Item 6 – Capital Strategy Including Treasury Management Strategy

These reports for the 2025/6 financial year are due to come to this Committee today. However, given the fact that the 2023/24 Accounts will be presented at the meeting tonight and they are a key input into these strategies, it is proposed that they are deferred and dealt with through “written representations” next week once the reports can be fully updated with the final 2023/24 data.

To prepare Members for those report coming out to them, it is proposed that in the meeting on the 16th January that Officers take Members of the Committee through the Quarter 2 Monitoring Return for the area to ensure that have a more complete understanding of the area before the actual papers are circulated.

The Q2 Report is set out below:

Treasury Management Position

1. SUMMARY

The purpose of this report is to set out a half yearly update on the Council’s Capital and Treasury Management Strategies, including all prudential indicators.

2. RECOMMENDATIONS

Cabinet are asked to:

- **Note the Council’s Treasury performance for Q2 of the financial year 24/25.**
- **Note the position in relation to the Council’s Prudential indicators.**

3. BACKGROUND

Introduction

3.1 The Authority 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 Authority to approve, as a minimum, treasury management semi-annual and annual outturn reports.

3.2 This half yearly report provides an additional update and 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 Authority’s normal quarterly revenue report.

External Context

3.3 **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.

3.4 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.

3.5 Labour market data was slightly better from a policymaker perspective, showing an easing in the tightness of the job market, with inactivity rates and vacancies declining. However, a degree of uncertainty remains given ongoing issues around the data collected for the labour force survey by the Office for National Statistics. Figures for the three months to July showed the unemployment rate fell to 4.1% (3mth/year) from 4.4% in the previous three-month period while the employment rate rose to 74.8% from 74.3%.

3.6 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%.

3.7 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 meeting minutes and vote suggested a reasonably hawkish tilt to rates, with sticky inflation remaining a concern among policymakers.

3.8 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.

3.9 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.

3.10 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.

3.11 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.

3.12 **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.

3.13 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.

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

3.15 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.

3.16 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.

3.17 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.

3.18 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.

3.19 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.

Local Context

3.20 On 31st March 2024, the Authority had net borrowing of £10.09m arising 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 balance sheet resources are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.24 Actual £m	**31.3.25 Forecast £m**
General Fund CFR	32.65	33.77
Total CFR	**32.65**	**33.77**
Less: *Other debt liabilities *(if any)*	0	0
Borrowing CFR	**32.65**	**33.77**
Less: External borrowing**	-7.5	-10.20
Internal borrowing	25.15	23.57
Less: Usable reserves	-11.96	-11.72
Less: Working capital	-3.1	-3.1
Net borrowing	**10.09**	**8.75**

* finance leases, PFI liabilities and transferred debt that form part of the Authority's total debt
** shows only loans to which the Authority is committed and excludes optional refinancing

3.21 The treasury management position at 30th September and the change over the first six months of 24/25 is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.24 Balance £m	Movement £m	30.9.24 Balance £m	30.9.24 Rate %
Long-term borrowing Short-term borrowing	7.5	-7.5	0	
Total borrowing	**7.5**	**-7.5**	**0**	
Short-term investments Cash and cash equivalents	0.0	4.5	4.5	4.94%
Total investments	**0.0**	**4.5**	**4.5**	
Net investments	**-7.5**	**12.0**	**4.5**	

Borrowing Strategy and Activity

3.22 As outlined in the treasury strategy, the Authority’s chief objective when borrowing has been to strike an appropriately 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 Authority’s long-term plans change being a secondary objective. The Authority’s borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. At the present time short term interest rates are higher than long term interest rates.

3.23 After substantial rises in interest rates since 2021 many central banks have now begun to reduce rates, albeit slowly. Gilt yields were volatile over the 6-month period and have reduced slightly between April and September 2024. Much of the downward pressure from lower inflation figures was counteracted by upward pressure from positive economic data. Data from the US continues to impact global bond markets including UK gilt yields.

3.24 The PWLB certainty rate for 10-year maturity loans was 4.80% at the beginning of the half year and 4.79% at the end. The lowest available 10-year maturity rate was 4.52% and the highest was 5.18%. Rates for 20-year maturity loans ranged from 5.01% to 5.57% during the half year, and 50-year maturity loans from 4.88% to 5.40%.

