REPORT OF THE AUDIT COMMITTEE No. 1, 2023/24

FULL COUNCIL 4th of March 2024

Chair: Councillor Erdal Dogan   Deputy Chair: Cllr Eldridge Culverwell

1. INTRODUCTION

The Council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code), which requires the Council to agree a Treasury Management Strategy Statement, including an Investment Strategy annually in advance of the new financial year.

This report presents Council with the updated Treasury Management Strategy Statement for 2024/25 following its scrutiny at the Overview and Scrutiny Committee, presentation at the Audit Committee and in consultation with the Cabinet Member for Finance and Local Investment.

TREASURY MANAGEMENT STRATEGY STATEMENT 2024-25

We considered the Treasury Management Strategy Statement for 2024-25 which outlined the Council's strategy for managing its cash flows, borrowing, investments, and the associated risks in accordance with the CIPFA Treasury Management Code of Practice.

We noted that the report had been reviewed by the Overview and Scrutiny Committee on 18 January 2024 and was advised that further to responses to questions on the report, the Committee had recommended that the future Treasury Management Strategy Statement reports include an assessment of the probabilities of unforeseen risks occurring and the likelihood of certain scenarios playing out, such as a 1% above expected increase in borrowing costs. It was suggested that something similar to this was done when reporting on the pension fund and Members would like that to be replicated for future TMSS reports and noted that officers have agreed to take forward.

We were informed that the document was set by statutory requirements as to what should be included in a treasury strategy statement and that it was usually included as part of the budget process. The capital strategy document set out how schemes were costed. The capital programme decisions did not form the treasury strategy. The treasury strategy looked at the agreed capital programme (this involved aspects such as building housing arounds around the borough, rebuilding schools or refurbishment work). This was then appraised and then costed for in the capital strategy document. The document looked at how the element of borrowing was exercised by the Council. The draft budget (medium term financial strategy) would be agreed by Cabinet.

We discussed the following:

- That the Cabinet Member had been consulted on the report, but the report was be scheduled to be formally adopted by Full Council.
- The financial situation across the country and how this was taken into account locally. We heard that higher inflation, higher interest rates and a slowing economy presented a challenge and this was compounded by local authorities having issues with funding. This had been considered in relation to the budget, which members had been consulted upon. Where Treasury Management was involved in the process was articulating what interest costs would be given the Council's spending plans. Given the framework and given the budget process for the Council, there had to be risk management and control in terms of how those in-year decisions were made. There was a budget which Treasury Management had to adhere to. There were also risks that could occur when making investments, such as loss of investment. The report tried to build in controls in relation to this. There were limits in terms of how much could be placed with different institutions, but there was also consideration of the relative expense of borrowing. The approach in the Treasury Strategy was acknowledging that interest rates were higher, but there had to be a framework in terms of how certain decisions during the course of the year would be taken. This was assessed through the affordability of the budget setting process that was set through the Council. We noted that this report would be submitted to the Full Council meeting, it would be an appendix to the main budget.
- Page 15 of the report, which stated that the Council may utilise banks and building societies which were unsecured and registered providers which were unsecured. In response, we heard that in recent years, the Council had never placed any deposits or any arrangement with the bank. Barclays was used for day-to-day cash flow management, but the Council never secured deposits with any other bank. It was included in the strategy because there were times when the bigger banks could offer more attractive rates. However, the focus for the strategy was to work with the safest counterparties which was considered to be the UK Government through the Debt Management Office followed by money market funds, which were usually AA rated - the highest investment grade rating possible. If the Council had excess liquidity (more money than it normally would to complete the three-month payments), then the Council could place capital into areas such as banks and building societies, if they offered a high rate. We noted that given how the Council had been managing its cash, there had never been a need for the Council to place extra money with the banks, but the remit was there in the strategy in case that was something that became attractive for the Council to utilise.
- The level of risk regarding housing revenue account as some of the capital extensions had not gone ahead because of failed programs. In response, we heard that the capital plans had been considered as part of the budget as the

Council had to acknowledge that the economic environment had changed. One of the key things was the discount rate that was applied to the capital programs (which was the 5.5%). Last year, when the schemes were being assessed, it was based on 4.5%. As a result, it meant that a number of schemes were not able to pass the minimum benchmark for them to be affordable for the Council and would be an additional risk on the Council. These were things that were considered when setting the capital program. We noted that the Director of Finance had been consulting with members in terms of addressing what the implications would be. There was an acknowledgement that if the borrowing became too high, then it would take a big part of the revenue budget, which would then have an impact on the other revenue plans that the Council had in place. In relation to the Housing Revenue Account (HRA), it had a different funding structure to the general fund. We noted that a lot of the HRA borrowing had been assessed in line with the HRA business plan. These were robustly tested. The HRA were informed what the borrowing rates were and they were figured into that plan. In terms of the reduction, it was mainly acknowledging that the cost of borrowing was higher. We further noted that if the cost of borrowing was to become lower, then there would likely be another reassessment on some of those projects that had been suspended or were taken out of the capital program.

