Appendix 1

Treasury Management Report April – September 2024/25

Introduction

In January 2023 the Council 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 includes the requirement in the 2021 Code of quarterly reporting of the treasury management prudential indicators.

The Council's treasury management strategy for 2024/25 was approved at a meeting on 29 January 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.

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.

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%.

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

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 Council'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 Council's counterparty list recommended by Arlingclose remain under constant review.

Local Context

On 31 March 2024, the Council had net borrowing pf £127.4m 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	21.7	40.1
HRA CFR	177.3	189.1
Total CFR	**199.0**	**229.2**
Less: *Other debt liabilities	0	(0.8)
Borrowing CFR	**199.0**	**228.4**
External borrowing**	(142.8)	(157.0)
Internal borrowing	56.2	71.4
Less: Balance sheet resources	(70.2)	(81.4)
Net	**14.0**	**10.0**

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

The treasury management position at 30 September and the change over the six months 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 – PWLB	142.8	12.0	154.8	3.91
Total Borrowing	**142.8**	**12.0**	**154.8**	**3.91**
Short-Term Investments	(14.0)	1.5	(12.5)	(5.53)
Cash and cash Equivalents	(1.4)	0.5	(0.9)	(4.90)
Total Investments	**(15.4)**	**2.0**	**(13.4)**	**(5.37)**
Net Borrowing	**127.4**	**14.0**	**141.4**	

Borrowing Strategy and Activity

As outlined in the treasury strategy, the Council'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 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 the present time short term interest rates are higher than long term interest rates.

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.

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%.

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%.

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 unless these loans are for refinancing purposes. The Council has no new plans to borrow to invest primarily for financial return.

Loans Portfolio: At 30 September the Council held £154.38m of loans, an increase of £12.0m to 31 March 2024, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30 September are summarised in Table 3A below.

Table 3A: Borrowing Position

PWLB Borrowing Term	**Maturity Profile 31 March 2024 £'000**	**Net Movement £'000**	**Maturity Profile 30 September 2024 £'000**
12 Months	6,109	(1,647)	4,462
1 - 2 years	9,000	800	9,800
2 - 5 years	10,284	2,400	12,684
5 - 10 years	28,326	4,000	32,326
10 - 15 years	42,000	400	42,400
Over 15 years	47,090	6,000	53,090
Total PWLB Debt	**142,809**	**11,953**	**154,762**

The Council's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short- and long-term borrowing was maintained.

There remains a strong argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields + 0.80%. The Council will evaluate and pursue these lower cost solutions and opportunities with its advisor Arlingclose.

The UK Infrastructure Bank is one alternative source of funding which offers funding at gilt yields + 0.40% (0.40% below the PWLB certainty rate) and the possibility of more flexible funding structures than the PWLB. Funding from UKIB is generally only available for certain types of projects that meet its criteria of green energy, transport, digital, water and waste. The minimum loan size is £5 million.

Treasury Management Investment Activity

The CIPFA Treasury Management Code defines treasury management investments as those investments which arise from the Council'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.

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the half year, the Council's investment balances ranged between £10.0 and £29.0 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

Bank Name	Duration of Loan	B/Fwd 01/04/24 £000's	Amount Invested 2024/25 £000's	Amount Returned 2024/25 £000's	Balance Invested 30/09/24 £000's	Interest Received 30/09/24 £000's
Federated Fund 3	Call	3,000	18,053	(18,553)	2,500	(53)
Aberdeen Standard	Call	0	5,005	(5,005)	0	(5)
CCLA Public Sector Deposit Fund	1 Day Call	0	4,011	(4,011)	0	(11)
Aviva	Call	0	23,071	(23,071)	0	(71)
Invesco	Call	1,000	1	(1,001)	0	(1)
JP Morgan	Call	0	0	(0)	0	(0)
Goldman Sachs	Call	0	0	(0)	0	(0)
SSGA	Call	0	5,007	(5,007)	0	(7)
Lancashire County Council	12 Months	5,000	149	(149)	5,000	(149)
Aberdeen County Council	12 Months	5,000	140	(140)	5,000	(140)
Total		**14,000**	**55,437**	**(56,937)**	**12,500**	**(437)**

Overnight Investments

The balance of the daily surplus funds can be placed as overnight investments with the Council's bank which is Lloyds. The maximum amount invested with Lloyds in the first two quarters of the financial year was £4.788m. There has been no breach of the £5m limit set in the Treasury Management Strategy. For clarity, this limit relates to the amount invested and doesn't include interest accruing as a result. The interest earned from daily balances up to 30 September 2024 is £47k.

