Report to the Audit & Governance Committee

Date of meeting: 19th September 2024

Epping Forest District Council

Portfolio: **Finance & Economic Development**

Subject: **Treasury Management Quarter 1 Update 2024/25**

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

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

Recommendations/Decisions Required:

(1) To note the Treasury Management Quarter 1 Update 2024/25 ***(Appendix A)*** and pass comment for full Council.

Executive Summary:

The Council's Treasury Management Strategy (including Investment Strategy) for 2024/25 was considered at a meeting of the Audit and Governance Committee on 15th February 2024 and was subsequently agreed by full Council on 20th February 2024.

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 1 Update for 2024/25 (presented in ***Appendix A***) sets out the Council's actual Treasury Management activity for the first three months (Quarter 1) of 2024/25 (i.e., April to June 2024).

Appendix A begins by setting the external context for Quarter 1 of 2024/25 by exploring the Economic Background, Financial Markets and Credit Ratings, including declining Inflation and stable Interest Rates.

The Borrowing and Investment position for Epping Forest District Council as at 30th June 2024 shows the following:

- *Borrowing* – external borrowing reduced by £0.7 million (from £253.1 million to £252.4 million) during the period April to June 2024; and

- *Investments* – there was also a reduction in investments of £12.8 million (from £43.9 million to £31.1 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 £68.986 million as at 30th June 2024)
- Commercial Property (Balance Sheet value of £156.224 million as at 31st March 2024); and a
- Qualis Investment Loan (value of £30.0 million as at 30th June 2024).

Appendix A concludes by considering compliance with CIPFA's Treasury Management Code and the Treasury Management Strategy for 2024/25, including Prudential and Other adopted indicators. Compliance with reportable indicators was achieved in all areas in Quarter 1.

Reasons for Proposed Decision:

To enable the robust scrutiny the Council's Treasury Management performance in 2024/25 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) 2024/25 (Audit and Governance Committee, 15th February 2024).

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 1 Update 2024/25

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 15th February 2024 and was subsequently agreed by full Council on 20th February 2024. 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 June 2024

Economic Background: UK inflation continued to decline over the quarter, with CPIS falling from an annual rate of 3.2% in March 2024 to 2.0% in May 2024 (to bring it in line with the Bank of England's target). The core measure of inflation, however, only declined from 4.2% to 3.5% over the same period, which, together with stubborn services price inflation at 5.7% in May, helped contribute to the Bank of England (BoE) maintaining the Bank Rate at 5.25% during the period, a level unchanged since August 2023. Arlingclose maintained its central view that 5.25% is the peak in Bank Rate and that interest rates will most likely be cut later in the second half of 2024.

The UK economy emerged from the technical recession at the end of 2023 to expand by 0.7% (upwardly revised from the initial estimate of 0.6%) in the first quarter of the calendar year. Monthly Gross Domestic Product (GDP) data showed zero growth in April 2024, following an expansion of 0.4% in the previous month.

Financial Markets: Sentiment in financial markets showed signs of improvement over the quarter, but bond yields remained volatile, but generally finished higher than at the start of the period.

Over the quarter, the 10-year UK benchmark gilt yield started at 3.94% and ended at 4.18% having reached 4.41% in May 2024. While the 20-year gilt started at 4.40%, hit 4.82% in May, before ending the period at 4.61%. The Sterling Overnight Rate (SONIA) averaged 5.20% over the quarter to 30th June 2024.

Credit Review: Arlingclose maintained the advised maximum duration limit for all banks on its recommended Counterparty List to 100 days over the period.

Having placed Warrington Borough Council on review for a downgrade in March 2024, Moody's subsequently withdrew its ratings for the council in June 2024.

Market volatility is expected to remain a feature, at least in the near term, and the institutions and durations on the Council's counterparty list recommended by Arlingclose remain under constant review.

