From:	Deputy Leader and Cabinet Member for Finance, Corporate and Traded Services Interim Corporate Director – Finance
To:	Governance and Audit Committee – 12 December 2024
Subject:	Treasury Management Mid-Year Update
Classification:	Unrestricted
Future Pathway of report	County Council

Summary: This report provides an overview of Treasury Management activity to the end of September 2024.

Recommendation: The Committee is asked to endorse this report and recommend that it is submitted to County Council.

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1. Introduction

1.1 This report covers Treasury Management activity up to the end of September 2024 and developments in 2024-25 up to the date of this report.

1.2 If agreed by the Committee, this report will be presented to County Council.

1.3 The Council's Treasury Management Strategy for 2024-25 was approved by the County Council on 19 February 2024.

1.4 The Council has both 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. This report covers treasury activity and the associated monitoring and control of risk.

1.5 Treasury risk management at the Council is conducted within the framework of CIPFA's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

1.6 The Council has nominated the Governance & Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

2. External context

2.1 **Economic Update:** The following economic commentary has been provided by the Council's retained treasury advisor, Link Group.

2.2 "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

2.3 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.

2.4 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.

2.5 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.

2.6 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%.

2.7 *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.*

2.8 *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.*

2.9 *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.*

2.10 *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.*

2.11 *Our forecast is next due to be updated around mid-November following the 30 October Budget, 5 November US presidential election and the 7 November MPC meeting and the release of the Bank of England Quarterly Monetary Policy Report.*

2.12 *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%.*

2.13 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."

3. Local context

3.1 The treasury management position on 31 March 2024 and the change over the 6 months to 30 September 2024 is shown in the following table. Borrowing and investment activity occurring over the first half of the year is discussed further in sections 6 and 7 below.

	31-Mar-24 Balance £m	**2024-25 Movement £m**	**30-Sep-24 Balance £m**	**30-Sep-24 Average Rate %**
Long-term borrowing	771.9	-25.1	746.8	4.35
Total borrowing	**771.9**	**-25.1**	**746.8**	**4.35**
Long-term investments	280.1	32.9	312.9	4.71
Short-term investments	44.4	12.4	56.7	4.96
Cash and cash equivalents	128.9	4.1	133.0	4.99
Total investments	**453.4**	**49.3**	**502.6**	**4.82**
Net borrowing	**318.5**	**-74.4**	**244.1**	

4. Borrowing Update

4.1 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.

5. Borrowing Strategy during the period

5.1 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.

5.2 At 30 September 2024 the Council held £746.8m of loans as part of its strategy for funding previous capital programmes. No net new borrowing was undertaken in the half-year and £25.1m of existing loans were allowed to mature without replacement.

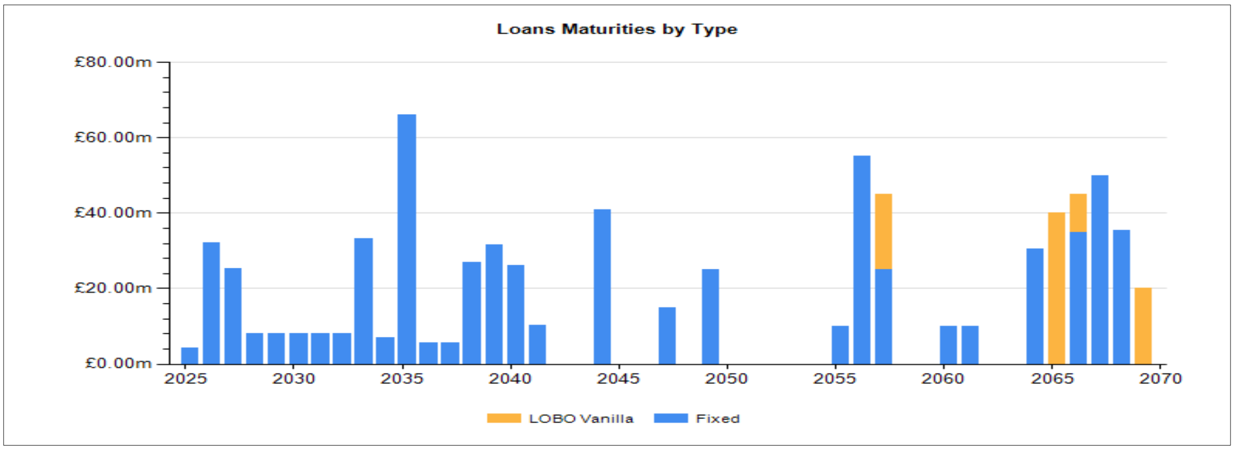
5.3 Interest rates very slightly increased over the first half of the financial year in both the long and short term, with rates at the end of September around 0.07% - 0.09% higher than those at the beginning of April. The PWLB 10-year maturity certainty rate stood at 4.83% at 30 September 2024, 20 years at 5.29% and 30 years at 5.36%.

