Appendix 1 - Treasury Management Update Report – Q2 2024/25

1. Introduction

1.1. 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 approve, as a minimum, treasury management semi-annual and annual reports.

1.2. This report includes the requirement in the 2021 Code of quarterly reporting of the treasury management prudential indicators.

1.3. The Council's treasury management strategy for 2024/25 was approved at a full Council meeting on 4 March 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.

2. External Context (provided by the Council's treasury management advisor, Arlingclose)

Economic background

2.1. UK inflation rates remained around the Bank of England's (BoE) target in recent months. The UK Consumer Price Index (CPI) inflation fell from 3.2% in March 2024 to 2.0% in May 2024. It then rose slightly to 2.2% in August 2024 – an expected increase due to energy price base effects.

2.2. With headline inflation lower, the BoE's Monetary Policy Committee (MPC) cut the Bank Rate from 5.25% to 5.00% in August 2024. The decision was finely balanced, voted by a 5–4 majority, with four members preferring to hold the rate at 5.25%.

2.3. At the September MPC meeting, committee members voted 8–1 to maintain rates at 5.00%. The minutes and voting pattern revealed a notably hawkish stance on rates, as policymakers remained concerned about persistent inflation. The table below provides an extract of the Bank Rate over the past four quarters, along with the current rate.

	Dec-23	Mar-24	Jun-24	Sep-24	Current Rate
BoE Bank Rate	5.25%	5.25%	5.25%	5.00%	4.75%

2.4. Data released during the period showed that the UK economy had emerged from the technical recession at the end of 2023, expanding by 0.7% in the first quarter of the calendar year. Growth continued in the second quarter, though at a slower pace of 0.6%.

2.5. Labour market data showed improvement from a policymaker's perspective, with an easing in job market tightness as both inactivity rates and vacancies declined. The unemployment rate was report at 4.1% during the period. The table below shows an extract of the annual unemployment rate reported over the past four quarters.

	Dec-23	Mar-24	Jun-24	Sep-24
Unemployment rate	3.8%	4.4%	4.4%	4.1%

2.6. According to the Bank of England's November Monetary Policy Report, while UK Gross Domestic Product (GDP) has risen sharply in 2024, policymakers expect it to moderate in 2025. A graduate recovery is expected to follow as both the lagged effects of previous Bank Rate increases fade and restrictive measures ease.

2.7. Arlingclose, the Council's treasury adviser, maintains its central view that 5.25% is the peak Bank Rate. However, following the November MPC meeting, the adviser has revised their forecasts, now predicting a slower and more modest reduction in the Bank Rate, with a projected low of 3.75% instead of the previously forecast 3.00%.

2.8. The US Federal Reserve also cut rates over the period, reducing the Fed Funds Rate to a target range of 4.50–4.75% by November 2024. Recent forecast released by the central bank suggest further easing is expected in 2025; however, the pace and timing remains uncertain.

2.9. Over in Europe, the European Central Bank (ECB) cut rates in September, reducing its main refinancing rate to 3.65% and its deposit rate to 3.50%. While the ECB has not specified its future rate path, inflation projections align with previous forecasts—remaining above the 2% target through 2026 on an annual basis.

Financial markets

2.10. Financial market sentiment showed signs of improvement over the period, though bond yields remained volatile. Yields climbed steadily early in the period, but mixed economic data and investors' ongoing reassessment of potential rate cuts caused a few pronounced, albeit short-lived, dips. The volatility in response to economic, financial and geopolitical issues meant it was a turbulent period for bond investors.

2.11. The table below shows the movement of the major benchmark gilt yields throughout the period.

Benchmark Gilt Yield	Dec-23	Mar-24	Jun-24	Sept-24
5 year	3.48%	3.83%	3.94%	3.76%
10 year	3.54%	3.92%	4.18%	4.00%
20 year	4.13%	4.40%	4.41%	4.51%

2.12. The Sterling Overnight Rate (SONIA) averaged 5.12% over the period to 30 September 2024.

Credit review

2.13. Arlingclose maintained its advised recommended maximum unsecured duration limit on all banks on its counterparty list at 100 days.

