 2023 and was subsequently agreed by full Council on 28th February 2023. The Council 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. The successful identification, monitoring and control of risk remains central to the Council's Treasury Management Strategy.

External Context: April to September 2023

Economic Background: UK inflation remained stubbornly high over much the period compared to the US and Euro Zone, keeping expectations elevated of how much further the Bank of England (BoE) would hike rates. However, inflation in the latter part of the period was lower than expected, causing financial markets to reassess the anticipated peak in the Bank Rate. This was followed very soon after by the BoE deciding to keep the Bank Rate on hold at 5.25% in September, against an expected increase of another 0.25% rise. Arlingclose, the Council's Treasury Adviser, has now revised its interest forecast to reflect the central view that 5.25% will be the peak in the Bank Rate.

Economic growth in the UK remained relatively weak over the period. In April to June 2023, the economy expanded by 0.2%. However, monthly GDP data showed a 0.5% contraction in July, the largest fall to date in 2023 and worse than the 0.2% decline predicted which could be an indication that the monetary tightening cycle is starting to cause recessionary, or at the very least, stagnating economic conditions.

July data showed the unemployment rate increased to 4.3% while the employment rate rose to 75.5%. Pay growth was 8.5% for total pay (including bonuses) and 7.8% for regular pay, which for the latter was the highest recorded annual growth rate. Adjusting for inflation, pay growth in real terms was positive at 1.2% and 0.6% for total pay and regular pay respectively.

Inflation continued to fall from its peak as annual headline CPI declined to 6.7% in July 2023 from 6.8% in the previous month against expectations for a tick back up to 7.0%. The largest downward contribution came from food prices.

Financial Markets: Market sentiment and bond yields remained volatile, with the latter generally trending downwards as there were signs inflation, while still high, was moderating and interest rates were at a peak.

Gilt yields fell towards the end of the period. The 5-year UK benchmark gilt yield rose from 3.30% to peak at 4.91% in July before trending downwards to 4.29%, the 10-year gilt yield rose from 3.43% to 4.75% in August before declining to 4.45%, and the 20-year yield from 3.75% to 4.97% in August and then fell back to 4.84%. The Sterling Overnight Rate (SONIA) averaged 4.73% over the period.

Credit Review: Having completed a review of its credit advice on unsecured deposits at UK and non-UK banks following concerns of a wider financial crisis after the collapse of Silicon Valley Bank purchase of Credit Suisse by UBS, as well as other well-publicised banking sector issues, in March 2023, Arlingclose reduced the advised maximum duration limit for all banks on its recommended counterparty list to 35 days. This stance continued to be maintained at the end of the period.

Heightened market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remains under constant review.

Local Context

On 31st March 2023, the Council had net borrowing of £267.5 million arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31/03/23 Actual £m	**31/03/24 Forecast £m**
General Fund CFR	159.088	216.894
HRA CFR	154.475	166.891
Total CFR	**313.563**	**383.785**
Less: Other Debt liabilities	0	0
Borrowing CFR	**313.563**	**383.785**
Less: External borrowing	(282.681)	(352.903)
Internal borrowing:	**30.882**	**30.882**
Less: Balance Sheet resources	(43.678)	(44.069)
Net Investments	**(12.796)**	**(13.187)**

The Treasury Management position as at 30th September 2023 and the change during the first six months of the financial year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31/03/23 Balance £m	Movement £m	30/09/23 Balance £m	30/09/23 Rate %
Long-term Borrowing	248.6	5.2	253.8	3.3%
Short-term Borrowing	33.0	3.5	36.5	4.6%
Total Borrowing	**281.6**	**8.7**	**290.3**	
Long-Term Investments	0	0	0	N/A
Short-term Investments	0*	4	4	5.2%
Cash and Cash Equivalents	14.1	(9.9)	4.2	3.3%
Total Investments	**14.1**	**(5.9)**	**8.2**	
Net Borrowing	**267.5**		**282.2**	

