

Treasury Management – 2024/25 Mid Year review

1.0 Introduction & Background

- 1.1 This appendix provides a review of treasury management activity for the first half of 2024/25 as required by the Treasury Management Code. It reports the performance against the Treasury Management strategy and key Prudential and Treasury Indicators for the first half of the year. This has formerly been presented as a separate report but has been subsumed as an appendix to the Target Budget Management report since 2023/24 Outturn report, approved at Cabinet at its meeting of 27 June 2024.
- 1.2 The 2024/25 Treasury Management Strategy Statement (TMSS), which includes the Annual Investment Strategy (AIS), was approved by Budget, Strategy, Finance & City Regeneration Committee on 8 February 2024 and full Council on 22 February 2024 as part of the Budget Report. The Treasury Management Strategy sets out the role of Treasury Management, the strategy for Treasury Management activity in 2024/25, and the key parameters and indicators for investing council cash balances and undertaking borrowing for the year.
- 1.3 The council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Effective cash flow planning enables surplus monies to be invested in counterparties (financial institutions) or financial instruments commensurate with the council's risk appetite, providing adequate cash availability (liquidity) is maintained
- 1.4 The second main function of the treasury management service is the funding of the council's capital plans. These capital plans provide a guide to the borrowing need of the council, essentially the longer-term cash flow planning, to ensure that the council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn on may be restructured to meet the council's risk or cost objectives.
- 1.5 The Chartered Institute of Public Finance & Accountancy (CIPFA) defines treasury management as:

“The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions, the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks.”

2 Economic Background

- 2.1 The council's treasury advisors, Link Asset Services, have provided their assessment of the UK and global economic landscapes as set out at **Annex 2**.
- 2.2 It should be noted that, as widely anticipated, the Bank of England Base Rate has since reduced by a further 0.25% to 4.75% on 7 November 2024. The expectation is that the Bank of England Base Rate will continue to be reduced further during 2025, although not as fast and deep as previously forecast.

3 Treasury Management Activity

- 3.1 Within the year, the council complied with its legislative and regulatory requirements with regards to treasury management. A summary of the action taken in the 6 months to March 2024 is provided in Appendix 3 to this report. The main points are:

Appendix 7 – Treasury Management – Mid Year Review

- The council entered into no new borrowing in the last 6 months of 2023/24;
- The highest risk indicator during the period was 0.016% which is below the maximum benchmark of 0.050%;
- The return on investments has exceeded the budgeted rates but has lagged slightly behind the target benchmark rates in the 6 months as a result of the sharp reduction in new fixed term investments undertaken due to reducing cash balances;
- The two borrowing limits approved by full Council have not been exceeded;
- The Annual Investment Strategy parameters have been met throughout the 6-month period.

3.2 The following table summarises the treasury activity in the half year to March 2024 compared to the corresponding period in the previous year:

October to March	2021/22	2022/23	2023/24
Long-term borrowing raised (General Fund)	(£25.0m)	(£0.0m)	(£0.0m)
Long-term borrowing raised (HRA)	(£30.0m)	(£0.0m)	(£0.0m)
Long-term borrowing repaid (General Fund)	£1.0m	£5.3m	£4.2m
Long-term borrowing repaid (HRA)	£0.6m	£5.4m	£4.2m
Short-term borrowing (raised)/repaid	£4.5m	(£0.5m)	(£25.0m)
Investments made	£438.9m	£314.9m	£334.6m
Investments maturing	(£424.1m)	(£397.4m)	(£407.0m)

- 3.3 The Financing Costs budget variance in 2023/24 was a £2.223m underspend. This is primarily due to improved investment income as a result of a combination of improved investment rates and balances compared to the assumptions within the budget (as demonstrated in 4.8 below).
- 3.4 The table below summarises how the day-to-day cash flows in the second half-year have been funded compared to the same period in the previous two years. The final column shows the full year cashflows for 2023/24. There has been a significant reduction in investment balances over the last two years. The reduction in 2023/24 is mainly as a result of a significant increase in under-borrowing: using the council's own internal reserves and balances to temporarily finance the borrowing need in the capital programme. More detail on this is contained in section 5 below.