2.14. Credit default swap prices were generally lower at the end of the period compared to the beginning for the vast majority of the names on UK and non-UK lists. Price volatility over the period was also generally more muted compared to previous periods.

2.15. Financial market volatility is expected to remain a feature, at least in the near term and credit default swap levels will be monitored for signs of ongoing credit stress. As always, the institutions and durations on the Council’s counterparty list recommended by Arlingclose remain under constant review.

3. Local Context

3.1. On 31 March 2024, the Council had net borrowing of £819.4m arising from its revenue and capital income and expenditure. The Capital Financing Requirement (CFR) measures the underlying need to borrow for capital purposes. A breakdown of the CFR is summarised in Table 1.

Table 1: Balance Sheet Summary

	31.03.24 Actual £m
General Fund CFR	677.1
HRA CFR	542.9
Total CFR[1]	**1,220.0**
Less: Other debt liabilities[2]	(31.0)
Borrowing CFR - comprised of:	**1,189.0**
External borrowing	819.4
Internal borrowing	369.6

[1]subject to audit
[2]finance leases, PFI liabilities and transferred debt that form part of the Council's total debt

3.2. The Council continued to pursue its long-standing strategy of keeping borrowing and investments below their underlying levels, also known as internal borrowing, in order to reduce risk and keep interest costs low.

3.3. The treasury management position on 30 September 2024 and the change over the year is shown in Table 2.

Table 2: Treasury Management Summary

Type of Borrowing/Investment	31.03.24 Balance £m	Movement £m	30.09.24 Balance £m	30.09.24 Weighted Av. Rate %
Long-term borrowing	779.4	(0.5)	778.9	3.24%
Short-term borrowing	40.0	73.0	113.0	5.11%
Total borrowing	**819.4**	**72.5**	**891.9**	**3.47%**
Short-term investment	0.0	0.0	0.0	0.00%
Cash and cash equivalents	33.9	6.1	40.0	4.95%
Total investments	**33.9**	**6.1**	**40.0**	**4.95%**
Net borrowing	**785.5**	**66.4**	**851.9**	

4. Borrowing Strategy and Activity

4.1. As outlined in the treasury strategy, the Council's primary objective when borrowing has been to strike an appropriate risk balance between securing lower 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. At present, short-term interest rates are higher than long-term interest rates.

4.2. Policy interest rates have risen substantially since 2021 although they have remained mostly steady in the last year. UK Gilt yields were volatile over the six-month period, with a slight reduction between April and September 2024. Much of the downward pressure from lower inflation figures was offset by positive economic data. US data continues to influence global bond markets, including UK gilt yields.

4.3. Over the period, the PWLB certainty rate for 10-year maturity loans fluctuated between 4.52% and 5.18%. During the same time period, 20-year maturity loans ranged from 5.01% to 5.57%, and 50-year maturity loans varied between 4.88% and 5.40%.

4.4. Table 3 shows the movement in rates offered across the various Public Works Loan Board (PWLB) maturities on 30 September 2024. The rates shown include the 0.20% certainty discount rate offered by the PWLB to qualifying authorities.

Table 3: PWLB Rates

PWLB Maturity	Dec-23	Mar-24	Jun-24	Sept-24
10-year	4.19%	4.74%	4.96%	4.79%
20-year	4.90%	5.18%	5.37%	5.27%
50-year	4.67%	5.01%	5.15%	5.13%

4.5. Whilst the cost of short-term borrowing from other local authorities peaked at around 7% in late March 2024, primarily due to a lack of liquidity during the month, as expected shorter-term rates reverted to a more normal range and were generally around 5.00% to 5.25% over the period.

4.6. CIPFA's 2021 Prudential Code emphasises that local authorities should not borrow to invest primarily for financial returns. Local authorities should not make investment or spending decisions that increase the capital financing requirement, resulting in new borrowing, unless such decisions are directly and primarily related to the functions of the local authority. Local authorities are no longer permitted to secure PWLB loans for purchasing investment assets primarily for yield unless the loans are for refinancing purposes.

4.7. The Council has not invested in assets primarily for financial return or that are not primarily related to the functions of the Council. It has no plans to do so in the future.