**DMADF deposits reclassified from Short-Term to Cash & Cash Equivalents*

The Council's cash flows during April to September 2023 were relatively stable with a gradual move away from Internal Borrowing towards External Borrowing as surplus Section 31 payments on account in respect of Business Rate Reliefs and Covid-related Grants were returned to the Government in accordance with the respective scheme requirements (lowering available cash balances). Thus:

- *Borrowing* – the strategy is to gradually move away from taking out new short-term loans over the past 12 months despite the small increase in the Short-Term Borrowing balance presented above, which reflects imminent loan maturities, including two Long-Term Maturity Loans due to be repaid in 2023/24 (total value £13.0 million); and

- *Investments* – low level Investment balances have continued in Quarter 2 in accordance with deliberate strategy (reflecting "Liquidity Allowance" of £15.0 million). The balance includes £2.0 million in "Debt Management Account Deposit Facility" (DMADF) deposits and £4.0 million in Money Market Funds (MMF) deposits.

Borrowing Update

Local authorities can borrow from the PWLB provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 Officer. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing.

Acceptable use of PWLB borrowing includes Service Delivery, Housing, Regeneration, Preventative Action, Refinancing and Treasury Management.

The Council is not planning to purchase any investment assets primarily for yield within the next three years and so is able fully access the PWLB.

Borrowing Strategy

At 30th September 2023, the Council held £290.3 million in loans (an increase of £8.7 million compared to the position as at 31st March 2023), as part of its strategy for funding the Capital Programme. Outstanding loans on 30th September 2023 are summarised in Table 3 below.

Table 3: Borrowing Position

	31/03/23 Balance £m	Net Movement £m	30/09/23 Balance £m	30/09/23 Weighted Average Rate %	30/09/23 Weighted Average Maturity (Years/Days)
Public Works Loan Board	261.6	5.2	266.8	3.35%	13 Years
Banks	0	0	0	N/A	N/A
Local authorities (long-term)	0	0	0	N/A	N/A
Local authorities (short-term)	20.0	3.5	23.5	4.75%	33 Days
Total Borrowing	**281.6**	**8.7**	**290.3**		

The chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective. The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

There has been a substantial rise in the cost of both short and long-term borrowing over the last 18 months. In Quarter 2, the Bank Rate rose a further 0.25% from 5.00% to 5.25% so is significantly higher than its level of 1.25% at the end of June 2022.

Other Debt Activity

The Council did not raise any other capital finance in the first six months of 2023/24.

Treasury Investment Activity

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held, and money borrowed in advance of need. During the first six months of 2023/24, as is normal, the Council's investment balances varied due to timing differences between income and expenditure. The Council held £8.2 million in Treasury Investments as at 30th September 2023 as shown in Table 4 below.

Table 4: Treasury Investment Position

	31/03/23 Balance £m	Net Movement £m	30/09/23 Balance £m	30/09/23 Income Return %	30/09/23 Weighted Average Maturity Days
Banks & Building Societies (unsecured)	1.1	1.1	2.2	1.45%	Instant Access
Government (incl. local authorities)	3.0	(1.0)	2.0	5.25%	19 days
Money Market Funds	10.0	(6.0)	4.0	4.72%	Instant Access
Total Investments	**14.1**	**(5.9)**	**8.2**		

Both the CIPFA Code and Government guidance requires local authorities to invest funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

The Bank Rate increased by 0.25% in Quarter 2, from 5.00% at the beginning of July to 5.25% by the end of September and was reflected in short-dated cash rates, which rose commensurately.

The rates on "Debt Management Account Deposit Facility" (DMADF) deposits also rose to 5.25% by the end of September 2023, as well as Money Market rates (typically in the range 5.1% to 5.3%).

Non-Treasury Investments

The definition of investments in CIPFA's Treasury Management Code covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e., management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).

Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) also includes within the definition of investments all such assets held partially or wholly for financial return.

The Council holds a range of both Service and Commercial investments. As at 30th September 2023, active investments included the following:

- *Service Investments*
    - Loans to Subsidiaries (Qualis)
    - Home Assistance Loans

- *Commercial Investments*
    - Commercial Property
    - Loans to Subsidiaries (Qualis).

