Appendix 1 - Treasury Management Update Report – Q3 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. The impact on the UK from the government's Autumn Budget, slower expected interest rate cuts, a short-term boost to but modestly weaker economic growth over the medium term, together with the impact from President-elect Trump's second term in office and uncertainties around US domestic and foreign policy, will be major influences on the Authority's treasury management strategy for 2025/26.

2.2. The Bank of England's (BoE) Monetary Policy Committee (MPC) reduced rates at the February 2025 meeting, seven Committee members voted to reduce Bank Rate to 4.5% while two members preferred to reduce it to 4.25%.

	Mar-24	Jun-24	Sep-24	Dec-24	Current Rate (Feb 25)
BoE Bank Rate	5.25%	5.25%	5.00%	4.75%	4.50%

2.3. The November quarterly Monetary Policy Report (MPR) expected Gross Domestic Product (GDP) growth to pick up to around 1.75% (four-quarter GDP) in the early period of the BoE's forecast horizon before falling back. The impact from the Budget pushes GDP higher in 2025 than was expected in the previous MPR, before becoming weaker. Current GDP growth was shown to be zero (0.0%) between July and September 2024 and 0.4% between April and June 2024, a further downward revision from the 0.5% rate previously reported by the Office for National Statistics (ONS).

2.4. ONS figures reported the annual Consumer Price Index (CPI) inflation rate at 2.6% in November 2024, up from 2.3% in the previous month and in line with expectations. Core CPI also rose, but by more than expected, to 3.6% against a forecast of 3.5% and 3.3% in the previous month. The outlook for CPI inflation in the November MPR showed it rising above the MPC's 2% target from 2024 into 2025 and reaching around 2.75% by the middle of calendar 2025. This represents a modest near-term increase due to the ongoing impacts from higher interest rates, the Autumn Budget, and a projected margin of economic slack. Over the medium-term, once these pressures ease, inflation is expected to stabilise around the 2% target.

2.5. The labour market appears to be easing slowly, but the data still require treating with some caution. The latest figures reported the unemployment rate rose to 4.3% in the three months to October 2024 and economic inactivity fell to 21.7%. Pay growth for the same period was reported at 5.2% for both regular earnings (excluding bonuses) and for total earnings. Looking ahead, the BoE MPR showed the unemployment rate is expected to increase modestly, rising to around 4.5%, the assumed medium-term equilibrium unemployment rate, by the end of the forecast horizon.

	Mar24	Jun-24	Sep-24	Dec-24
Unemployment rate	4.4%	4.4%	4.1%	4.4%

2.6. The US Federal Reserve has continued cutting interest rates, bringing down the Fed Funds Rate by 0.25% at its December 2024 monetary policy meeting to a range of 4.25%-4.50%, marking the third consecutive reduction. Further interest rate cuts are expected, but uncertainties around the potential inflationary impact of incoming President Trump's policies may muddy the waters in terms of the pace and magnitude of further rate reductions. Moreover, the US economy continues to expand at a decent pace, rising at an (upwardly revised) annual rate of 3.1% in the third quarter of 2024, and inflation remains elevated suggesting that monetary policy may need to remain more restrictive in the coming months than had previously been anticipated.

2.7. Interest rate forecast (December 2024): The Authority's treasury management adviser Arlingclose expects the Bank of England's MPC will continue reducing Bank Rate through 2025, taking it to around 3.75% by the end of the 2025/26 financial year. The effect from the Autumn Budget on economic growth and inflation has reduced previous expectations in terms of the pace of rate cuts as well as pushing up the rate at the end of the loosening cycle.

2.8. Euro zone inflation rose above the European Central Bank (ECB) 2% target in November 2024, hitting 2.2% as was widely expected and a further increase from 2% in the previous month. Despite the rise, the ECB continued its rate cutting cycle and reduced its three key policy rates by 0.25% in December. Inflation is expected to rise further in the short term, but then fall back towards the 2% target during 2025, with the ECB remaining committed to maintaining rates at levels consistent with bringing inflation to target, but without suggesting a specific path.

