

Corporate Policy and Resources



15 October 2024

Title	Amendment to Treasury Strategy 2024/25- updated report subsequent to Committee on 15 th October
Purpose of the report	An amendment to the Treasury Management Strategy to allow use of Pooled Strategic Funds to fund the Capital Programme and minimise impact of high borrowing costs
Report Author	Prithiva Janaka, Treasury Management and Capital Accountant
Wards affected	All Wards
Exempt	No
Corporate Priority	Community Addressing Housing Need Resilience Environment Service delivery
Recommendations	Committee is asked to recommend to Council to: 1. Approve the amendment to Treasury Management Strategy for 2024/25 as set out in this report.
Reason for Recommendation	To allow draw down of the strategic pooled investment funds (currently £35m) to help to minimise further additional borrowing

1. Introduction

The Treasury Management Strategy for 2024-25 was agreed by Council 22 February 2024, with some amendments made by Council at its meeting of 25th April to the borrowing limits. The Strategy currently includes the maintenance of investments in Pooled Investment Funds of approximately £35m. See Appendix 1 for a summary of the current Funds and their balances.

Summary of the report

What is the situation	Why we want to do something
<ul style="list-style-type: none"> • The Council have a statutory responsibility to review and approve the Treasury Management Strategy annually before the beginning of the new financial year, and any major changes to the strategy they wish to adopt during the financial year • The Council has both a significant debt portfolio (most of which is at fixed rates) of £1,068m and equally investment funds both pooled and cashflow, of £41.6m. • The Council has recently achieved practical completion (PC) on Phase 1 of its new Eclipse leisure centre and needs to focus on securing the balance of funding for the centre on a longer-term basis • The Council has a portfolio of pooled investment funds of approximately £35m at 31/08/24 to deliver an investment return which over the last decade has average 4% • The Council needs to seek to minimise financing costs whilst maximising returns on surplus funds 	<ul style="list-style-type: none"> • Treasury management is crucial to the Council’s cash flow, investment and borrowing to mitigate the risk we should plan a head on <ul style="list-style-type: none"> ○ Operational Limit ○ Authority limit ○ Diversify investment. ○ Borrowing • To fund major capital projects and avoid the need for further borrowing • With PC of Eclipse, it is now timely to review options for financing the balance which include: <ul style="list-style-type: none"> ○ Drawing down investment funds, or ○ Retaining flexibility by rolling forward short-term financing before fixing when rates fall further, ○ Using drawn down funds to pay off PWLB balances at discounted rates • The preferred option is to draw down funds as an alternative to additional borrowing • Council has significant existing debt and is in the spotlight with respect to borrowing levels • Whilst interest rates have started to ease, they are still relatively high
This is what we want to do about it	These are the next steps
<ul style="list-style-type: none"> • Make a strategic decision as to whether to continue with the portfolio of pooled investment funds or drawn them down • Mitigate risk by diversifying investment and minimising borrowing. • Continuing to seek professional advice from our advisers 	<ul style="list-style-type: none"> • Review and approve the amendment to the Treasury management Strategy 2024/25 by Corporate Policy and Resource Committee and the Council. • If the funds are drawn down, it needs to be done in a managed way to minimise any capital losses

- 1.1 The objective of this Treasury Strategy Report is to seek the Council's approval to draw down the Pooled Investment Funds of £35m, to cover the treasury needs for additional borrowing required for the capital programme, including Spelthorne Leisure centre, on a long-term basis.
- 1.2 By drawing down the Pool funds, even though Council will forfeit a potential return on investment of £1.3m per annum, it will save on loan interest payments per annum of £1.8m (£35m@5%) on additional borrowing foregone. The saving arising as the percentage rate of return on the pooled funds is less than the rate of interest we will be paying if we took out additional borrowing This is subject economic climate and movements in interest rates, it might be higher or lower.
- 1.3 The Treasury Management Strategy aims to protect the Council from market-related risks by monitoring interest rates, economic indicators, and UK and overseas government finances. A range of information sources is used to inform economic analysis and forecasts.

2. Operational Analysis and Proposals

- 2.1 Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

Summary position

- 2.2 On 31st August 2024, the Council held £1,068m of long-term borrowing, all long-term fixed rate loans with Public Works Loan Board (PWLB), £21.0m of short-term borrowing from other Local Authorities, £12.2m of treasury investments and £763.1m of non-treasury investment property. Overall, the Council has a net borrowing position of £313.7m. This detailed in Table 1 below. If the Pooled Funds are drawn future borrowing will be reduced therefore saving in debt interest payments.