Service Investments

The total value of Service Investments as at 30th September 2023 was £50.890 million and is summarised in Table 5 below.

Table 5: Service Investments

Description	**31/03/23 Balance Owing***	**Movement (Q1 & Q2 23/24)**	**30/09/23 Balance Owing***	**Total Approved Limit**
	£000's	**£000's**	**£000's**	**£000's**
Subsidiaries (Qualis):				
Working Capital Loan	6,000	0	6,000	6,000
Asset Purchase Loan	14,138	(246)	13,892	16,782
Development Loans	18,333	12,295	30,628	68,218
Regeneration Loans	0	0	0	35,000
Home Assistance Loans (General Fund)	387	(17)	370	150**
Total Value	**38,858**	**12,032**	**50,890**	**126,150**

* *Loss Allowances excluded (calculated annually for Balance Sheet purposes only)*
** *Capital Programme allocation 2023/24 to 2027/28 (£30,000 annually over five-years).*

An additional £12.295 million in Developments Loans have been granted to Qualis in the first six months of the financial year, which is enabling the continued development of Cottis Lane Multi-Story Car Park and the former Conder site (for Housing). The balance on the Working Capital Loan has remained stable, reflecting the nature of the "revolving credit facility".

Commercial Investments

The Council also holds significant Commercial Property Investments on its Balance Sheet comprising a diverse portfolio of Shops, Industrial Units, and a range of other property assets. In addition, the Council holds a Commercial Loan with its wholly owned subsidiary, Qualis.

The value and return from the Commercial Property portfolio in Quarter 2 is summarised in Table 6 below.

Table 6: Commercial Property Investments

Category	31/03/23 Balance Sheet Value	Net Income 2023/24 (6 months April – Sept 2023) *** Actual	Net Income 2022/23 (6 months April – June 2022) *** (50% Actual)
	£Ms	**£Ms**	**£Ms**
Shops*	93.479	3.046	2.868
Industrial Units	38.114	0.593	0.844
Other**	16.890	0.482	0.512
Total Value/Net Income	**148.483**	**4.121**	**4.224**

* Includes Public Houses and a Petrol Station **Includes North Weald Airfield and Sports Facilities

The Council received total net income of £4.121 million from Commercial Property Investments in the first six months of 2023/24 (compared to £4.224 million for the corresponding period in 2022/23).

Whilst robust returns have been achieved from Shops in particular so far in 2023/24, there has been a reduction in rental income from Industrial Units, driven by four properties that have been demolished for redevelopment and a further four vacant units.

Rent reviews, combined with inducements such as rent-free periods (temporarily restraining rent receipts in the first six months of the year), means that rental levels on Shops are expected to continue to grow during the latter half of the financial year.

The Committee should note that the numbers reflect the accrued position currently in the Council's books, which does not take account of the collectability of income. The Commercial Property portfolio proved very resilient during the pandemic, but an increase in write-offs cannot be ruled out in the future given the current economic climate.

The Commercial Loan with Qualis had an outstanding balance of £30.0 million as at 30th September 2023 and is presented in Table 7 below.

Table 7: Commercial Loans

Description	Balance Owing 31/03/23	Movement	Balance Owing 30/09/23	Approved Limit
	£000's	**£000's**	**£000's**	**£000's**
Qualis Investment Loan	30,000	0*	30,000	30,000

** 10-Year Maturity Loan (principal repayable upon maturity in September 2030)*

Members should note that, in accordance with the Council's MRP Policy and the prevailing accounting rules at the point at which the Commercial Loan to Qualis was granted (in September 2020), MRP is not provided on this loan. However, the Council has purposely protected its position in the form of a "floating charge" on the underlying commercial assets that were purchased (by Qualis) with the proceeds from the loan.

Compliance

The Strategic Director and Section 151 Officer reports that Treasury Management activities undertaken during the first three months of the year fully complied with the CIPFA Code of Practice.

Compliance with the approved Treasury Management Strategy has been achieved in almost all areas, although available cash has dropped slightly below target levels recently as further borrowing has been minimised in the light of higher interest rates.