Local Context

On 31st March 2024, the Council had net borrowing of £209.2 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

	31/03/24 Actual £m	31/03/25 Forecast £m
General Fund CFR	188.906	234.457
HRA CFR	154.625	179.323
Total CFR	**343.531**	**413.780**
Less: Other Debt liabilities	0	0
Borrowing CFR	**343.531**	**413.780**
Less: External borrowing	(253.052)	(306.480)
Internal borrowing:	**90.479**	**107.300**
Less: Balance Sheet resources	(126.438)	(122.300)
Net Investments	**(35.959)***	**(15.000)***

**Excludes Accrued Interest and includes Cash-in-Transit*

The Treasury Management position as at 30th June 2024 and the change during the first three months of the financial year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31/03/24 Balance £m	Movement £m	30/06/24 Balance £m	30/06/24 Rate %
Long-term Borrowing	253.1	(0.7)	252.4	3.31%
Short-term Borrowing	0	0	0	N/A
Total Borrowing	**253.1**	**(0.7)**	**252.4**	
Long-Term Investments	0	0	0	N/A
Short-term Investments	19.0	(9.0)	10.0	5.25%
Cash and Cash Equivalents	24.9	(3.8)	21.1	5.00%
Total Investments	**43.9**	**(12.8)**	**31.1**	
Net Borrowing	**209.2**	**12.1**	**221.3**	

The cash flow pattern for the Council in Quarter 1, is reflected in a gradual reduction in both Borrowing and (especially) Investment balances. It is part of a deliberate strategy in managing the cash available from the North Weald Airfield capital receipt against the expenditure needs of the Capital Programme in the most cost-effective way. Thus:

- *Borrowing* – the further rollout of Development Loans to Qualis and funding the wider Capital Programme (including the new Epping Leisure Centre) has not required additional borrowing in Quarter 1; and instead
- *Investments* – available cash from the North Weald Airfield capital receipt – held in Investments and Cash and Cash Equivalents – has been used in lieu of additional external borrowing in order to fund Development Loans to Qualis (from which the Council receives a margin) and the wider Capital Programme.

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 June 2024, the Council held £252.4 million in loans (a decrease of £0.7 million compared to the position as at 31st March 2024), as part of its strategy for funding the Capital Programme. Outstanding loans on 30th June 2024 are summarised in Table 3 below.

Table 3: Borrowing Position

	31/03/24 Balance £m	Net Movement £m	30/06/24 Balance £m	30/06/24 Weighted Average Rate %	30/06/24 Weighted Average Maturity (Years/Days)
Public Works Loan Board	253.1	(0.7)	252.4	3.31%	13.1 Years
Banks	0	0	0	N/A	N/A
Local authorities (long-term)	0	0	0	N/A	N/A
Local authorities (short-term)	0	0	0	N/A	N/A
Total Borrowing	**253.1**	**(0.7)**	**252.4**		

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.

As indicated above, further long-term PWLB borrowing has been averted in Quarter 1 due to the availability of cash balances following the land disposal at North Weald Airfield in December 2023. The small reduction in balance outstanding (£0.7 million) in Quarter 1 reflects the repayment of principal on existing loans (Note – the Council holds a majority of Maturity Loans, which is reflected in the relatively slow decline in the overall outstanding balance as only interest payments are made prior to the maturity date).

Other Debt Activity

The Council did not raise any other capital finance in the first three months of 2024/25.

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 three months of 2024/25, as is normal, the Council's investment balances varied due to timing differences between income and expenditure. The Council held £31.1 million in Treasury Investments as at 30th June 2024 as shown in Table 4 below.