5.4 The Council continues to hold LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. Rising interest rates increases the likelihood of a lender exercising their option although no banks exercised their option during the period.

5.5 The Council's borrowing activity in the 6 months to 30 September is as follows:

	31/03/2024	2024-25	30/09/2024	30/09/2024	30/09/2024
	Balance	**Movement**	**Balance**	**Average Rate**	**Value Weighted Average Life**
	£m	**£m**	**£m**	**%**	**yrs**
PWLB Loan	456.3	-23.9	432.4	4.33	15.11
Banks (LOBO)	90.0	0.0	90.0	4.15	39.38
Banks (Fixed Term)	216.1	0.0	216.1	4.54	37.73
Streetlighting project	9.5	-1.3	8.2	2.85	15.84
Total borrowing	**771.9**	**-25.1**	**746.8**	**4.35**	**24.59**

5.6 The maturity profile of the Council's outstanding debt at 30 September 2024 was as follows:



6. Treasury investment activity

6.1 CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes on 20th December 2021. These define treasury management investments as investments that arise from the organisation's cash flows or treasury risk management activity that represents balances that need to be invested until the cash is required for use in the course of business.

6.2 The Council holds significant invested funds representing income received in advance of expenditure plus balances and reserves held. During the period, the Council's investment balance ranged between £443.1m and £622.9m due to timing differences between income and expenditure.

6.3 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 investments before seeking the highest 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.

6.4 Bank Rate decreased from 5.25% at the beginning of the year to 5.00% at the end of September 2024. Short-dated cash rates, which had ranged between 5.08% - 5.25% at the beginning of April, dropped by around 0.25% for overnight/7-day maturities and 0.37% for 6-12 month maturities.

6.5 The Council continues to hold significant cash balances in money market funds as well as in bank call accounts which have same day availability. This liquid cash is diversified over several counterparties and money market funds to manage both credit and liquidity risks.

6.6 During the 6 months to 30 September, the Council loaned £2.9m to the no use empty loans programme. At 30 September 2024, the Council had outstanding loans totalling £16.8m to the programme now achieving a return of 3.48% which is available to fund general services. A £29.6m net increase in covered bonds in the 6 months brings the total bond portfolio up to £117.9m. These instruments are negotiable and have the benefit of collateral cover.

6.7 The Council's investments during the 6 months to the end of September are summarised in the table below and a detailed schedule of investments as at 30 September 2024 is in Appendix 1.

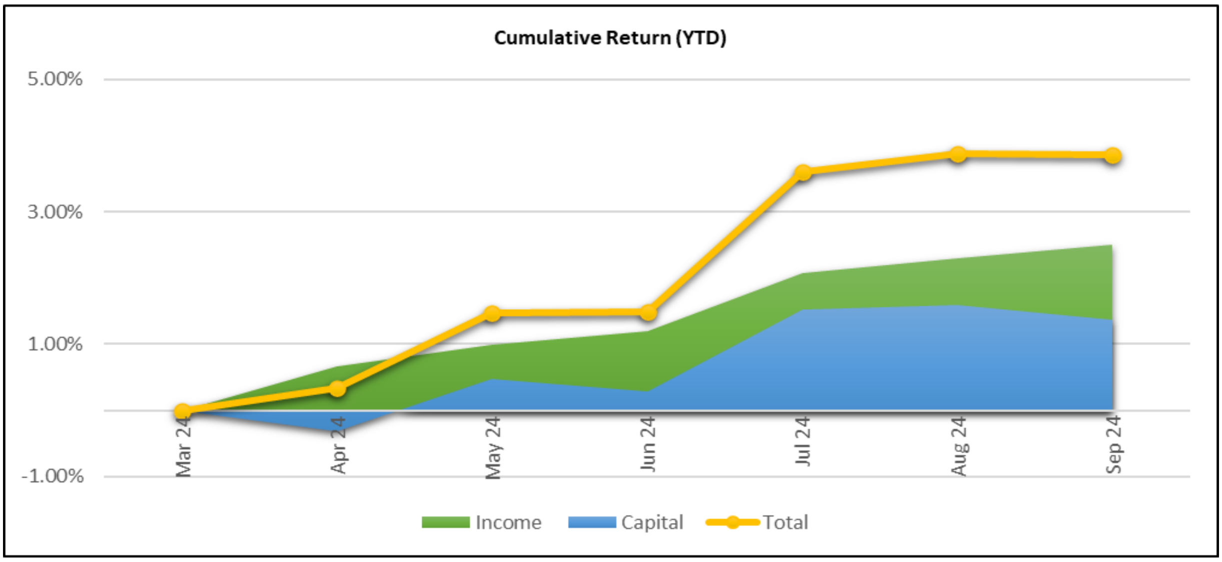
	31-Mar-24	2024-25	30-Sep-24	30-Sep-24	30-Sep-24
	Balance	**Movement**	**Balance**	**Rate of Return**	**Average Credit Rating**
	£m	**£m**	**£m**	**%**	
Call Deposits (Banks)	13.6	-7.6	6.0	4.41	A+
Money Market Funds	128.9	4.1	133.0	4.99	AAA
Covered Bonds	88.2	29.6	117.9	4.54	AAA
DMADF Deposits (DMO)	0.0	32.7	32.7	4.94	AA-
Treasury Bills (UK Government)	30.8	-12.8	18.0	5.17	AA-
No Use Empty Loans	16.0	0.8	16.8	3.48	
Equity	1.3	0.0	1.3		
Internally Managed Cash	**278.8**	**46.8**	**325.6**	**4.74**	AA+
Strategic Pooled Funds	**174.6**	**2.4**	**177.0**	**4.97**	
Total	**453.4**	**49.3**	**502.6**	**4.82**	