- The risk of going over the rate of 5.5%, we heard that in terms of the 5.5%, this figure had been obtained from the advice the Council received from its treasury advisers. The report had an economic outlook and this would be assessed based on market movements, how different products in the market, such as credit default swaps, were being priced and an estimation would be made of where the future trend would be. This was not only for the bank rate, but for rates as a whole. This was what was then included as part of the assessment. There was also buffer in the estimation to make sure that the Council was being prudent, but not overly prudent.

- How the bank rate affected capital spending, we heard that the bank rate was just the rate that the other banks could borrow from the Bank of England. This was not necessarily directly related to how much the Council could borrow from the Public Works Loan Board (PWLB). At times, how much the Council could borrow from the PWLB was considerably higher because the PWLB itself applied a 1% threshold to whatever the gilt yields were, which was the cost of borrowing that the UK Government issued on a regular basis. This was then priced into how much as an authority the Council was able to borrow. We noted that the Council received a 20% discount. There was a 2% discount on some of the loans and the HRA loans were a bit lower. The bank rate may move up and down, but the long-term cost of borrowing may still remain higher. The way interest rates were costed, there was the bank rate’s level, but there was also the risk that markets perceived in relation to the relative fiscal position of the UK. Two years ago, when the government came up with the budget and rates went up to 6%, the Bank of England had not made any changes on its rates. This was all based on the market's view of how precariously the UK fiscal situation looked. Arlingclose had taken this into account along with the bank rate. If it was to drop 2%, then this would be significant. We noted that the report was just acknowledging that there was more risk that rates would remain higher and if the Council was to borrow at that rate, then there was a risk that certain costs would go into the budget and other revenue streams or other revenue projects might then have to be stopped instead of the capital schemes.

- The approved counterparties in terms of environmental, social governance (ESG) considerations, we heard that there had been no direct assessment made on any organisations because most of the deposits were made by the UK government and many of the deposits were short term, in some cases for only up to a day. However, other pooled organisations (outlined in the additional investment limits on table 6 of the report) listed some providers which may have an impact on ESG. There were some real estate investment trusts that focused only on improving affordable housing and also making housing more environmentally friendly. These would be considered if the Council chose this route. However, the Council strategy generally long term had not been to invest in these types of avenues.

- Whether it would be possible for our Committee to be informed if there had been any borrowing or investment usage of key organisations that were exploiting the environment. We heard that this would be possible although the Treasury investment would not invest in any high-risk company equity (such as Shell).

  Following from page 17 of the agenda papers, which highlighted security, liquidity, short term borrowing, interest rate exposure. In the quarterly report, there was usually a column next to these items that stated if each one was compliant. In response, we heard that in terms of the strategy, the prudential indicators that been set were the ones that would be going into future quarterly reports regarding compliance. We noted that Full Council had received the reports which would have the figures relating to compliance. There had been changes to reflect one how the Council was implementing its strategy, but the changes were also due to the economic environment.

- Section 4 of the appendix, relating to borrowing strategy. A report was previously presented to Full Council which included a table regarding borrowing limits and this table had been present in all the previous quarterly reports but was not present in the report presented at this meeting. In response, we heard that CIPFA code, which had been adopted by the Council, did not require certain other items to be included in the report. We noted that the Treasury Strategy was simply supposed to be focused on the risks of the Treasury Management. Some of the elements of the investment strategy examined how the Council dealt with the investments in the local community, such as giving loans to small businesses. This was not considered Treasury Management activity but was part of the capital structure of the Council. We asked for the table to be brought back in as additional credential indicator, because the CIPFA code allowed for any indicators that members found it useful to be included. We asked that the table relating to the borrowing limits be included as part of the TMSS report.

5. RECOMMENDATIONS

Full Council is recommended:

To agree the proposed updated Treasury Management Strategy Statement for 2024-25 as attached to agenda item 13, 2024-25 Budget and Medium-Term Financial Strategy 2024/28 at Annex 4.