Table 4: Treasury Investment Position

	31/03/24 Balance £m	Net Movement £m	30/06/24 Balance £m	30/06/24 Income Return %	30/06/24 Weighted Average Maturity Days
Banks & Building Societies (unsecured)	0.4	0.2	0.6	3.04%	Instant Access
The UK Government	3.0	5.0	8.0	5.20%	20 days
Local authorities & other Government entities	19.0	(9.0)	10.0	5.25%	56 days
Money Market Funds (MMF)	21.5	(9.0)	12.5	5.11%	Instant Access
Total Investments	**43.9**	**(12.8)**	**31.1**		

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 table above illustrates the progressive application of the North Weald Airfield capital receipt towards the Capital Programme (including Qualis Loans). Interest rates on Investments have been very stable in Quarter 1.

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 June 2024, 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 June 2024 was £68.986 million and is summarised in Table 5 below.

Table 5: Service Investments

Description	31/03/24 Balance Owing* £000's	Movement (Q1 24/25) £000's	30/06/24 Balance Owing* £000's	Total Approved Limit £000's
Subsidiaries (Qualis):				
Working Capital Loan	5,145	0	5,145	6,000
Asset Purchase Loan	16,002	(143)	15,860	16,782
Development Loans	43,162	4,500	47,662	68,218
Regeneration Loans	0	0	0	35,000
Home Assistance Loans (General Fund)	344	(24)	320	150*
Leaseholder Loans (HRA)	0	0	0	250**
Total Value	**64,653**	**4,333**	**68,986**	**126,400**

** 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 £4.5 million in Developments Loans have been granted to Qualis in the first three months of the financial year, which is enabling the continued development of a range of sites including Conder, St. John's, Cottis Lane and Cartersfield Road. 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 1 is summarised in Table 6 below.

Table 6: Commercial Property Investments

Category	31/03/24 Balance Sheet Value £Ms	Net Income 2024/25 (3 months April-June 2024) £Ms	Net Income 2023/24 (3 months April-June 2023) £Ms
Shops*	96.06	1.669	1.491
Industrial Units	43.83	0.413	0.331
Other**	16.334	0.224	0.283
Total Value/Net Income	**156.224**	**2.306**	**2.105**

** Includes Public Houses and a Petrol Station **Includes North Weald Airfield (excluding electricity recharges) and Sports Facilities*

The Council received total net income of £2.306 million from Commercial Property Investments in the first three months of 2024/25 (compared to £2.105 million for the corresponding period in 2023/24).

Both Shops and Industrial Units have had rent reviews early in 2024/25 resulting in increased income forecasts for the remainder of the year. Other Property income is marginally down following an unexpected Business Rates charge at a former site used by HMRC.

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 June 2024 and is presented in Table 7 below.

Table 7: Commercial Loans

Description	Balance Owing 31/03/24 £000's	Movement £000's	Balance Owing 30/06/24 £000's	Approved Limit £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 all areas.

Table 8: Investment Limits

Sector	Time limit	Counterparty limit	Sector limit	30/06/24	Complied? (Yes/No)
The UK Government	50 years	Unlimited	N/A	£8.0 million	Yes
Local authorities & other Government entities	25 years	£10 million	Unlimited	£10.0 million	Yes
Banks (unsecured)*	13 months	£3.0 million	£20.0 million	£0.6 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)	£12.5 million (3 MMFs)	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	Q1 2024/25 Maximum £000's	30/06/24 Actual £000's	Operational Boundary 2024/25 £000's	Authorised Limit 2024/25 £000's	Complied? (Yes/No) £000's
Borrowing	253,052	252,369	415,621	425,621	Yes
PFI & Finance Leases	0	0	0	0	Yes
Total Debt	**253,052**	**252,369**	**415,621**	**425,621**	**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.