4.8. Following the Chancellor's Autumn Statement, the PWLB HRA rate, which is 0.4% below the certainty rate, has been extended until June 2026. This discounted rate is to support local authorities borrowing for the Housing Revenue Account and for refinancing existing HRA loans, providing a window of opportunity for HRA-related borrowing and to replace some of the Council's loans relating to the HRA maturing during this time frame.

4.9. As part of its strategy for funding previous and current years' capital programmes, the Council held £891.9 million in loans on 30 September 2024, an increase of £72.5 million compared to 31 March 2024. The outstanding loans on 30 September are summarised in Table 4.

Table 4: Borrowing Position

Type of Borrowing	31.03.24 Balance £m	Net Movement £m	30.09.24 Balance £m	30.09.24 Weighted Ave. Rate %	30.09.24 Weighted Ave. Maturity years
Public Works Loan Board	679.4	(0.5)	678.9	3.02%	23.4
Banks (LOBO)	100.0	0.0	100.0	4.73%	34.1
Local authorities	40.0	73.0	113.0	5.11%	0.4
Total borrowing	**819.4**	**72.5**	**891.9**	**3.47%**	**21.7**

4.10. £30m of new long-term borrowing was undertaken during the period. However, £0.5m of PWLB loans were allowed to mature without immediate replacement. The Council's borrowing decisions are not based on any single outcome for interest rates, and it maintains a balanced portfolio of short and long-term borrowing.

4.11. The Council has a significant capital program that extends into the foreseeable future. A large proportion of this program will be financed by borrowing, which the Council will need to undertake during the current and upcoming years.

LOBO Loans

4.12. The Council holds £100m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost.

4.13. With market interest rates having risen, the probability of LOBOs being called has been higher than in the recent past. £50m of LOBO loans had call option dates during the period to 30 September 2024, however no lender exercised their option.

4.14. The Council currently holds £50m in LOBO loans, with call dates within the next 12 months. The Council has been working with treasury management advisors Arlingclose to assess the likelihood of the loan options being exercised. If the option is exercised, the Council plans to repay the loan at no additional cost. If required, the Council will use available cash or borrow from other local authorities or the PWLB to repay the LOBO loans.

5. Treasury Investment Activity

5.1. The CIPFA Treasury Management Code defines treasury management investments as those arising from an organisation's cash flows or treasury risk management activities. These investments represent balances that need to be invested until the cash is required for business operations.

5.2. The Council holds invested funds, which represent income received in advance of expenditure, as well as balances and reserves. Throughout the period, the Council's investment balances ranged between £33.9 million and £83.0 million due to timing differences between income and expenditure. The investment position on 30 September 2024 is shown in Table 5.

Table 5: Treasury Investment Position

Type of Investment	31.03.24 Balance £m	Net Movement £m	30.09.24 Balance £m	30.09.24 Weighted Ave. Rate %	30.09.24 Weighted Ave. Maturity
Debt Management Office	33.9	(3.9)	30.0	4.94%	1
Money market funds	-	10.0	10.0	2.50%	0
Total investments	**33.9**	**6.1**	**40.0**	**4.95%**	**1 days**

5.3. Both the CIPFA Code and government guidance require the Council to invest its funds prudently, taking into account the security and liquidity of its treasury investments before seeking the optimum rate of return or yield. The Council aims to strike an appropriate balance between risk and return when making treasury investments, while minimising the risk of incurring losses from defaults and receiving unsuitably low investment income.

5.4. The Bank of England's Bank Rate reduced from 5.25% to 5.00% in August 2024, with short-term rates hovering around this level. In November 2024, the MPC cut rates by a further 0.25% to 4.75%. During the period, the overnight deposit rates from both the Debt Management Account Deposit Facility DMADF) and Money Market Funds (MMFs) averaged around 5.00%.

5.5. The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 6.

Table 6: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Ave. Maturity (Days)	Rate of Return
31.03.2024	3.67	AA-	0%	1	5.19%
30.09.2024	3.90	AA-	25%	1	4.95%
Similar Local Authorities	4.70	A+	75%	11	4.97%
All Local Authorities	4.39	AA-	61%	12	4.90%

Scoring:
AAA = highest credit quality = 1; D = lowest credit quality = 26
Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

6. Treasury Performance

6.1. The budget for treasury investment income for 2024/25 was set at £2.4m. This was based on a treasury investment portfolio of £50m with an average rate of return of 4.75%. The most recent forecast for the year shows an average rate of return of 5.09%. Therefore, the Council's expected treasury investment income remains in line with the budget.

