MEETING:	**GOVERNANCE AND AUDIT COMMITTEE**
DATE:	**28 NOVEMBER 2024**
TITLE:	**TREASURY MANAGEMENT 2024-25 MID YEAR REVIEW**
PURPOSE:	**CIPFA's Code of Practice recommends that a report on the Council's actual Treasury Management during the current financial year is produced.**
RECOMMENDATION:	**RECEIVE THE REPORT FOR INFORMATION**
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1. INTRODUCTION

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 outturn reports.

This report also includes the requirement in the 2021 Code, of quarterly reporting of the treasury management prudential indicators. The non-treasury prudential indicators are incorporated in the Council's normal quarterly reports.

The Council's Treasury Management Strategy for 2024/25 was approved at Full Council on 7th 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 are therefore central to the Council's Treasury Management Strategy.

2. EXTERNAL CONTEXT

Economic Background: UK headline consumer price inflation remained around the Bank of England (BoE) target later in the period, falling from an annual rate of 3.2% in March to 2.0% in May and then rebounding marginally to June to 2.2% in July and August, as was expected, due to base effects from energy prices. Core and services price inflation remained higher at 3.6% and 5.6% respectively in August.

The UK economy continued to expand over the period, albeit slowing from the 0.7% gain in the first calendar quarter to 0.5% (downwardly revised from 0.6%) in the second. Of the monthly figures, the economy was estimated to have registered no growth in July.

Over the same period average regular earnings (excluding bonuses) was 5.1%, down from 5.4% in the earlier period, and total earnings (including bonuses) was 4.0% (this figure was impacted by one-off payments made to NHS staff and civil servants in June and July 2023). Adjusting for inflation, real regular pay rose by 2.2% in May to July and total pay by 1.1%.

With headline inflation lower, the BoE cut Bank Rate from 5.25% to 5.00% at the August Monetary Policy Committee (MPC) meeting. The decision was finely balanced, voted by a 5-4 majority with four members preferring to hold at 5.25%. At the September MPC meeting, committee members voted 8-1 for no change at 5.00%, with the lone dissenter preferring Bank Rate to be cut again to 4.75%.

The latest BoE Monetary Policy Report, published in August, showed policymakers expected GDP growth to continue expanding during 2024 before falling back and moderating from 2025 to 2027. Unemployment was forecast to stay around 4.5% while inflation was shown picking up in the latter part of 2024 as the previous years' energy price declines fell out of the figures before slipping below the 2% target in 2025 and remaining there until early 2027.

Arlingclose, the authority's treasury adviser, maintained its central view that Bank Rate would steadily fall from the 5.25% peak, with the first cut in August being followed by a series of further cuts, with November 2024 the likely next one, taking Bank Rate down to around 3% by the end of 2025.

The US Federal Reserve (the Fed) also cut interest rates during the period, reducing the Federal Funds Rate by 0.50% to a range of 4.75%-5.00% at its policy meeting in September. The forecasts released at the same time by the central bank suggested a further 1.00% of easing is expected by the end of the calendar year, followed by the same amount in 2025 and then a final 0.50% of cuts during 2026.

Having first reduced interest rates in June, the European Central Bank (ECB) held steady in July before cutting again in September, reducing its main refinancing rate to 3.65% and its deposit rate to 3.50%. Unlike the Fed, the ECB has not outlined a likely future path of rates, but inflation projections remain in line with the central bank's previous forecasts where it will remain above its 2% target until 2026 on an annual basis.

Financial markets: Sentiment in financial markets continued to mostly improve over the period, but the ongoing trend of bond yield volatility remained. The general upward trend in yields in the early part of the period was reversed in the later part, and yields ended the half-year not too far from where they started. However, the volatility in response to economic, financial and geopolitical issues meant it was a bumpy ride for bond investors during that time.

Over the period, the 10-year UK benchmark gilt yield started at 3.94% and ended at 4.00% but hit a high of 4.41% in May and a low of 3.76% in mid-September. While the 20-year gilt started at 4.40% and ended at 4.51% but hit a high of 4.82% in May and a low of 4.27% in mid-September. The Sterling Overnight Rate (SONIA) averaged 5.12% over the period to 30th September.

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

Having had its outlook increased by Fitch and ratings by S&P earlier in the period, Moody's upgraded Transport for London's rating to A2 from A3 in July.

Moody's also placed National Bank of Canada on Rating Watch for a possible upgrade, revising the outlook on Standard Chartered to Positive, the outlook to Negative on Toronto Dominion Bank, and downgrading the rating on Close Brothers to A1 from Aa3.