3.25 Whilst the cost of short-term borrowing from other local authorities spiked to around 7% in late March 2024, primarily due a dearth of LA-LA lending/borrowing activity during the month, as expected shorter-term rates reverted to a more normal range and were generally around 5.00% - 5.25%.

3.26 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 Authority. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield unless these loans are for refinancing purposes. The Authority has no new plans to borrow to invest primarily for financial return.

3.27 **Loans Portfolio:** At 30th September the Authority held no loans.

Table 3: Borrowing Position

	31.3.24 Balance £m	Net Movement £m	30.9.24 Balance £m
Public Works Loan Board			
Banks (LOBO)			
Banks (fixed-term)			
Local authorities (long-term)			
Local authorities (short-term)	7.5	-7.5	0
Total borrowing	**7.5**	**-7.5**	**0**

Treasury Investment Activity

3.28 The CIPFA Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (revised in 2021) defines treasury management investments as investments that arise from the organisation's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

3.29 The Authority does not hold any invested funds, representing income received in advance of expenditure plus balances and reserves held. During the period, the Authority's investment balances ranged between £1.0 and £6.0 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.24 Balance £m	Net Movement £m	30.9.24 Balance £m	30.9.24 Income Return %	30.9.24 Weighted Average Maturity days
Banks & building societies (unsecured)					
Banks & building societies (secured deposits)					
Covered bonds (secured)					
Government					
Local authorities and other govt entities					
Corporate bonds and loans					
Money Market Funds	0.0	4.5	4.5	4.94%	1
Total investments	**0.0**	**4.5**	**4.5**		

3.30 Both the CIPFA Code and government guidance require the Authority 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 Authority'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.

3.31 As demonstrated by the liability benchmark in this report, the Authority expects to be a long-term investor and treasury investments therefore include both short-term low risk instruments to manage day-to-day cash flows and longer-term instruments where limited additional risk is accepted in return for higher investment income to support local public services.

3.32 Bank Rate reduced from 5.25% to 5.00% in August 2024 with short term interest rates largely being around this level. The rates on DMADF deposits also reduced from 5.19% to 4.94%.

Non-Treasury Investments

3.33 The definition of investments in the Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).

3.34 Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) and Welsh Government also includes within the definition of investments all such assets held partially or wholly for financial return.

Treasury Performance

3.35 The Authority 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, as shown in table 5 below.

Table 5: Performance

	Actual **£m**	**Budget** **£m**	**Over/** **under**	**Actual** **%**	**Benchmark** **%**	**Over/** **under**
Total borrowing	**0.0**	**0.0**	**0.0**			
PFI and Finance leases	0.0	0.0	0.0			
Total debt	0.0	0.0	0.0			
Total treasury investments	**4.5**	**0.0**	**4.5**			
				n/a	n/a	n/a

MRP Regulations

3.36 On 10th April 2024 amended legislation and revised statutory guidance were published on Minimum Revenue Provision (MRP). The majority of the changes take effect from the 2025/26 financial year, although there is a requirement that for capital loans given on or after 7th May 2024 sufficient MRP must be charged so that the outstanding Capital Financing Requirement (CFR) in respect of the loan is no higher than the principal outstanding less the Expected Credit Loss (ECL) charge for that loan.

3.37 The regulations also require that local authorities cannot exclude any amount of their CFR from their MRP calculation unless by an exception set out in law. Capital receipts cannot be used to directly replace, in whole or part, the prudent charge to revenue for MRP (there are specific exceptions for capital loans and leased assets).

Compliance

3.38 The Director of Resources and Section 151 officer reports that all treasury management activities undertaken during the period complied fully with the principles in the Treasury Management Code and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 6 below.

Table 6: Investment Limits

	2024/25 Maximum	**30.9.24 Actual**	**2024/25 Limit**	**Complied?** Yes/No
Any single organisation, except the UK Government	£4m each			
UK Central Government	Unlimited			
Unsecured investments with banks and building societies	**£2.5m in total**			
Loans to unrated corporates	**£1m in total**			
Money Market Funds	**£20m in total**	**£4.5m**	**£20m**	**Yes**
Foreign countries	**£5m per country**			
Real Estate Investment Trusts	**£2.5m in total**			