6.2. The borrowing costs for 2024/25 are also forecast to be in line with the budget at Q2 at £40.7m (£25.9m HRA, £14.8m General Fund).

7. Compliance

7.1. The Director of Finance reports that all treasury management activities carried out during the quarter complied fully with the principles in the Treasury Management Code and the Council's approved Treasury Management Strategy.

7.2. Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 7 below.

Table 7: Debt Limits

	30.09.24 Actual £m	2024/25 Operational Boundary £m	2024/25 Authorised Limit £m	Complied?
Borrowing	891.9	1,276.7	1,326.7	Yes
PFI and Finance Leases	15.8	15.8	17.4	Yes
Total debt	**907.7**	**1,292.5**	**1,344.1**	**Yes**

7.3. The operational boundary is a management tool for in-year monitoring. Therefore, it is not significant if the operational boundary is breached on occasion due to variations in cash flow, and this is not considered a compliance failure. However, the council's debt remained well below this limit throughout the period.

8. Treasury Management Indicators

8.1. The Council measures and manages its exposures to treasury management risks using the following prudential indicators.

Security

8.2. The Council has adopted a voluntary measure to assess its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. To calculate this score, a value is assigned to each investment based on its credit rating (AAA=1, AA+=2, etc.), and the arithmetic average is taken, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	30.09.24	2024/25	Complied?

	Actual	Target	
Portfolio average credit score	3.90 (AA-)	7.0 (A-)	Yes

Liquidity

8.3. The Council has adopted a voluntary measure to monitor its exposure to liquidity risk. This is done by tracking the amount of cash available to meet unexpected payments over a rolling three-month period, without borrowing additional funds.

	30.09.24 Actual	2024/25 Target	Complied?
Total cash available within 3 months	£40.0m	£30.0m	Yes

Interest Rate Exposures

8.4. This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

	30.09.24 Actual	2024/25 Target	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	£1.1m	£2m	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	£0.4m	£2m	Yes

8.5. The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at new market rates.

8.6. For context, the changes in PWLB interest rates during the period were:

	31.03.24	30.09.24
Bank Rate	5.25%	5.00%
1-year PWLB certainty rate, maturity loans	5.36%	4.95%
5-year PWLB certainty rate, maturity loans	4.68%	4.55%
10-year PWLB certainty rate, maturity loans	4.74%	4.79%
20-year PWLB certainty rate, maturity loans	5.18%	5.27%
50-year PWLB certainty rate, maturity loans	5.01%	5.13%

Maturity Structure of Borrowing

8.7. This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	30.09.24 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	17.2%	50%	0%	Yes
12 months and within 24 months	2.4%	40%	0%	Yes
24 months and within 5 years	8.0%	40%	0%	Yes
5 years and within 10 years	14.7%	40%	0%	Yes
10 years and within 20 years	11.9%	40%	0%	Yes
20 years and within 30 years	9.1%	40%	0%	Yes
30 years and within 40 years	11.6%	50%	0%	Yes
40 years and within 50 years	25.1%	50%	0%	Yes
50 years and above	0.0%	40%	0%	Yes

8.8. 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.

8.9. In the past, the Council has extensively used short-term borrowing (less than 1 year in duration) from other local authorities as an alternative to longer-term borrowing from the PWLB. This was due to lower interest rates at the time, resulting in revenue savings.

8.10. However, short-term borrowing exposes the Council to refinancing risk. This is the risk that rates will rise quickly over a short period of time and will be at significantly higher rates when loans mature and new borrowing is required. With this in mind, the Council has set a limit on the total amount of short-term local authority borrowing as a proportion of all borrowing.

	30.06.24 Actual	**2024/25 Target**	**Complied?**
Upper limit on short-term borrowing from other local authorities as a percentage of total borrowing	12.7%	30%	Yes