	Oct - Mar 2021/22	Oct - Mar 2022/23	Oct - Mar 2023/24	Full Year 2023/24
Net cash flow (shortage)/surplus	(£34.0m)	(£72.1m)	(£88.0m)	(£80.4m)
Represented by:				
Increase/(reduction) in long-term borrowing	£53.4m	(£10.7m)	(£8.4m)	(£24.7m)
Increase/(reduction) in short-term borrowing*	(£4.5m)	£0.5m	£25.0m	£20.5m
Reduction/(increase) in investments	(£14.8m)	£82.5m	£73.4m	£85.3m
Reduction/(increase) in bank balance	(£0.1m)	(£0.2m)	(£1.0m)	(£0.7m)

4 Investment Strategy

- 4.1 All parameters in the Annual Investment Strategy have been complied with in full.

Appendix 7 – Treasury Management – Mid Year Review

- 4.2 No new counterparties have been added to the approved counterparty list during the year.
- 4.3 A summary of investments made by the in-house team and outstanding as at 30 September 2024 is set out in the table below and shows that investments continue to be held in good quality, short-term instruments in line with the approved strategy.

Amount invested 1 Apr 2024 to 30 Sep 2024	Fixed Deposits	MMFs & Notice Accounts	Total	
'AAA' rated money market funds	-	£5.97m	£5.97m	19%
'AA' rated institutions*	£5.00m	-	£5.00m	16%
'A' rated institutions	£10.53m	-	£10.53m	33%
'BBB' rated institutions	-	-	£0.00m	0%
Unrated Funds	-	£10.00m	£10.00m	32%
Total	£15.53m	£15.97m	£31.50m	100%
Maturity less than one week	-	£15.97m	£15.97m	51%
Between one week and one month	-	-	£0.00m	0%
Between one month and three months	£5.10m	-	£5.10m	16%
Between three months and 1 year	-	-	£0.00m	0%
Period – more than 1 year**	£10.43m	-	£10.43m	33%
Total	£15.53m	£15.97m	£31.50m	100%

* For the purposes of this analysis, other Local Authorities are assumed to have the same credit rating as the UK government (AA).

** All investments that are over one year either have a legal offset against debt with the same counterparty, or are with other Local Authorities.

Risk

- 4.4 As part of the investment strategy for 2024/25 the council agreed a maximum risk benchmark of 0.05% i.e. there is a 99.95% probability that the council will get its investments back. The benchmark is a simple target that measures risk based on the financial standing of counterparties and length of each investment based on historic default rates. The actual risk indicator has varied between 0.001% and 0.006% between April 2024 and September 2024, reflecting the very high proportion of investments held in high security and/or very liquid investments. It should be remembered however that the benchmark is an 'average risk of default' measure and does not constitute an expectation of loss for any particular investment.

Investment Risk benchmark	0.050%
Maximum investment risk experienced Oct - Mar	0.006%

- 4.5 The treasury management service is subject to a detailed audit on a regular basis. This includes the testing of the control environment and the management of risk. A 'substantial' level of assurance was provided during the most recent audit (October 2022). No recommendations were made in the course of the audit. A further internal audit is currently underway and is anticipated to complete later in the year.

Investment Performance

- 4.6 The council's investment portfolio (excluding pooled funds) achieved an average rate of 5.21% over the first six months of the year against a benchmark rate of 5.12% for the same period.

