

Corporate Policy & Resources Committee



15 April 2024

Title	<i>2024-25 Treasury Management Strategy – addendum re Operational Boundary and Authorised Limit for external debt</i>
Purpose of the report	To note the breach of the Operational Boundary between 1 and 25 April 2024. To recommend to Council that the Operational Boundary and Authorised Limit for external debt be increased.
Report Author	<i>Paul Taylor Chief Accountant</i>
Ward(s) Affected	All Wards
Exempt	No
Corporate Priority	Community Addressing Housing Need Resilience Environment Service Delivery
Recommendations	Committee is asked to: <ol style="list-style-type: none"> 1. Note that on 1 April the approved Operational Boundary for external debt was breached. 2. Recommend to Council that the approved Operational Boundary for external debt be increased from £1,067m to £1,170m. 3. Recommend to Council that the approved Authorised Limit for external debt be increased from £1,167m to £1,270m.
Reason for Recommendation	Since preparing the Treasure Management Strategy 2024-25 report which was approved by Council on 22 February 2024 a number of key assumptions have changed, as highlighted below, which has caused a breach in the Operational Boundary from 1 April and officers are recommending that the Operational Boundary and Authorised Limit be increased to reflect these changes.

1. Definitions

- 1.1 The Operational Boundary for external debt - is based on the Council's prudent estimate of possible and likely borrowing levels in the financial year, but it is not the worst case scenario. Both the Operational Boundary and the

Authorised Limit are figures set by the Council in accordance with the Treasury Management Code of Practice issued by the Chartered Institute of Public Finance and Accountancy, taking into account the advice from both officers and external advisers and in the context of the Council's Capital Programme,

- 1.2 Authorised limit for external debt – is the maximum amount of debt that the Council can legally take out.
- 1.3 The Operational Boundary differs from the Authorised Limit in that it is based on expectations of the maximum external debt of the authority according to probable – not simply possible – events and is consistent with the maximum level of external debt projected by the authority's financial plans and budgets. This limit will be lower than the authorised limit because cash flow variations may lead to the occasional (but not sustained) breaches of operational boundary. Therefore, a short-term breach of the Operational Boundary is not fundamental in the way that a breach of the Authorised Limit would be.
- 1.4 This limit will be lower than the Authorised Limit because cash flow variations may lead to the occasional (but not sustained) breaches of operational boundary.
- 1.5 Sustained breaches of the Operational Boundary would give an indication that the authority may be in danger of stepping beyond the prudential boundaries it has set itself. It would be inadvisable to set an Operational Boundary at the level of the Authorised Limit since in those circumstances the Operational Boundary would be unable to alert the authority to the possibility of an imminent breach of the authorised limit.
- 1.6 The Authorised Limit in addition needs to provide headroom over and above the Operational Boundary, sufficient for example for unusual cash movements, such as short-term local authority cashflow loans

The Authorised Limit is certainly not a limit up to which an authority will expect to borrow on a regular basis. It is crucial that it is not treated as an upper limit for borrowing for capital expenditure alone since it must also encompass borrowing for temporary purposes. However, it does represent a limit beyond which a local authority must not borrow until prudential indicators are reviewed or amended.

2. Summary of the report

What is the situation	Why we want to do something
<ul style="list-style-type: none"> • Some key assumptions that were made by officers when preparing the Treasury Management Strategy report for 2024-25 in late December/early January have changed, due to outside economic factors, including delays with the completion of the leisure centre, moving final completion to 2025-26, projected decreases in Public 	<ul style="list-style-type: none"> • The temporary breach of the Operational Boundary is an event that needs to be notified to Council. • Increasing the Operational Boundary and Authorised Limit provides Council; with greater flexibility on how to fund the leisure centre and deal with the changes in external economic factors.

<p>works Loan Board (PWLB) 50-year fixed term interest rates to below the average yield from the Council's investment portfolio.</p> <ul style="list-style-type: none"> • The issue has arisen not because of a significant increase in the amount of Capital expenditure or borrowing to be undertaken but due to a change of approach of how elements within the Capital Programme will be financed. • Working with ArlingClose the Council's financial advisors, Officers were also considering using some of the funds received from selling the Council's short term investments and use them to take advantage of the early settlement discounts offered by the Public Works Loan Board (PWLB) and thus reduce the existing loans, through internal funding, which would have avoided the breach of the Operational Boundary and reduced the £1,068m existing PWLB loans to circa £1,140m, which would have kept the Council within the Operation Boundary. • This has caused a temporary breach to the approved Operational Boundary on 1 April 2024. <p>Going forward the total level of borrowing is anticipated to steadily reduce</p>	
<p>This is what we want to do about it</p>	<p>These are the next steps</p>
<ul style="list-style-type: none"> • Note that this is a temporary breach of the Operational Boundary due to external economic indicators and factors. 	<ul style="list-style-type: none"> • To note the temporary breach of the Operational Boundary. • To recommend to Council that the approved Operational Boundary be increased from £1,067m to £1,170m.