Table 1: Current Investment & Debt Portfolio

As at 15.09.2024	Actual Portfolio
	£m
External Borrowing:	
Public Works Loan Board	(1,068.0)
Local Authorities (short term)	(21.0)
Total Gross External Debt	(1,089.0)
Long-Term Investments:	
Pooled Fund Investments	
Funding Circle	0.0
Short-Term Investments:	
Local Authorities	5.0
Subsidiaries	1.1
Fixed Rate Deposits	0.0
Money Market Funds	6.1
Total Investments	12.2
Net (borrowing)/ investments	(1,076.8)
Non-treasury investments:	
Investment property (as at 15.09.24)	763.1
Overall net borrowing	(313.7)

- 2.3 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. The Council's current strategy is to maintain borrowing and investments below their underlying levels, also known as internal borrowing. Forecast changes in the CFR, investments and borrowing are shown in Table 2 below.

Table 2: Capital Financing Requirement

	Draft Actual	Estimate	Estimate	Estimate	Estimate
Financial Year	23/24	24/25	25/26	26/27	27/28
	£m	£m	£m	£m	£m
Opening CFR	1,135.0	1,157.6	1,164.3	1,153.4	1,139.7
In-year movement (below)	22.6	6.7	(11.0)	(13.7)	(13.2)
Closing CFR	1,157.6	1,164.3	1,153.4	1,139.7	1,126.5
Less: External borrowing	(1,096.5)	(1,089.0)	(1,078.0)	(1,064.3)	(1,051.1)
Internal borrowing	61.1	75.3	75.4	75.4	75.4
<i>Capital programme:</i>					
Housing & Regeneration	39.6	21.0	0.0	0.0	0.0
Other capital expenditure	1.4	3.1	4.4	2.6	2.5
Total Capital Expenditure	41.0	24.2	4.4	2.6	2.5
<i>Financing:</i>					
Capital Receipts	0.0	(2.3)	(0.3)	(0.3)	(0.2)
Capital Grants and Contributions	(4.4)	(1.3)	(0.9)	(0.9)	(0.9)
Revenue Contribution	(1.6)				
Lease Funding		(0.9)	(0.9)	(0.9)	0.0
Net Financing Need	35.0	19.6	2.2	0.4	1.3
Less: Minimum Revenue Provision (MRP)	(12.4)	(12.9)	(13.2)	(14.1)	(14.5)
In-year movement in CFR	22.6	6.7	(11.0)	(13.7)	(13.2)

- 2.4 The increase in Internal Borrowing between 31.3.2023 and 31.3.2024 has funded the Major Capital Projects including the Spelthorne Leisure Centre, and has been covered by short-term borrowing from other local authorities and is thus unsustainable in the long term. It should be replaced either with the drawing down of Pooled Investments as recommended, or by long term external borrowing.
- 2.5 To avoid losing the diversification within our Pooled Investment Fund portfolio, it is recommended that we drawdown the whole balance of Pooled Investment Funds.
- 2.6 The Council's planned Capital Programme for the next 4 years (including 2024/25) is given on the Table above, major spendings are on the Council's housing delivery (Property acquisition of temporary accommodation for families

and settlement accommodation for Afghan and Ukrainians) to top up the Local Authority Housing Fund grant) for the and regeneration programme and on service projects such as the new Leisure Centre, phase 1 of which has just completed with the new Eclipse Leisure Centre opening in mid-October.

- 2.7 The Authorised Borrowing Limit has been increased £1,167m to £1,170m and Operational Boundary from £1,067m to £1,270m in April 2024 for 2024/25. These are considered appropriate for the above projections but will be reviewed and revised as needed to reflect borrowing requirements in future years. As can be seen in the above table the anticipated external borrowing figure falls below both limits.
- 2.8 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that an authority's total debt be lower than its highest forecast CFR over the next three years. Table 2 above shows that the Council expects to comply with this recommendation for 2024/25