Appendix 7 – Treasury Management – Mid Year Review

- 4.7 The investment performance has therefore outperformed the SONIA benchmark rate by 0.09% in the first six months of the year. This is due to the combination of new investments being undertaken at close to peak rates, and there being a lag of the reducing Base Rate being reflected in MMF yields.
- 4.8 The current forecast estimates that the average investment rate earned over the full year will be 4.96% as a result of further expected reductions in the Bank of England Base Rate. As set out in **Appendix 2**, Link Asset Services are currently forecasting that interest rates will fall to 4.5% by March 2025.
- 4.9 Interest rates peaked at 5.25%, with the first Base Rate reduction of 5.00% in August 2024, and a further reduction to 4.75% being agreed in November 2024. The transition to a falling rate environment, combined with significantly reduced liquid balances has prompted the decision not to place any long-term investments during the period. The current priority for officers is to maintain sufficient liquidity to allow the council to avoid external borrowing as long as possible, whilst rates continue to fall.
- 4.10 The Royal London (RLAM) short dated funds total return (capital and revenue combined) was 9.97% for the year to 30 September 2024. The total return since inception (i.e. since the initial investment date) is 4.44%, resulting from a decline in capital value since the initial investment. The reduction of capital value is not a reduction in the worth of the individual assets in the fund but reflects a “marked to market” valuation of the funds at the end of each month, declining due to the steep rise in interest rates since December 2021. Capital valuations have improved by 4.91% since 30 September 2023; a trend that is expected to continue.

5 Borrowing

- 5.1 The council operates separate debt portfolios for the General Fund and the HRA following the introduction of the HRA Self-Financing regime in 2012. The table below shows the Council's total external borrowing and average rates as at 30 September 2024, split between the General Fund and the HRA.

	General Fund Borrowing £m	HRA Borrowing £m	Total Borrowing	Average Rate
PWLB	145.1	176.0	321.1	2.67%
Market Loans	16.3	18.7	35.0	4.33%
Long-term borrowing	161.4	194.7	356.1	2.83%
Average rate of long-term borrowing	3.00%	2.70%	2.83%	
Short-term borrowing	4.0	0.0	4.0	5.05%
Total Borrowing	165.4	194.7	360.1	2.86%

- 5.2 Link Asset Services had been forecasting that interest rates have peaked and would begin to fall during 2024. Therefore, new long-term borrowing for both the General Fund and the HRA has been avoided over the last two years with borrowing need for the capital programme being met by using existing cash balances and short-term borrowing from other local authorities until long-term rates start reducing.
- 5.3 Short-term borrowing of £4m was undertaken at the end of September on a short-term basis of 8 days at a rate of 5.05% to manage temporary cash flow requirements. Further short-term borrowing may be required to cover similar cash flow requirements for the remainder of the year until a decision is made on when to undertake longer term borrowing.

Appendix 7 – Treasury Management – Mid Year Review

- 5.4 The below table demonstrates that if no new long-term borrowing is undertaken before the end of the year, the General Fund and HRA will be under-borrowed by £116.0m and £106.0m respectively. This is one reason for the sharp decline in investment balances. Officers are reviewing a range of short-term borrowing opportunities to continue to avoid long-term borrowing. Additionally, the officer Capital Programme Board is currently reviewing capital investment requirements to assess the likely future borrowing need including the timing of the borrowing need.
- 5.5 The Capital Financing Requirement (CFR) for both the General Fund and HRA are shown in the table below.

General Fund Capital Financing Requirement (CFR) – Underlying Borrowing requirement	Original Estimate 2025/25 £m	Actual 2024/25 £m
Opening General Fund CFR	237	234
In year borrowing requirement	49	54
Minimum Revenue Provision	(11)	(10)
Closing General Fund CFR	275	277
GF External Long-term Borrowing as at 30 September 2024		161
General Fund Under-borrowing as at 30 September 2024		116
HRA Capital Financing Requirement (CFR) – Underlying Borrowing requirement	Original Estimate 2023/24 £m	Actual 2023/24 £m
Opening HRA CFR	239	242
In year borrowing requirement	62	59
Minimum Revenue Provision	(0)	(0)
Closing HRA CFR	301	301
HRA External Long-term Borrowing as at 30 September 2024		195
HRA Under-borrowing as at 30 September 2024		106

- 5.6 The table below shows that the Council has complied with the Operational Boundary and Authorised Borrowing Limits set within the Treasury Management strategy.