3.39 Compliance with the Authorised Limit and Operational Boundary for external debt is demonstrated in table 7 below.

Table 7: Debt and the Authorised Limit and Operational Boundary

	Q1 2024/25 Maximum	**30.9.24 Actual**	**2024/25 Operational Boundary**	**2024/25 Authorised Limit**	**Complied?** Yes/No
Borrowing	Nil	Nil	55,000	60,000	Yes
PFI and Finance Leases	Nil	Nil	1,000	1,000	Yes
Total debt	**Nil**	**Nil**	**56,000**	**61,000**	

3.40 Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure

Treasury Management Prudential Indicators

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

Liability Benchmark

3.42 This indicator compares the Authority’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 £2m required to manage day-to-day cash flow

	31.3.24 Actual	31.3.25 Forecast	31.3.26 Forecast	31.3.27 Forecast
Loans CFR	32.645	33.772	34.543	35.401
Less: Balance sheet resources	-15.55	-14.823	-14.241	-14.16
Net loans requirement	17.59	18.949	20.302	21.241
Plus: Liquidity allowance	**0.2**	**0.2**	**0.2**	**0.2**
Liability benchmark	**17.79**	**19.149**	**20.502**	**21.441**
Existing borrowing	**7.5**	**10.20**	**12.54**	**14.84**

3.43 Following on from the medium-term forecast above, the long-term liability benchmark assumes capital expenditure funded by borrowing of £14.8m, minimum revenue provision on new capital expenditure based on a 40 year asset life and income, expenditure and reserves all increasing by inflation of 2.0% p.a. This is shown in the chart below together with the maturity profile of the Authority's existing borrowing. Presently borrowing has been delivered through the use of internal resources and the Council has no long term borrowing.

Maturity Structure of Borrowing

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

	Upper Limit	Lower Limit	30.6.24 Actual	Complied?
Under 12 months	50%	0%	0%	Yes
12 months and within 24 months	50%	0%	0%	Yes
24 months and within 5 years	50%	0%	0%	Yes
5 years and within 10 years	50%	0%	0%	Yes
10 years and above	100%	0%	0%	Yes

3.45 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.

Long-term Treasury Management Investments

3.46 The purpose of this indicator is to control the Authority'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 fixed date
Limit on principal invested beyond year end	£0.5m	£0.5m	£0.5m	£0.5m
Actual principal invested beyond year end	Nil	Nil	Nil	Nil
Complied?	Yes	Yes	Yes	Yes

3.47 Long-term investments with no fixed maturity date include strategic pooled funds, real estate investment trusts and directly held equity but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

Additional indicators

Security**:**

3.48 The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	2024/25 Target	30.9.24 Actual	Complied?
Portfolio average credit rating	A	UK Govt	Yes

Liquidity:

3.49 The Authority 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	£4.5m	Nil	Yes
Total sum borrowed in past 3 months without prior notice	Nil	Nil	Yes

Interest Rate Exposures:

3.50 This indicator is set to control the Authority's exposure to interest rate risk.

Interest rate risk indicator	2024/25 Target	30.9.24 Actual	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	500,000	0	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	500,000	0	Yes

3.51 For context, the changes in interest rates during the quarter were:

	31/3/24	30/9/24
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%

3.52 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.

4. IMPLICATIONS

Legal Implications

4.1 A number of statutes governing the provision of services covered by this report contain express powers or duties to charge for services. Where an express power to charge does not exist the Council has the power under Section 111 of the Local Government Act 1972 to charge where the activity is incidental or conducive to or calculated to facilitate the Councils statutory function.

Service / Operational Implications

4.2 Monitoring is undertaken to ensure that income targets are achieved, with Treasury Management activities taking place on a daily basis.

Customer / Equalities and Diversity Implications

4.3 The only impact of treasury transactions is in respect of ethical investment linked to the Councils investment counterparties. Presently the Council has a limited counterparty list based on financial risk to the Authority.

5. RISK MANAGEMENT

5.1 There is always significant risk in relation to treasury transactions, this is why Councils appoint Treasury advisors, which in the case of Bromsgrove is Arlingclose. In addition, there is the requirement in this area to provide an Annual Strategy report containing indicators/limits that must be met, a quarterly update and closure report all of which must be reported to full Council.

6. APPENDICES

None

7. BACKGROUND PAPERS

MTFP 2024/25 – February 2024 which contains this years Capital Strategy, Treasury Management Strategy and MRP Policy.

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