<ul style="list-style-type: none"> Review the report, particularly section 3 which provides background information and section 4 which highlights what has changed. 	<ul style="list-style-type: none"> To Recommend to Council that the approved Authorised Limit be increased from £1,167m to £1,270m.
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3. Background

- 3.1 Both the Authorised Limit and the Operational Boundary for external debt need to be consistent with the authority's plans for capital expenditure and financing, and with its treasury management policy, strategy and practices.
- 3.2 Risk analysis and risk management strategies will also be taken into account when calculating both indicators.
- 3.3 The Operational Boundary for external debt is based on the authority's estimate of most likely, i.e. prudent, but not worst-case scenario and should equate to the maximum level of external debt projected by this estimate.
- 3.4 The setting of this Operational Boundary is a matter of careful judgement. If it is set too high, then it may be too near the authorised limit for there to be a margin sufficient to allow time to take corrective action before the authorised limit is breached. Alternatively, if it is set too low, it will be breached so frequently that it will cease to act as a credible warning indicator.
- 3.5 The establishment of the Operational Boundary and the Authorised Limit, and consequently the margin between them, will therefore be based on each authority's assessment of the risks that it faces. It is possible, for example, that the margin may be greater in an authority that has few or no investments since in those circumstances total gross debt may be more variable. .

4. Key issues

- 4.1 When completing the Treasury Management Strategy 2024-25 report that was approved by Council on 22 February 2024 officers requested that the Operational Boundary and Authorised Limits be set at £1,067m and £1,167m respectively.
- 4.2 This was based on several assumptions concerning the funding of the Leisure Centre and the projected Public Works Loan Board (PWLB) fixed interest rate, together with the option of liquidating the Council's £33m Pooled Fund Investment to provide sufficient cash proceeds to fund the Leisure Centre and avoid the need to take out additional loans, together with the requirement for net Local Authority borrowing, to cover short term weekly and monthly fluctuations in the Councils cashflow (please note that any surplus cash is also lent out on the Local Authority Exchange). Also, the Council has approved an additional £17m of housing stock under the Local Authority Housing funding programme, where up to 40% of the property costs are funded from central Government. (Leaving £10m net of funding to be financed)
- 4.3 Since the initial report to Council, the completion of the Leisure Centre has been delayed and it looks like the completion date for phase II of the project has moved from 2024-25 to early 2025-26.

- 4.4 Further, the PWLB fixed interest rate has been predicted to fall beyond the levels forecast towards the end of 2023 and beginning of 2024 when the original report was produced.
- 4.5 This predicted trend in PWLB from an average 5%, changes the benefit of cashing in the Council's Pooled Investments which currently generate an income yield of just over 4%. With PWLB interest rates forecast to fall to below 4% in the next eighteen months, this now turns this decision from a net saving to a net cost to the Council.
- 4.6 External borrowing estimates for the year are shown below, noting that the LAHF Housing Programme 2a, which has been approved by Council (which eases housing pressures and will assist the housing revenue budget) represents new net borrowing, after the subsidy received from central Government, the other elements relate to a change of approach of how existing planned approved expenditure is financed:

Operational Boundary for external Debt	£m
Current Public Works Loan Board Loans	1,068
Current Leases	3
LAHF Housing Programme phases 1 & 2 (net) (36 properties)	7
LAHF Housing Programme 2a (net) (42 properties)	10
Leisure Centre	48
Short term Local Authority Borrowing	30
Aggregate loans	1,166

- 4.7 Therefore, officers are proposing the following changes:

£m	Current	Proposed
Operational Boundary	1,067	1,170
Authorised Limit	1,167	1,270

- 4.8 The proposed change to the Operational Boundary has no impact on any of the Council approved capital projects, and it is Council that must approve the final sign off on each project and how the project will be funded from reserves.

5. Options analysis and proposal

- 5.1 It is possible for Council to acknowledge the breach of the Operational Boundary and leave the limits approved by Council in February unchanged. However, it is recommended that once a breach has occurred, officers review the Operational Boundary and if the breach is likely to be occurring throughout the year, Council should be asked to amend the agreed figures.

6. Financial management comments

- 6.1 As explained above.

7. Risk management comments

- 7.1 There are no risk implications to Council by increasing the Operational Boundary and Authorised Limit for external borrowing, as every capital project must come to Council for approval.
- 7.2 By deferring the disposal of the short term investments, officers have greater flexibility to manage the Council's finances over the next 12 months, as the loans taken out to cover the approved capital programme, will replenish operating cashflow.
- 7.3 Working with Arlingclose, the future trends for the PWLB interest rates is downwards and based on borrowing £65m for the Leisure Centre and LAHF projects, every 0.5% reduction in fixed term interest rates will save the Council approximately £15m in reduced loan repayments, over the term of the loan.
- 7.4 In the event that interest rates forecast show an upward trend, the reverse would happen, i.e., for every 0.5% increase in fixed interest rates beyond 5%, it would cost the Council £15m over the term of the loan. At this point, officers would be looking to liquidate the short term investments and use the funds to reduce external PWLB external loans.
- 8. Procurement comments**
- 8.1 There are no procurement implications.
- 9. Legal comments**
- 9.1 The Council has a statutory duty to make arrangements for the proper administration of its financial affairs under the Local Government Act 1972 (section 151). Consequently the Council has a legal duty to set a range of prudential and treasury management indicators for each financial year including the operational boundary and borrowing limit.
- 10. Other considerations**
- 10.1 There are none.
- 11. Equality and Diversity**
- 11.1 Not applicable
- 12. Sustainability/Climate Change Implications**
- 12.1 Not applicable
- 13. Timetable for implementation**
- 13.1 To go to Council on 25 April for approval and immediate implementation.
- 14. Contact**
- 14.1 Paul Taylor p.taylor@spelthorne.gov.uk

Background papers: Treasury Management Strategy 2024-25.

Appendices: There are none.