Borrowing Limits	Operational Boundary £m	Authorised Borrowing Limit £m
Limit set for 2024/25	630.0	680.0
Less: PFI & Leases	44.0	44.0
Limit for Underlying Borrowing	586.0	636.0
Actual External Borrowing at 30 September 2024*	360.1	360.1
Headroom*	225.9	275.9

* Includes £4.0m short term borrowing held at 30/09/24

**Authorised Borrowing headroom cannot be less than zero

- 5.7 The maturity profile of the Authority's borrowing is within the limits set within the strategy.

Appendix 7 – Treasury Management – Mid Year Review

Maturity Structure of borrowing	Lower Limit set	Upper Limit set	Actual as at 31 March 2024
Under 12 Months	0%	40%	2%
12 months to 2 years	0%	40%	2%
2 years to 5 years	0%	50%	3%
5 years to 10 years	0%	75%	4%
Over 10 years	40%	100%	89%

6 Treasury Advisors

- 6.1 Officers recognise that responsibility for decisions remains with the organisation at all times and ensure that undue reliance is not placed upon external service providers and advisers. However, it is recognised that there is value in employing external providers of treasury management services in order to access specialist skills and resources.

7 Member Training

- 7.1 It is a requirement of CIPFA's Treasury Management code to ensure that the members responsible for decision making and scrutiny of the authority's TMSS are adequately trained to undertake their roles in this area.
- 7.2 Treasury Management training was last provided in January 2024. This was offered to all members and is currently available on the Members section of the Learning Zone.

Annex 1 – Glossary of Terms

Authorised Borrowing Limit: The limit for which the council's external borrowing cannot breach. This limit is set by Council as part of the budget each year. This needs to be approved by Council to amend in the year if required.

Capital Financing Requirement (CFR): The council's cumulative need to borrow to support its capital programme. This increases each year by capital expenditure where existing funding streams (such as reserves, capital receipts, grants or revenue contributions) have not been applied (which is also known as funding through borrowing). The Council must make an annual minimum revenue provision (MRP) which reduces the CFR.

Credit Ratings: The council uses the credit ratings for counterparties provided by the three main credit ratings agencies (Moody's, Fitch and Standard & Poor) to determine how much and for how long the council can lend to them. The highest credit rating as described in the strategy is AAA, and the lowest credit rating that the council is willing to lend to is BBB.

Debt Maturity Profile: The timeline over which the council has to repay its debt. A smooth profile is preferable, as small, regular repayments reduce the risk of having to replace a lot of debt at a time when it may not be the optimum market conditions.

Lender Option Borrower Option (LOBO) Loans: Loans held with market lenders (such as banks), where lenders hold the right to increase the interest rate on the loans at set intervals during the loan. The council has the right to repay the loans without penalty if the lender chooses to increase the interest rate. The council's LOBO Loan portfolio is currently £15m held with two different lenders.

Marked to Market: An accounting method of measuring the fair value of investments at a point in time by valuing the investment under prevailing market conditions.

Minimum Revenue Provision (MRP): A statutory provision that the council sets aside from revenue to reduce its CFR. This has the impact of setting aside the cash to repay any debt incurred as a result of funding the capital programme by borrowing.

Operational Boundary: A limit set by Council as part of the budget each year. Whilst the Authorised Limit cannot be breached, the operational boundary is the expected level at which external debt will reach, taking into account current levels of debt, maturing debt that may need replacing and capital plans for the forthcoming year.

PWLB Loans: Loans held with the Public Works Loans Board. This is the primary lender for Local Authorities, and the PWLB forms part of the Debt Management Office (DMO) within the HM Treasury department of Central Government.

Appendix 7 – Treasury Management – Mid Year Review

Risk Benchmark: An indicator used to monitor the perceived level of risk within the council's investment portfolio.

Under-borrowing: (also known as internal borrowing) The difference between the council's CFR and actual level of debt, where the actual debt is lower than the CFR. This occurs when council uses cash from its own reserves to temporarily fund capital expenditure. Also known as Internal Borrowing.