S&P upgraded the rating on National Bank of Canada to A+ from A, and together with Fitch, the two rating agencies assigned Lancashire County Council with a rating of AA- and A+ respectively.

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.

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 ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remain under constant review.

3. LOCAL CONTEXT

On 31st March 2024, the Council had net investments of £40.9m rising 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 the usable reserves and working capital are the underlying resources available for investment.

These factors are summarised in the table below.

Balance Sheet Summary –

	31.3.24 Actual £m
CFR	174
Less: Other debt liabilities	(1)
Borrowing CFR	**173**
Less: Usable reserves	(128)
Less: Working capital	(86)
Net borrowing/ (investment)	**(41)**

The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

The treasury management position at 30th September 2024 and the change during the period is shown in the table below.

Treasury Management Summary

	31.3.24 Balance £m	6 month Movement £m	30.9.24 Balance £m
Long-term borrowing	(94.0)	1.1	(92.9)
Short-term borrowing	(5.6)	(1.1)	(6.7)
PFI	(1.0)	0.0	(1.0)
Total borrowing	**(100.6)**	**0.0**	**(100.6)**
Short-term investments	97.6	20.2	117.8
Cash and cash equivalents	43.9	2.2	46.1
Total investments	**141.5**	**22.4**	**163.9**
Net investments	**40.9**	**22.4**	**63.3**

4. BORROWING STRATEGY AND ACTIVITY

CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the Council.

PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield and the Council intends to avoid this activity in order to retain its access to PWLB loans.

Borrowing Position

At 30th September 2024 the Council held £98.3m of loans as part of its strategy for funding previous years' capital programmes, and £1.3m for specific projects. Outstanding loans on 30th September 2024 are summarised in the table below:

	31.3.24 Balance £m	6 month Movement £m	30.9.24 Balance £m	30.9.24 Rate %
Public Works Loan Board	82.1	0.0	82.1	5.60
Bank (long term)	16.2	0.0	16.2	4.22
Specific Projects	1.3	(0.0)	1.3	n/a
Total borrowing	**99.6**	**(0.0)**	**99.6**	

The Council's 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 debt stability of the debt portfolio.

The Council considers it to be more cost effective in the near term to use internal resources and borrow short term loans when required. This strategy enables the Council to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

5. TREASURY INVESTMENT ACTIVITY

CIPFA revised Treasury Management Code defines treasury management investments as those which arise from the Council's cash flows or treasury risk management activity that ultimately represents balances which need to be invested until the cash is required for use in the course of business.

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the 6 months, the Council's investment balance ranged between £93.8 and £222.8 million due to timing differences between income and expenditure. The investment position during the period is shown in the following table:

Treasury Investment Position

	31.3.24 Balance £m	**6 month Movement £m**	**30.9.24 Balance £m**	**30.9.24 Income Returns %**
Banks & building societies (unsecured)	5.9	5.0	10.9	4.97
Local authorities	81.0	(5.0)	76.0	5.10
Money Market Funds	43.0	2.2	45.2	5.00
Pooled Funds	11.6	0.2	11.8	5.94
Debt Management Office	0.0	20.0	20.0	4.90
Total investments	**141.5**	**22.4**	**163.9**	

Both the CIPFA Code and government guidance require the Council to invest its 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.

As demonstrated by the liability benchmark in this report, the Council expects to be a long-term borrower and new treasury investments are therefore primarily made to manage day-to-day cash flows using short-term low risk instruments. The existing portfolio of strategic pooled funds will be maintained to diversify risk into different asset classes and boost investment income.

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

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
31.03.2024	5.30	A+	38%	36	5.59
30.09.2024	5.22	A+	37%	42	5.33
Similar LAs	**4.01**	**AA-**	**34%**	**97**	**5.19**
All LAs	**4.39**	**AA-**	**61%**	**11**	**5.42**

Bank Rate reduced from 5.25% to 5.00% in August 2024 with short term interest rates largely being around these levels. The rates on DMADF deposits ranged between 4.90% and 5.20% and Money Market Rates between 4.89% and 5.29%.

£13m of the Council's investments has been invested in externally managed strategic pooled property, multi-asset, bond and equity funds where short- term security and liquidity are lesser consideration, and the objectives instead are regular revenue income and long- term price stability. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued stability in meeting the Council's investment objective are regularly reviewed.