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 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.

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 money market funds averaged 5.25%.

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below.

Table 5: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	**Credit Rating**	**Bail-in Exposure**	**Weighted Average Maturity (days)**	**Rate of Return %**
31.03.2024 30.09.2024	5.35	A+	25%	34	5.58
Similar LAs **All LAs**	4.62	A+	60%	52	4.92

*Weighted average maturity

Statutory override: In April 2023 the Ministry for Housing, Communities and Local Government published the full outcome of the consultation on the extension of the statutory override on accounting for gains and losses on pooled investment funds. The override has been extended for 2 years until 31st March 2025 but no other changes have been made; whether the override will be extended beyond the new date is unknown but commentary to the consultation outcome suggests not. The Council will discuss with Arlingclose the implications for the investment strategy and what action may need to be taken.

ESG policy: Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Council's strategy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, the Council will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code.

Non-Treasury Investments

The definition of investments in the Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council 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).

Investment Guidance issued by the Ministry of Housing, Communities and Local Government (MHCLG) and Welsh Government also includes within the definition of investments all such assets held partially or wholly for financial return.

The Council also held £15.853m of such investments in:

- Loans to Rykneld Homes Ltd of £6.501m; and
- Loans to MyPad Ltd £9.352m.

The Council held £21.8m of investments made for commercial purposes:

- Directly owned property of £21.8m

These investments generated £0.302m of investment income for the Council after taking account of direct costs, representing a rate of return of 1.38% as at 30 September 2024.

Treasury 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, as shown in table 6 below.

Table 6: Performance

	Actual £m	**Budget £m**	**Over/ under**	**Actual %**	**Benchmark %**	**Over/ under**
PWLB Borrowing	154.8	157.0	Under	3.91	4.86	Under
Total borrowing	154.8	157.0	Under	3.91	4.86	Under
Total debt	154.8	157.0	Under	3.91	4.86	Under
Investments (see table 4)	12.5	10.0	Over	5.37	4.50	Over
Total treasury investments	12.5	10.0	Over	5.37	4.50	Over

MRP Regulations

On 10 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 70 May 2024 sufficient MRP must be charged so that the outstanding CFR in respect of the loan is no higher than the principal outstanding less the Expected Credit Loss (ECL) charge for that loan.

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

The S151 Officer reports that all treasury management activities undertaken during the half year 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 table 7 below.

Table 7: Investment Limits

	2024/25 Maximum	30.9.24 Actual	2024/25 Limit	Complied?
The UK Government	Unlimited	£0m	n/a	Yes
Local authorities & other government entities	£5m	£10m	Unlimited	Yes
Secured investments	£5m	£0m	Unlimited	Yes
Banks (unsecured)	£5m	£0m	Unlimited	Yes
Building societies (unsecured)	£5m	£0m	£20m	Yes
Registered providers (unsecured)	£5m	£0m	£20m	Yes
Money market funds	£5m	£2.5m	Unlimited	Yes
Strategic pooled funds	£5m	£0m	£20m	Yes
Real Estate Investment Trusts	£5m	£0m	£20m	Yes
Other investments	£5m	£0m	£20m	Yes

Compliance with the Authorised Limit and Operational Boundary for external debt is demonstrated in table 8 below.

Table 8: Debt and the Authorised Limit and Operational Boundary

	H1 2024/25 Maximum	30.9.24 Actual	2024/25 Operational Boundary	2024/25 Authorised Limit	Complied?
Borrowing	157.0	154.8	234.2	239.2	Yes
Total debt	**157.0**	**154.8**	**234.2**	**239.2**	Yes