SONIA: Sterling Over Night Index Average – A benchmark rate calculated and administrated by the Bank of England. This rate effective replaces LIBOR from 1 January 2022 as the key benchmark rate in the UK. The calculation of SONIA is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and institutional investors.

Annex 2 – Economic Overview

Provided by Link Asset Services – September 2024

The third quarter of 2024 (July to September) saw:

- GDP growth stagnating in July following downwardly revised Q2 figures (0.5% q/q)
- A further easing in wage growth as the headline 3myy rate (including bonuses) fell from 4.6% in June to 4.0% in July;
- CPI inflation hitting its target in June before edging above it to 2.2% in July and August;
- Core CPI inflation increasing from 3.3% in July to 3.6% in August;
- The Bank of England initiating its easing cycle by lowering interest rates from 5.25% to 5.0% in August and holding them steady in its September meeting;
- 10-year gilt yields falling to 4.0% in September.

The economy's stagnation in June and July points more to a mild slowdown in GDP growth than a sudden drop back into a recession. Moreover, the drop in September's composite activity Purchasing Managers Index, from 53.8 in August to 52.9, was still consistent with GDP growth of 0.3%-0.4% for the summer months. This is in line with the Bank of England's view, and it was encouraging that an improvement in manufacturing output growth could be detected, whilst the services PMI balance suggests non-retail services output grew by 0.5% q/q in Q3. Additionally, the services PMI future activity balance showed an uptick in September, although readings after the Chancellor's announcements at the Budget on 30th October will be more meaningful.

The 1.0% m/m jump in retail sales in August was stronger than the consensus forecast for a 0.4% m/m increase. The rise was reasonably broad based, with six of the seven main sub sectors recording monthly increases, though the biggest gains came from clothing stores and supermarkets, which the ONS reported was driven by the warmer-than-usual weather and end of season sales. As a result, some of that strength is probably temporary.

The government's plans to raise public spending by around £16bn a year (0.6% GDP) have caused concerns that a big rise in taxes will be [announced in the Budget](#), which could weaken GDP growth in the medium-term. However, if taxes are raised in line with spending (i.e., by £16bn) that would mean the overall stance of fiscal policy would be similar to the previous government's plan to reduce the budget deficit. Additionally, rises in public spending tend to boost GDP by more than increases in taxes reduce it. Our colleagues at Capital Economics suggest GDP growth will hit 1.2% in 2024 before reaching 1.5% for both 2025 and 2026.

The further easing in wage growth will be welcomed by the Bank of England as a sign that labour market conditions are continuing to cool. The 3myy growth rate of average earnings fell from 4.6% in June to 4.0% in July. On a three-month annualised basis, average earnings growth eased from 3.0% to 1.8%, its lowest rate since December 2023. Excluding bonuses, the 3myy rate fell from 5.4% to 5.1%.

Other labour market indicators also point to a further loosening in the labour market. The 59,000 fall in the alternative PAYE measure of the number of employees in August marked the fourth fall in the past five months. And the 77,000 decline in the three months to August was the biggest drop since November 2020.

Moreover, the number of workforce jobs fell by 28,000 in Q2. The downward trend in job vacancies continued too. The number of job vacancies fell from 872,000 in the three months to July to 857,000 in the three months to August. That leaves it 34% below its peak in May 2022, and just 5% above its pre-pandemic level. Nonetheless, the Bank of England is still more concerned about the inflationary influence of the labour market rather than the risk of a major slowdown in labour market activity.

Appendix 7 – Treasury Management – Mid Year Review

CPI inflation stayed at 2.2% in August, but services inflation rose from a two-year low of 5.2% in July to 5.6%, significantly above its long-run average of 3.5%. Food and fuel price inflation exerted some downward pressure on CPI inflation, but these were offset by the upward effects from rising furniture/household equipment inflation, recreation/culture inflation and a surprisingly large rise in airfares inflation from -10.4% in July to +11.9% in August. As a result, core inflation crept back up from 3.3% to 3.6%. CPI inflation is also expected to rise in the coming months, potentially reaching 2.9% in November, before declining to around 2.0% by mid-2025.