Financial markets

2.9. During Q4 2024 up to 31 December, financial market sentiment exhibited elevated uncertainty, contributing to bond yields remaining volatile. Yields experienced a steady increase through the quarter; however, mixed economic data and investors' ongoing reassessment of potential rate cuts led to several pronounced, albeit short-lived, dips. The volatility in response to economic, financial, and geopolitical developments rendered the period turbulent for bond investors.

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

Benchmark Gilt Yield	Mar-24	Jun-24	Sept-24	Dec-24
5 year	3.83%	3.94%	3.76%	4.35%
10 year	3.92%	4.18%	4.00%	4.57%
20 year	4.40%	4.41%	4.51%	5.08%

2.11. The Sterling Overnight Rate (SONIA) averaged 4.80% over the period to 31st December 2024.

Credit review

2.12. Arlingclose recommends either a 6 month or 100 day maximum unsecured duration limit for its list of counterparty banks, depending on institution.

2.13. Credit Default Swap (CDS) prices have typically followed a general trend downwards during 2024, reflecting a relatively more stable financial period compared to the previous year. Improved credit conditions in 2024 have also led to greater convergence in CDS prices between ringfenced (retail) and non-ringfenced (investment) banking entities again.

2.14. Higher interest rates can lead to a deterioration in banks' asset quality through increased loan defaults and volatility in the value of capital investments. Fortunately, the rapid interest rate hikes during this monetary tightening cycle, while putting some strain on households and corporate borrowers, has not caused a rise in defaults, and banks have fared better than expected to date, buoyed by strong capital positions. Low unemployment and robust wage growth have also limited the number of problem loans, all of which are positive in terms of creditworthiness.

2.15. Moreover, while a potential easing of US financial regulations under a Donald Trump Presidency may aid their banks' competitiveness compared to institutions in the UK and other regions, it is unlikely there will be any material impact on the underlying creditworthiness of the institutions on the counterparty list maintained by Arlingclose, the authority's treasury adviser.

2.16. Overall, the institutions on our adviser Arlingclose's counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

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	956.9
Internal borrowing	232.1

[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 31st December 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	31.12.24 Balance £m	31.12.24 Weighted Av. Rate %
Long-term borrowing	779.4	102.5	881.9	3.44%
Short-term borrowing	40.0	35.0	75.0	4.99%
Total borrowing	**819.4**	**137.5**	**956.9**	**3.56%**
Short-term investment	0.0	0.0	0.0	0.00%
Cash and cash equivalents	33.9	30.76	64.5	4.72%
Total investments	**33.9**	**30.76**	**64.5**	**4.72%**
Net borrowing	**785.5**	**106.9**	**892.4**	

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. Over the 9-month period to December 24, the PWLB certainty rate for 10-year maturity loans fluctuated between 4.52% and 5.44%. During the same time period, 20-year maturity loans ranged from 5.01% to 5.87%, and 50-year maturity loans varied between 4.88% and 5.69%.

4.3. Table 3 shows the movement in rates offered across the various Public Works Loan Board (PWLB) maturities at the end of each quarter for the 12 months to 31st December 24. The rates shown include the 0.20% certainty discount rate offered by the PWLB to qualifying authorities.

Table 3: PWLB Rates

PWLB Maturity	Mar-24 %	Jun-24 %	Sept-24 %	Dec-24 %
10-year	4.74	4.96	4.79	5.43
20-year	5.18	5.37	5.27	5.86
50-year	5.01	5.15	5.13	5.68

4.4. 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 5.50% over the period.

4.5. 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.

4.6. 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.

4.7. Following the Chancellor's Autumn Statement, the PWLB HRA rate, which is 0.4% below the certainty rate, has been extended until March 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.

4.8. As part of its strategy for funding previous and current years' capital programmes, the Council held £956.9m in loans on 31st December 2024, an increase of £137.5m compared to 31 March 2024. The outstanding loans on 31st December are summarised in Table 4.