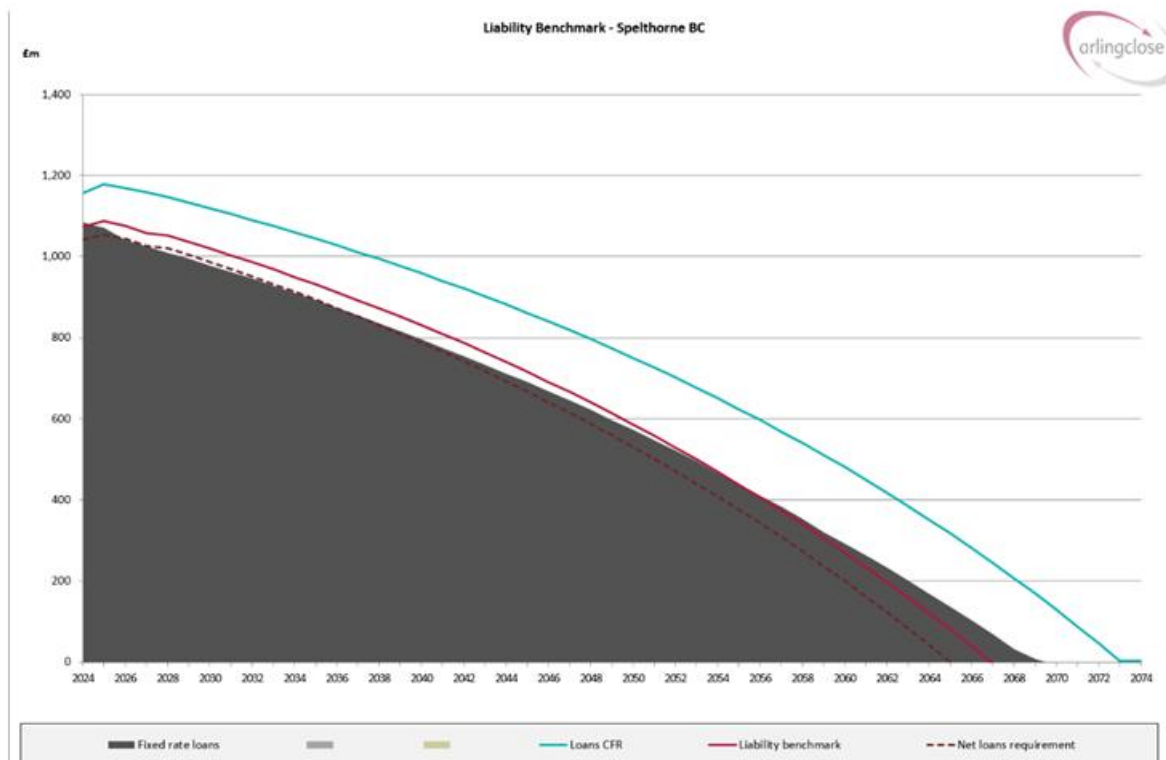
Local context - Liability benchmark

- 2.9 To compare the Council's actual borrowing against an alternative strategy, a liability benchmark (a measure of risk outlined in the CIPFA TM Code and now required to be reported on for future years) has been calculated showing the lowest risk level of borrowing, as shown at Table 3. This assumes the same forecasts as Table 2 above, but that cash and investment balances are kept to a minimum level of £20m at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 3: Liability benchmark

Financial Year	Audited	Draft	Estimate	Estimate	Estimate
	Actual	Actual			
	23/24	24/25	25/26	26/27	27/28
	£m	£m	£m	£m	£m
CFR	1,157.0	1,164.3	1,153.4	1,139.7	1,126.50
Balance Sheet resources	(111.0)	(113.0)	(119.0)	(113.0)	(113.0)
Minimum cash for liquidity	20.0	20.0	20.0	20.0	20.0
Liability benchmark	1,066	1,071.3	1,054.4	1,046.7	1,033.5

- 2.10 The liability benchmark indicates that the required level of borrowing is forecast to be £1,085m as at 31 March 2025 after taking into account other resources such as usable reserves and the minimum level of cash for liquidity of £20.0m.
- 2.11 Following on from the medium-term forecasts in table 2 above, the longer-term liability benchmark shows the level of borrowing that will be required in future years – consistently low at around £0.1m to £0.2m (the gap under the top, green line). The Council will be working with Arlingclose to further develop this modelling to help identify and apply internal resources effectively.