The performance of our pooled property, multi-asset, bond and equity funds at 30 September 2024 can be seen below:

STRATEGIC POOLED FUND PORTFOLIO — GWYNEDD — From: 22/02/2019 — To: 30/09/2024

FUND NAME	ASSET CLASS	No of Units Held in Period	Current Value £	Capital Growth £	Dividends Earned £	Holding Period (yrs)	Capital Return	Income Return	Total Return	Volatility
AEGON (KAMES) DIVERSIFIED MONTHLY INCOME FUND	MULTI ASSET	1,158,480	1,194,683	-55,317	357,010	5.6	-4.43%	28.56%	24.14%	9.2%
CCLA - LAMIT PROPERTY FUND	PROPERTY	1,524,344	4,142,557	-857,444	1,093,767	5.6	-17.15%	21.88%	4.73%	6.2%
NINETY ONE (INVESTEC) DIVERSIFIED INCOME FUND	MULTI ASSET	1,228,153	1,130,930	-119,070	278,114	5.5	-9.53%	22.25%	12.72%	3.0%
PAYDEN ABSOLUTE RETURN BOND FUND	ABSOLUTE RETURN	233,541	2,005,698	5,698	131,110	1.1	0.28%	6.56%	6.84%	1.0%
SCHRODER INCOME MAXIMISER FUND	EQUITY - UK	7,625,245	3,308,031	-207,278	993,263	3.9	-5.90%	28.26%	22.36%	11.0%
GRAND TOTAL			11,781,899	-1,233,410	2,853,263	4.4	-9.48%	21.92%	12.45%	4.8%

Unrealised capital [illegible] since purchase: -1,218,102 — Annualised income return: 4.54%

Average Bank Rate: 1.96%

It is evident that the combined capital value of £11.782m is less than the initial investment of £13m. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters, and even years; but with the confidence that over a three to five year period total returns will exceed cash interest rates. Investment in these funds will be maintained in the medium term.

6. COMPLIANCE

The Head of Finance reports that all treasury management activities undertaken during the period complied fully with the principles in the Treasury Management Code and the Council's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in the table below.

Investment Limits

	Counterparty Maximum during period	Counterparty 30.9.24 Actual	Counterparty 2024/25 Limit	Complied
The UK Government	£72m	£20m	Unlimited	✓
Local authorities & other government entities	£5m	£5m	£10m	✓
Secured investments	£0m	£0m	£10m	✓
Banks (unsecured)	£5m	£5m	£5m	✓
Building societies (unsecured)	£0m	£0m	£5m	✓
Registered providers (unsecured)	£0m	£0m	£5m	✓
Money market funds	£10m	£10m	£10m	✓
Strategic pooled funds	£5m	£5m	£10m	✓
Real Estate Investment Trusts	£0m	£0m	£10m	✓
Other investments	£0m	£0m	£5m	✓

Compliance with the Authorised Limit and Operational Boundary for external debt is shown in the table below:

Debt Limits

	Maximum during period	30.9.24 Actual	2024/25 Operational Boundary	2024/25 Authorised Limit	Complied
Borrowing	£99.6m	£99.6m	£184m	£194m	✓
PFI & finance leases	£1.0m	£1.0m	£6m	£6m	✓
Total debt	**£100.6m**	**£100.6m**	**£190m**	**£200m**	✓

7. TREASURY MANAGEMENT PRUDENTIAL INDICATORS

As required by the 2021 CIPFA Treasury Management Code, the Council monitors and measures the following treasury management prudential indicators.