Table 8: Investment Limits

Sector	Time limit	Counterparty limit	Sector limit	30/09/23	Complied? (Yes/No)
The UK Government	50 years	Unlimited	N/A	£2.0 million	Yes
Local authorities & other Government entities	25 years	£10 million	Unlimited	£0	Yes
Banks (unsecured)*	13 months	£4.0 million	£20.0 million	£2.2 million	Yes
Building Societies* (unsecured)	13 months	£2.0 million	£2.0 million	£0	Yes
Registered Providers* (unsecured)	5 years	£3.0 million	£3.0 million	£0	Yes
Money Market Funds*	N/A	£10.0 million	Maximum of 3 Funds (£10 million each)	£4.0 million	Yes

** Minimum Credit Rating*

Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken account of.

Table 9: Debt and the Authorised Limit and Operational Boundary

Description	Q2 2023/24 Maximum	30/09/23 Actual	Operational Boundary 2023/24	Authorised Limit 2023/24	Complied? (Yes/No)
	£000's	£000's	£000's	£000's	£000's
Borrowing	286,764	290,348	443,184	453,184	Yes
PFI and Finance Leases	0	0	0	0	Yes
Total Debt	**286,764**	**290,348**	**443,184**	**453,184**	**Yes**

Treasury Management Prudential Indicators

As required by the 2021 CIPFA Treasury Management Code, the Council monitors and measures the following Treasury Management Prudential Indicators.