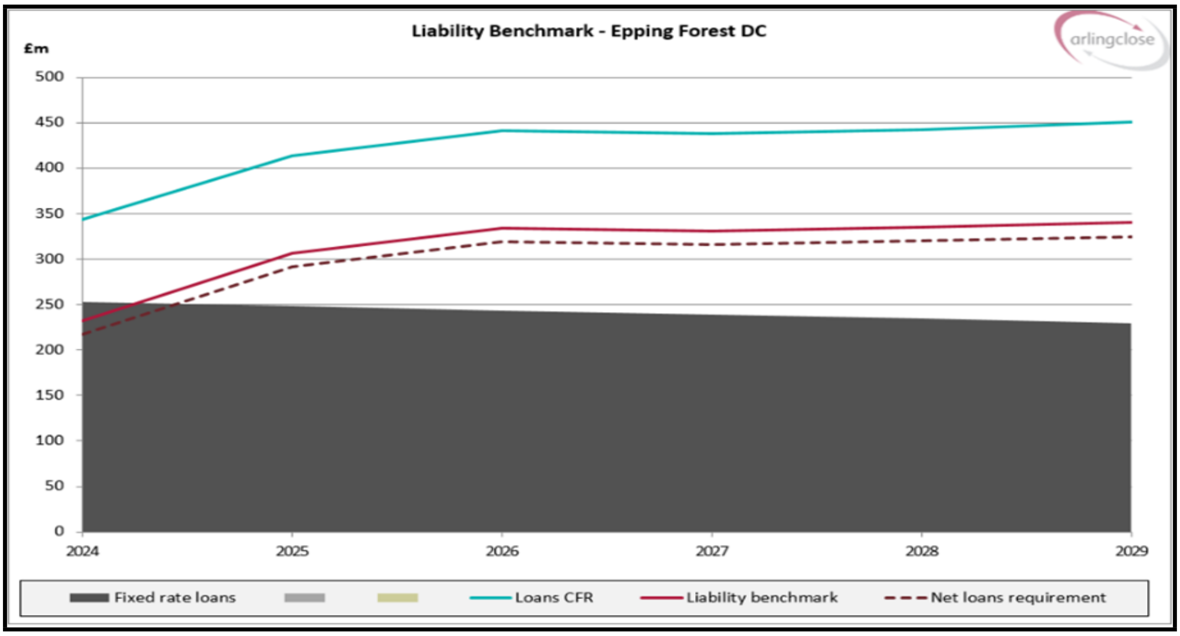
Liability Benchmark

This 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	31/03/24 Actual £M's	31/03/25 Forecast £M's	31/03/26 Forecast £M's	31/03/27 Forecast £M's
Loans CFR	343.5	413.8	441.0	438.4
Less: Balance Sheet resources	(126.4)	(122.3)	(122.3)	(122.3)
Net loans requirement	**217.1**	**291.5**	**318.7**	**316.1**
Plus: Liquidity Allowance	15.0	15.0	15.0	15.0
Liability Benchmark	**232.1**	**306.5**	**333.7**	**331.1**
Existing Borrowing	**253.1**	**248.4**	**243.8**	**239.1**

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	31/03/24 Actual	Complied?
Under 12 months	50%	0%	2%	Yes
12 months and within 24 months	50%	0%	2%	Yes
24 months and within 5 years	50%	0%	5%	Yes
5 years and within 10 years	50%	0%	20%	Yes
10 years and within 15 years	50%	0%	28%	Yes
15 years and within 20 years	50%	0%	39%	Yes
20 years and within 25 years	50%	0%	2%	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:

	2024/25 (April – June)
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.

	30/06/24 Actual	2024/25 Target	Complied?
Portfolio average credit rating	A+	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.

	30/06/24 Actual	2024/25 Target	Complied?
Total cash available within 3 months	£31.1 million	£15.0 million	Yes

Available cash initially increased sharply as a consequence of the North Weald Airfield capital receipt which was received by the Council in December 2023 and has since progressively declined as the Council has continued to fund the Capital Programme without recourse to additional external borrowing. The operational cash flow needs of the Council have continued to be met without recourse to the use of an overdraft facility throughout the period April to June 2024.

Interest Rate Exposure
The Treasury Management Strategy for 2024/25, 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.

	30/06/24 Actual	2024/25 Limit	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	(217,867)	(500,000)	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	217,867	500,000	Yes