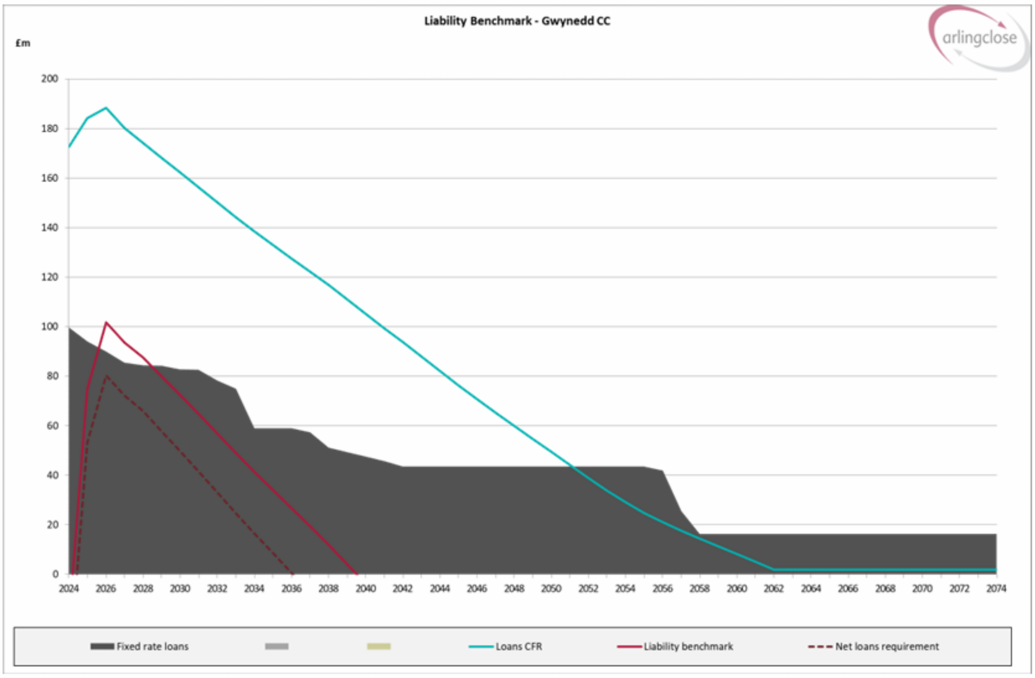
i. Liability Benchmark

This new 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 £21.5m required to manage day to day cash flow.

	31.3.24 Actual	**31.3.25 Estimate**	**31.3.26 Estimate**	**31.3.27 Estimate**
Loans CFR	172.5	184.1	188.4	180.1
Less: Balance Sheet resources	(214.0)	(131.1)	(108.1)	(108.1)
Net loans requirements	(41.5)	53.0	80.3	72.0
Plus: Liquidity allowance	21.5	21.5	21.5	21.5
Liability benchmark	**(20.0)**	**74.5**	**101.8**	**93.5**
Existing borrowing	**100.6**	**94.5**	**90.4**	**85.9**

The table shows that the Council expects to remain borrowed above its liability benchmark up until 2025. This is because the Council holds reserves, and cash outflows to date have been below the assumptions made when the loans were borrowed.

Following on from the medium-term forecast above, the long-term liability benchmark assumes no new capital expenditure funded by borrowing, minimum revenue provision on new capital expenditure based on a 50 year straight line method. This is shown in the chart below together with the maturity profile of the Council's existing borrowing.



The chart shows that there is no need to borrow long- term based on current projections, but maybe in the short term in the near future.

ii. Maturity Structure of Borrowing

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

	Actual	Upper	Lower	Complied
Under 12 months	6.7%	25%	0%	✓
12 months and within 24 months	3.0%	25%	0%	✓
24 months and within 5 years	7.2%	50%	0%	✓
5 years and within 10 years	23.9%	75%	0%	✓
10 years and above	59.3%	100%	0%	✓

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.

iii. 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 prudential limits on the long-term treasury management limits are:

	2024/25	2025/26	2026/27	No precise date
Actual principal invested beyond year end	£13m	£0	£0	£0
Limit on principal invested beyond year end	£40m	£20m	£20m	£20m
Complied	✓	✓	✓	✓

Additional indicators:
The Council measures and manages its exposures to treasury management risks using the following indicators:

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the time-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment and taking the arithmetic average, weighted by the length of each investment. Unrated investments are assigned a score based on their perceived risk.

	30.9.24 Actual	2024/25 Target	Complied
Portfolio average credit score	4.75	A score of 6 or lower	✓

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.

	30.9.24 Actual	2024/25 Target	Complied
Total cash available within 3 months	£147.1m	£10m	✓

Interest Rate Exposures: 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 interest rates was:

	30.9.24 Actual	2024/25 Limit	Complied
Upper limit on one year revenue impact of a 1% rise in interest rates	£1,353,149	£2,290,000	✓
Upper limit on one year revenue impact of a 1% fall in interest rates	£1,353,149	£2,290,000	✓

Treasury Management Performance

The Council measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates.

The Council's budgeted investment income for the year is £3.2m, however the actual expected investment income for the year 2024/25 is significantly lower, estimated at £2.2m due to the decrease in the base rate and forecasted future decreases.

8. INVESTMENT TRAINING

During the period, officers have attended investment training with Arlingclose and CIPFA relevant to their roles.

9. RECOMMENDATION

To receive the report for information.