2.12

3. Borrowing and Investment Strategies

Borrowing Strategy

- 3.1 The Council currently holds £1,068.0m of loans, which it is paying off on an annual basis (Table 1) as part of its strategy for funding previous years' capital programmes. The Council was debt-free before 2016/17, when the decision was taken to make strategic property acquisitions based on the opportunities available, with the important caveat that Council has no intention to buy investment assets primarily for yield. The forecast in Table 2 shows that the Council expects outstanding borrowing to be a maximum of £1,068m in 2024/25.
- 3.2 The revised draft Capital Programme budget for 2024/25 has been set at £24.2m, net of funding this is a reduction of almost 36% from 2023/24 mainly due to a number of programmes other than Spelthorne Leisure Centre being suspended. A proportion of rental income from existing investment property is set aside to increase sinking fund earmarked reserves, which contribute towards financing of future property-related costs. This is to help ensure, given the relatively illiquid nature of property assets, the Council does not get into a forced sale position on an asset if its income dips for a temporary period.
- 3.3 **Objectives:** The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty over those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.
- 3.4 **Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

- 3.5 With interest rates falling, we want to avoid fixing long term at rates which may then subsequently fall. By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.
- 3.6 The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis, the result of which will help determine whether the Council borrows additional sums at long-term fixed rates in 2024/25 with a view to keeping future interest costs low and gaining long term value for money even if costs are higher in the immediate to short term.
- 3.7 The Council has previously raised the majority of its long-term borrowing from the PWLB, which remains a relatively good option particularly as it was fixed at relatively low interest rates. Government guidance now prohibits authorities that have 'investments for yield' (which the Council does not intend to have) from accessing PWLB loans.
- 3.8 The Council is working with Arlingclose to identify alternative funding options for funding the balance of the reduced Capital Programme.
- 3.9 In addition, the Council may borrow short-term when needed to cover unplanned cash-flow shortages.

4. Financial implications

- 4.1 The MHCLG Guidance and the CIPFA TM Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer believes that the above proposed strategy amendment represents an appropriate balance between risk management and cost effectiveness. The strategy amendment proposal has been drawn up in consultation with the Council's independent treasury and investment advisers, to ensure a prudent and robust approach in the strategy.
- 4.2 As stated in section 1, through drawing down on the Pooled Investment Funds, the Council will forfeit a potential return on investment of £1.3m per annum but will save on loan interest payments per annum of £1.8m – a net gain of £0.5m per annum.
- 4.3 The drawdown of Pooled Investment Funds represents a cash movement, reducing the value of long term assets (ie the pooled investment funds) offset by a reduction in the short term liabilities of short term financing. It will only have an effect on the reserves held by the Council if it generates a gain or loss on sale. Otherwise, it will **not** impact the total net worth (difference between assets and values and that total is matched on the Balance Sheet by the value of the reserves) of the Council, and therefore **does not change the reserves** held by the Council.

Assets



minus

-

Liabilities



equals

=

Reserves



- 4.4 This drawdown will cover/avoid treasury need for additional borrowing required for the Capital Programme, including Eclipse Leisure centre, on a long-term basis.
- 4.5 Some alternative strategies, with their financial and risk management implications, are listed below in Table 11.

Table 11: Alternative strategies

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Lower investment sums resulting in less Interest income	Lower chance of losses from credit related defaults although such losses may be greater. Also, less diversity increases risk of losses.
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher with increased investment sums	Increased risk of losses from credit related defaults, but any such losses may be smaller. Increased diversity also decreases the risk of significant loss.
Borrow additional sums at long-term fixed interest rates (not in advance of need)	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default. However long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Reduced debt interest costs Less income for funding projects Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain Less resources available for the Capital Programme which would need to be reduced

5. Procurement considerations

Not applicable

6. Legal considerations

The Council has a statutory obligation, under The Local Government Act 2003 to approve and publish its Treasury Management Strategy. The Council has a statutory obligation to have regard to the Treasury Management and Prudential Codes

7. Other considerations

Not applicable.

8. Equality and Diversity

Not applicable

9. Sustainability/Climate Change Implications

The Corporate Policy and Resources Committee had agreed the parameters to be used in its Environmental, Social and Governance (ESG) strategy, the strategy has yet to be agreed. One of the intentions of developing an ESG strategy is to enable the Council to transition the investment portfolio to a more sustainable and environmentally sound approach. However, if Council agrees to draw down the pooled investment funds the above ESG parameters will cease to be applicable as we will not have need to evaluate funds against ESG criteria.

10. Timetable for implementation

If Council approves at its meeting on 24th October, officers will work with Arlingclose to draw down the funds. Some will take longer to close and transfer funds back.

11. Contact

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Background papers: None

Appendices:

Appendix 1: [Summary of current pooled investment funds](#)

Appendix 2: [Break down of Capital Programme](#)