The Bank initiated its loosening cycle in August with a 25bps rate cut, lowering rates from 5.25% to 5.0%. In its September meeting, the Bank, resembling the ECB more than the Fed, opted to hold rates steady at 5.0%, signalling a preference for a more gradual approach to rate cuts. Notably, one Monetary Policy Committee (MPC) member (Swati Dhingra) voted for a consecutive 25bps cut, while four members swung back to voting to leave rates unchanged. That meant the slim 5-4 vote in favour of a cut in August shifted to a solid 8-1 vote in favour of no change.

Looking ahead, CPI inflation will likely rise in the coming months before it falls back to its target of 2.0% in mid-2025. The increasing uncertainties of the Middle East may also exert an upward pressure on inflation, with oil prices rising in the aftermath of Iran's missile attack on Israel on 1 October. China's recent outpouring of new fiscal support measures in the latter stages of September has also added to the upshift in broader commodity prices, which, in turn, may impact on global inflation levels and thus monetary policy decisions. Despite these recent developments, our central forecast is still for rates to fall to 4.5% by the end of 2024 with further cuts likely throughout 2025. This is in line with market expectations, however, although a November rate cut still looks likely, December may be more problematic for the Bank if CPI inflation spikes towards 3%. In the second half of 2025, though, we think a more marked easing in inflation will prompt the Bank to speed up, resulting in rates eventually reaching 3.0%, rather than the 3.25-3.50% currently priced in by financial markets.

Looking at gilt movements in the first half of 2024/25, and you will note the 10-year gilt yield declined from 4.32% in May to 4.02% in August as the Bank's August rate cut signalled the start of its loosening cycle. Following the decision to hold the Bank Rate at 5.0% in September, the market response was muted, with the 10-year yield rising by only 5bps after the announcement. This likely reflected the fact that money markets had priced in a 25% chance of a rate cut prior to the meeting. The yield had already increased by about 10bps in the days leading up to the meeting, driven in part by the Fed's "hawkish cut" on 18 September. There is a possibility that gilt yields will rise near-term as UK policymakers remain cautious due to persistent inflation concerns, before declining in the longer term as rates fall to 3.0%.

The FTSE 100 reached a peak of 8,380 in the third quarter of 2024, but its performance is firmly in the shade of the US S&P500, which has breached the 5,700 threshold on several occasions recently. Its progress, however, may pause for the time being whilst investors wait to see who is elected the next US President, and how events in the Middle East (and Ukraine) unfold. The catalyst for any further rally (or not) is likely to be the degree of investors' faith in AI.

Interest rate forecast

Link Asset Services has provided the following forecast:

Link Group Interest Rate View 11.11.24													
	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27	Dec-27
BANK RATE	4.75	4.50	4.25	4.00	4.00	3.75	3.75	3.75	3.50	3.50	3.50	3.50	3.50
3 month ave earnings	4.70	4.50	4.30	4.00	4.00	4.00	3.80	3.80	3.80	3.50	3.50	3.50	3.50
6 month ave earnings	4.70	4.40	4.20	3.90	3.90	3.90	3.80	3.80	3.80	3.50	3.50	3.50	3.50
12 month ave earnings	4.70	4.40	4.20	3.90	3.90	3.90	3.80	3.80	3.80	3.50	3.50	3.50	3.50
5 yr PWLB	5.00	4.90	4.80	4.60	4.50	4.50	4.40	4.30	4.20	4.10	4.00	4.00	3.90
10 yr PWLB	5.30	5.10	5.00	4.80	4.80	4.70	4.50	4.50	4.40	4.30	4.20	4.20	4.10
25 yr PWLB	5.60	5.50	5.40	5.30	5.20	5.10	5.00	4.90	4.80	4.70	4.60	4.50	4.50
50 yr PWLB	5.40	5.30	5.20	5.10	5.00	4.90	4.80	4.70	4.60	4.50	4.40	4.30	4.30