Portsmouth
CITY COUNCIL

Title of meeting:	Governance and Audit and Standards Committee Cabinet City Council
Date of meeting:	08 March 2023 (Governance and Audit and Standards Committee) 07 March 2023 (Cabinet) 14 March 2023 (City Council)
Subject:	Treasury Management Policy 2023/24
Report by:	Chris Ward, Director of Finance and Resources (Section 151 Officer)
Wards affected:	All
Key decision:	Yes
Full Council decision:	Yes

---

1. Executive Summary of the Treasury Management Policy Statement

1.1. Treasury Management Policy

The attached Treasury Management Policy sets out the Council's policies on borrowing and investing temporarily unallocated cash resources flows for 2023/24.

In addition, the Prudential Code produced by the Chartered Institute of Public Finance and Accountancy (CIPFA) requires the City Council to also approve a Capital Strategy (reported elsewhere on the Cabinet Agenda for 07 March 2023) providing an overview of the Council's plans for capital expenditure, its borrowing, and its investments.

The Treasury Management Policy (attached) also sets several treasury management indicators that will establish the boundaries within which treasury management activities will be undertaken.

1.2. Annual Investment Strategy

The Treasury Management Policy includes the strategy for the investment of temporarily unallocated cash resources, known as the Annual Investment Strategy, which establishes the types of investment, investment counter parties and investment durations that the Council will operate within.

2. Purpose of report

1.1. The purpose of this report is to obtain the Council's approval of the updated Treasury Management Policy Statement (attached) which includes the Annual Investment Strategy.

3. Recommendations

1.1. That the upper limit for principal sums invested for longer than 365 days contained in paragraph 4.6 of the attached Treasury Management Policy Statement be approved;

1.2. That the upper and lower limits on the maturity structure of borrowing contained in appendix 5.1 of the attached Treasury Management Policy Statement be approved;

1.3. That the attached Treasury Management Policy Statement including the Treasury Management Strategy and Annual Investment Strategy for 2023/24 be approved;

1.4. That the following changes compared to the previous Treasury Management Policy be noted:

(i) the inclusion of a new treasury management indicator for 2023/24 known as the liability benchmark. This graphically compares the Council's net loans requirement against its existing loan debt, showing the amount of borrowing required in future years.

(ii) medium and longer dated borrowing rates are high, but are expected to fall from their current levels once prevailing inflation concerns are addressed by tighter near-term monetary policy. With this in mind, the Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement) has not been fully drawn with loan debt as cash from the Authority's reserves, balances and cash flows has been used as a temporary measure. This is a change of emphasis from the 2022/23 Treasury Management Strategy which was approved at a time of low interest rates which were expected to increase. The 2022/23 Treasury Management Strategy placed more emphasis on having a predictable revenue cost of borrowing in the long-term. Against this background and the risks within the economic forecast, caution will be adopted with the 2023/24 treasury operations. The Director of Finance and Resources (Section 151 Officer) will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances, always seeking to balance risk, certainty and cost.

(iii) where state institutions own 50% or more of an entity and can exert significant influence over the counterparty through their shareholdings, the Council will in future avoid investments in such institutions where the state institution has a poor human rights record.

1.5. As set out in paragraph 1.5 of the Treasury Management Policy Statement, the Director of Finance and Resources (Section 151 Officer) and officers nominated by him have delegated authority to:

(i) invest surplus funds in accordance with the approved Annual Investment Strategy;

(ii) borrow to finance short term cash deficits and capital payments from any reputable source within the authorised limit for external debt of £1,100m approved by the City Council on 28 February 2023;

(iii) reschedule debt to even the maturity profile or to achieve revenue savings;

(iv) to buy and sell foreign currency, and to purchase hedging instruments including forward purchases, forward options, and foreign exchange rate swaps to mitigate the foreign exchange risks associated with some contracts that are either priced in foreign currencies or where the price is indexed against foreign currency exchange rates

1.6. That the Director of Finance and Resources (Section 151 Officer) has the power to delegate treasury management operations to relevant staff;

1.7. That the Chief Executive, the Leader of the City Council and the Chair of the Governance and Audit and Standards Committee be informed of any variances from the Treasury Management Policy when they become apparent, and that the Leader of the City Council be consulted on remedial action (paragraph 1.2 of the Treasury Management Policy Statement).

2. Background

1.1. The Council's treasury management operations cover the following:

- Cash flow forecasting (both daily balances and longer-term forecasting)
- Investing temporary surplus cash flows in approved investments
- Borrowing to finance short term cash deficits and capital payments
- Management of debt (including rescheduling and ensuring an even maturity profile)
- Interest rate exposure management
- Hedging foreign exchange rate risks

1.2. The key risks associated with the Council's treasury management operations are:

- Credit risk - i.e. that the Council is not repaid, with due interest in full, on the day repayment is due;
- Liquidity risk - i.e. that cash will not be available when it is needed, or that the ineffective management of liquidity creates additional, unbudgeted costs;
- Interest rate risk - that the Council fails to get good value for its cash dealings (both when borrowing and investing) and the risk that interest costs incurred are more than those for which the Council has budgeted;

- Exchange rate risk - the risk that fluctuations in foreign exchange rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately;

- Inflation risk, i.e. the chance that cash flows from an investment will not be worth as much in future because of changes in purchasing power due to inflation;

- Maturity (or refinancing risk) - this relates to the Council's borrowing or capital financing activities, and is the risk that the Council is unable to repay or replace its maturing funding arrangements on appropriate terms;

- Procedures (or systems) risk - i.e. that a treasury process, human or otherwise, will fail and planned actions are not carried out through fraud, error, or corruption.