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

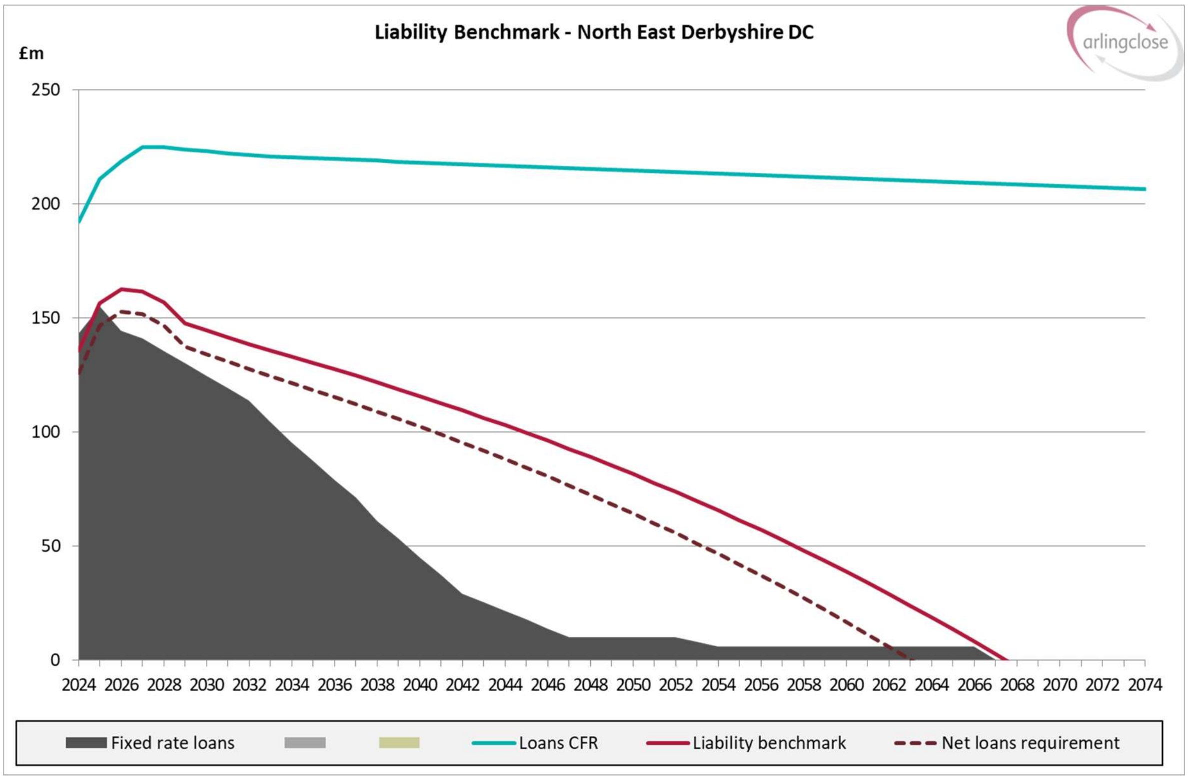
As required by the 2021 CIPFA Treasury Management Code, the Council monitors and measures the following treasury management prudential indicators.

1. Liability Benchmark:

This 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 £[X]m 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	199.0	229.2	233.8	236.6
Less: Balance sheet resources	(73.7)	(81.4)	(87.2)	(90.3)
Net loans requirement	**125.3**	**147.8**	**146.6**	**146.3**
Plus: Liquidity allowance	10.0	10.0	10.0	10.0
Liability benchmark	**135.3**	**157.8**	**156.7**	**156.3**
Existing borrowing	**142.8**	**157.0**	**156.0**	**155.9**

Following on from the medium-term forecast above, the long-term liability benchmark assumes capital expenditure funded by borrowing of £18.5m a year, minimum revenue provision on new capital expenditure based on a 50 year asset life. This is shown in the chart below together with the maturity profile of the Council's existing borrowing.



Whilst borrowing may be above the liability benchmark, strategies involving borrowing which is significantly above the liability benchmark carry higher risk.

2. 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 all borrowing were:

	Upper Limit	**Lower Limit**	**30.9.24 Actual**	**Complied?**
Under 12 months	20%	0%	4.15%	Yes
12 months and within 24 months	20%	0%	6.25%	Yes
24 months and within 5 years	40%	0%	8.09%	Yes
5 years and within 10 years	40%	0%	20.61%	Yes
10 years and above	90%	0%	60.90%	Yes

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.

3. 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 fixed date**
Limit on principal invested beyond year end	£20m	£20m	£20m	£20m
Actual principal invested beyond year end	£0m	£0m	£0m	£0m
Complied?	Yes	Yes	Yes	Yes

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**:** The Council 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	<3.0	2.33	Yes

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	10.0	12.5	Yes

Interest Rate Exposures: This indicator is set to control the Council'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	£1.5m	£0.0m	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	£1.5m	£0.0m	Yes

For context, the changes in interest rates during the half year 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%

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.