Table 4: Borrowing Position

Type of Borrowing	31.03.24 Balance £m	Net Movement £m	31.12.24 Balance £m	31.12.24 Weighted Ave. Rate %	31.12.24 Weighted Ave. Maturity years
Public Works Loan Board	679.4	102.5	781.9	3.28%	21.3
Banks (LOBO)	100.0	0.0	100.0	4.73%	33.8
Local authorities (short-term)	40.0	35.0	75.0	4.99%	0.6
Total borrowing	819.4	137.5	956.9	3.56%	20.9

4.9. There has been a net increase in long-term borrowing of £102.5m and a net increase in short-term borrowing of £35.0mThe 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.

4.10. 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

4.11. 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.

4.12. 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.

4.13. 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.

Table 5: LOBO Position

Lender Name	End Date	Original Principal £'000	Interest rate	LOBO Frequency Yr	Next Call Date
FMS Wertman	10/04/2053	20,000	4.75%	0.5	10/04/2025
FMS Wertman	10/04/2053	20,000	4.75%	0.5	10/04/2025
Dexia Credit Local	10/04/2043	10,000	4.75%	0.5	10/04/2025
Commerzbank	15/05/2066	6,800	4.70%	5	15/05/2028
Commerzbank	17/05/2066	10,200	4.70%	5	15/05/2028
Commerzbank	15/05/2066	13,200	4.70%	5	15/05/2028
Commerzbank	17/05/2066	19,800	4.70%	5	15/05/2028
Total borrowing		**100,000**			

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. For quarter 3, the Council's investment balances ranged between £30.3m and £83.3m due to timing differences between income and expenditure. The investment position on 31st December 2024 is shown in Table 6.

Table 6: Treasury Investment Position

Type of Investment	31.03.24 Balance £m	Net Movement £m	31.12.24 Balance £m	31.12.24 Weighted Ave. Rate %	31.12.24 Weighted Ave. Maturity
Debt Management Office	33.9	10.6	44.5	4.70%	1
Money market funds	-	20.0	20.0	2.38%	0
Local authorities	-	-	-	0.00%	0
Total investments	**33.9**	**30.6**	**64.5**	**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 31.12.2024	3.67 4.09	AA- AA-	0% 31%	1 1	5.19% 4.72%
Similar Local Authorities All Local Authorities	4.74 4.59	A+ A+	76% 61%	14 10	4.95% 4.91%

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 4.72%. Therefore, the Council's expected treasury investment income remains in line with the budget.

6.2. As at the end of Qtr3 borrowing costs are £21.1m forecast to circa £30k for year.

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

	31.12.24 Actual £m	2024/25 Operational Boundary £m	2024/25 Authorised Limit £m	Complied?
Borrowing	956.9	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 Actual	2024/25 Target	Complied?
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.

	31.12.24 Actual	2024/25 Target	Complied?
Total cash available within 3 months	£64.5m	£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:

	31.12.24 Actual	2024/25 Target	Complied?
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	£1.6m	£2m	Yes
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£1.6m	£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	31.12.24
Bank Rate	5.25%	4.75%
1-year PWLB certainty rate, maturity loans	5.36%	5.19%
5-year PWLB certainty rate, maturity loans	4.68%	5.10%
10-year PWLB certainty rate, maturity loans	4.74%	5.40%
20-year PWLB certainty rate, maturity loans	5.18%	5.84%
50-year PWLB certainty rate, maturity loans	5.01%	5.66%

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:

	31.12.24 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	12.0%	50%	0%	Yes
12 months and within 24 months	2.4%	40%	0%	Yes
24 months and within 5 years	14.3%	40%	0%	Yes
5 years and within 10 years	14.3%	40%	0%	Yes
10 years and within 20 years	15.0%	40%	0%	Yes
20 years and within 30 years	8.6%	40%	0%	Yes
30 years and within 40 years	12.0%	50%	0%	Yes
40 years and within 50 years	21.4%	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.

	31.12.24 Actual	**2024/25 Target**	**Complied?**
Upper limit on short-term borrowing from other local authorities as a percentage of total borrowing	7.84	30%	Yes