1.3. The total borrowings of the Council on 01 April 2023 are estimated to be £748m. The Council's investments on 01 April 2023 are estimated to be £325m. The cost of the Council's borrowings and the income derived from the Council's short-term treasury investments (i.e. excluding commercial property investments) are included within the Council's treasury management budget of £26m per annum. The Council's treasury management activities account for a sizeable proportion of the Council's overall budget. Therefore the Council's Treasury Management Policy aims to manage risk while optimising costs and returns. The Council will monitor and measure its treasury management position against the indicators contained in the Treasury Management Policy.

1.4. The City Council has adopted CIPFA's Treasury Management in the Public Services Code of Practice. The Code of Practice requires the City Council to approve a Treasury Management Strategy before the start of the financial year.

1.5. In addition the Government has issued statutory guidance that requires the Council to approve an Annual Investment Strategy before the start of the financial year.

1.6. The Treasury Management Strategy, and the Annual Investment Strategy are all contained within the attached Treasury Management Policy Statement.

5. Reasons for recommendations

1.7. The recommendations provide assurance that the Council's attached Treasury Management Policy Statement reflects CIPFA's Treasury Management Code of Practice and have regard to statutory guidance issued by the Government. These are designed to:

- Enable the Council to borrow funds as part of managing its cash flow or to fund capital expenditure in a way that minimises risk and costs;

- Provide for the repayment of borrowing;

- Ensure that the Council's investments are secure;

- Ensure that the Council maintains sufficient liquidity;

- Maximise the yield on investments in a way that is commensurate with maintaining the security and liquidity of the investment portfolio;

5.2 The inclusion of a new treasury management indicator for 2023/24 known as the liability benchmark is a requirement of CIPFA's Treasury Management in the Public Services Code of Practice. The liability benchmark graphically compares the Council's net loans requirement against its current borrowings. When the Council's existing loans exceed its net loans requirement, surplus funds must be invested, carrying credit risk if an investment counterparty defaults, and the risk that the temporary surplus cash cannot be invested at a return exceeding the cost of the borrowing, known as the cost of carry. When the Council's net loans requirement exceeds its current borrowings, the Council is exposed to the risk that interest rates could increase before actual external borrowing is undertaken.

5.3 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need, (the Capital Financing Requirement), has not been fully drawn with loan debt as cash from the Authority's reserves, balances and cash flows has been used as a temporary measure. This is a change of emphasis from the 2022/23 Treasury Management Strategy which placed more emphasis on having a predictable revenue cost of borrowing in the long-term, always seeking to balance risk, certainty and cost. Undertaking borrowing from external sources when required allows the Council to lock into an interest rate on its borrowings and have a predictable cost of borrowing in the long term. When interest rates are low but expected to increase, as was the case when the 2022/23 Treasury Management Strategy was approved, it can be beneficial in the long term to borrow externally. However, the Council does not have to borrow externally as soon as capital expenditure is financed from borrowing as it is currently holding cash from its general balances and earmarked reserves. This gives the Council the ability to fund capital expenditure from its cash balances in the short term. This is known as internal borrowing. With interest rates currently being high but expected to fall from their current levels once prevailing inflation concerns are addressed by tighter near-term monetary policy, it is likely to be beneficial to delay undertaking external borrowing. Delaying external borrowing until the Council needs the cash also eliminates the risk of a cost of carry in the short term. This is where the returns on the Council's investments are less than the cost of borrowing. However, delaying borrowing externally does carry the risk that interest rates may increase resulting in a higher long-term cost of borrowing. The Director of Finance and Resources will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

5.4 It is recommended that where state institutions own 50% or more of an entity and can exert significant influence over the counterparty through their shareholdings, the Council will in future avoid investments in such institutions where the state institution has a poor human rights record. This will ensure that the Council is acting in an ethical manner and protect the Council from reputational risks.

6. Integrated impact assessment

1.8. The contents of this report do not significantly impact Portsmouth's communities (other than through the finances of the City Council), or equality and diversity.

7. Legal implications

1.9. The Section 151 Officer is required by the Local Government Act 1972 and by the Accounts and Audit Regulations 2011 to ensure that the Council's budgeting, financial management, and accounting practices meet the relevant statutory and professional requirements. Members must have regard to and be aware of the wider duties placed on the Council by various statutes governing the conduct of its financial affairs.

8. Director of Finance's comments

1.10. All financial considerations are contained within the body of the report and the attached appendices.

……………………………………………

Signed by: Director of Finance and Resources

Appendices: Treasury Management Policy Statement 2023/24

Background list of documents: Section 100D of the Local Government Act 1972

The following documents disclose facts or matters, which have been relied upon to a material extent by the author in preparing this report:

Location:	**Location**
Information pertaining to the Treasury Management Strategy	Financial Services