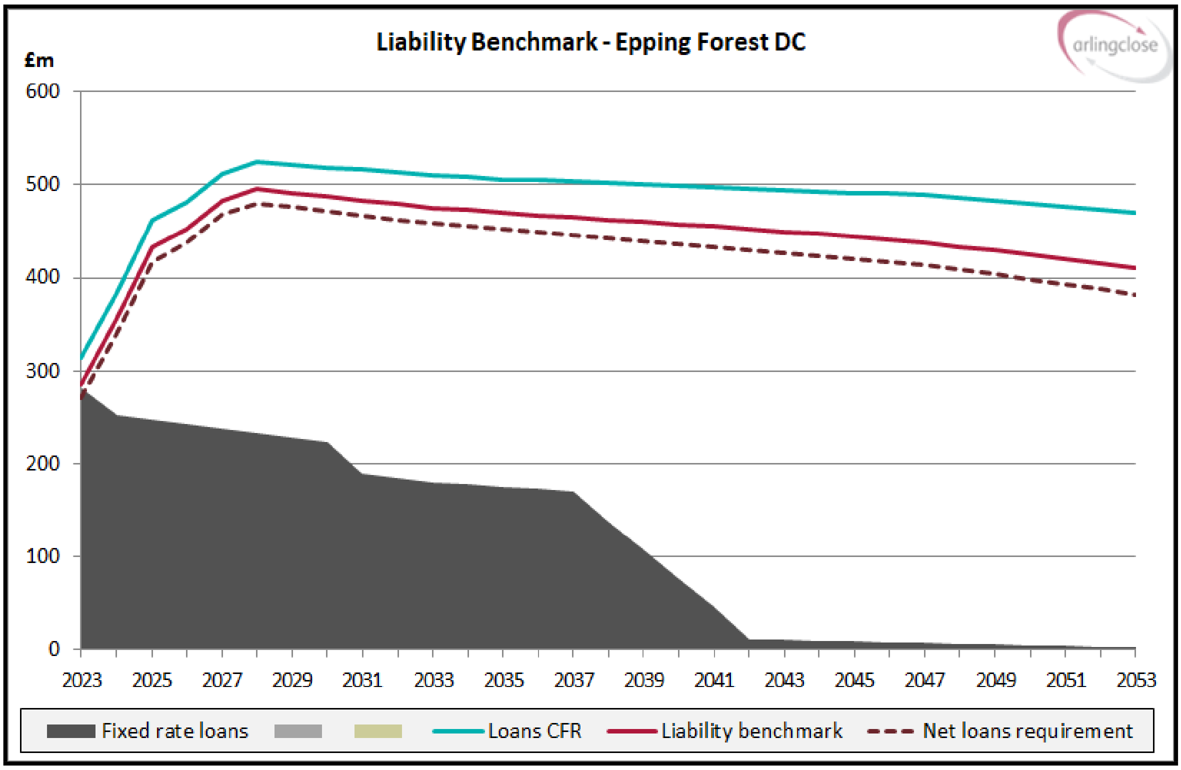
Liability Benchmark

This new indicator compares the Council's actual existing borrowing against a Liability Benchmark that has been calculated to show the lowest risk level of borrowing. The Liability Benchmark is an important tool to help establish whether the Council is likely to be a long-term Borrower or long-term Investor in the future, and so shape its strategic focus and decision making. It represents an estimate of the cumulative amount of external Borrowing the Council must hold to fund its current capital and revenue plans while keeping Treasury Investments at the minimum level of £15.0 million required to manage day-to-day cash flow.

Description	31/03/23 Actual	31/03/24 Forecast	31/03/25 Forecast	31/03/26 Forecast
	£M's	£M's	£M's	£M's
Loans CFR	313.6	383.8	461.2	481.0
Less: Balance Sheet resources	(43.7)	(43.7)	(43.7)	(43.7)
Net loans requirement	**269.9**	**340.1**	**417.5**	**437.3**
Plus: Liquidity Allowance	15.0	15.0	15.0	15.0
Liability Benchmark	**284.9**	**355.1**	**432.5**	**452.3**
Existing Borrowing	**281.6**	**252.3**	**247.8**	**243.2**

Following on from the medium-term forecast above, the long-term (30-year) Liability Benchmark below assumes:

- Minimum Revenue Provision (MRP) on new capital expenditure based on an average asset life of 29 years (covering a range of 7 to 50 years); and
- Income, expenditure, and reserves all increasing by inflation of 2.5% per annum.



Maturity Structure of Borrowing

This indicator is set to control exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

Refinancing Rate Risk Indicator	Upper Limit	Lower Limit	30/09/23 Actual	Complied?
Under 12 months	50%	0%	12%	Yes
12 months and within 24 months	50%	0%	3%	Yes
24 months and within 5 years	50%	0%	5%	Yes
5 years and within 10 years	50%	0%	18%	Yes
10 years and within 15 years	50%	0%	14%	Yes
15 years and within 20 years	50%	0%	44%	Yes
20 years and within 25 years	50%	0%	1%	Yes
25 years and above	50%	0%	2%	Yes

It should be noted that – based on Arlingclose advice – the proposed limits presented above are deliberately wide in range. This is because the indicator is only designed to cover the risk of replacement loans being unavailable, rather than interest rate risk.

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Long-Term Treasury Management Investments

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2023/24 (April – Sept)
Actual principal invested beyond year end.	£0
Limit on principal invested beyond year end.	£15.0 million
Complied?	Yes

Additional Indicators

Security

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	30/09/23 Actual	**2023/24 Target**	**Complied?**
Portfolio average credit rating	AA	A-	Yes

Liquidity

The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

	30/09/23 Actual	**2023/24 Target**	**Complied?**
Total cash available within 3 months	£8.2 million	£15.0 million	No

Available cash has dropped slightly below target levels recently as further borrowing has been minimised in the light of higher interest rates, although the operational cash flow needs of the Council have continued to be met without recourse to the use of an overdraft facility.

Interest Rate Exposure

The Treasury Management Strategy for 2023/24, considered by the Committee and adopted by the Council in February, included an Interest Rate Exposure Indicator, aimed at controlling the Council's exposure to interest rate risk (setting upper limits on the one-year revenue impact of a 1% rise or fall in interests). The indicator is not a requirement of the Treasury Management Code, although it is a reporting requirement within the Council's Statement of Accounts and is good practice recommended by Arlingclose.

	30/09/23 Actual	**2023/24 Limit**	**Complied?**
Upper limit on one-year revenue impact of a 1% rise in interest rates	79,962	£96,000	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	(79,962)	(96,000)	Yes