7. Externally managed investments

7.1 The Council is invested in equity, multi-asset and property funds. Because the pooled funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives are regularly reviewed.

7.2 Although expected returns are higher over the long term than comparable short term cash instruments, returns on pooled fund investments can be volatile from one year to the next, and therefore the Council only holds long term (strategic) cash balances in the strategic pooled funds' portfolio.

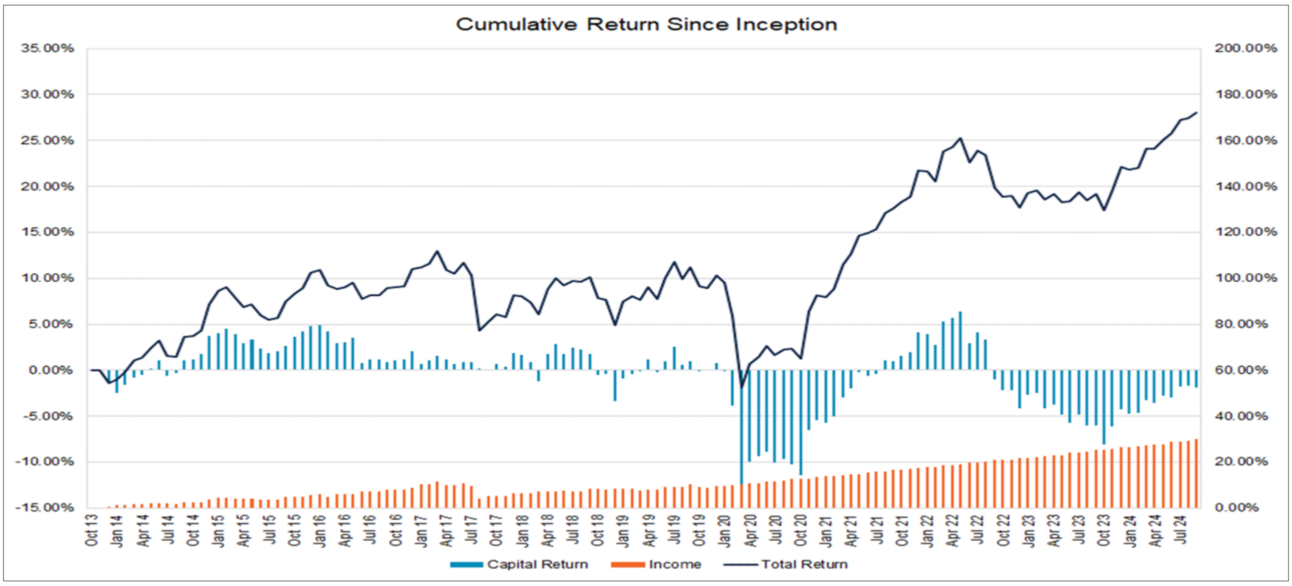
7.3 **Performance YTD** The value of our holdings increased to £177.0m at the end of September 2024, showing an unrealised gain of £2.4m (1.36%) over the period since the end of March 2024. The total return (comprised of both income and capital returns) on the pooled fund investments over the 6 months since 31 March 2024 is £6.9m (3.85%), as shown in the table below.



7.4 The market value of the pooled fund investments as at 30 September 2024 compared to the position as at 31 March 2024 is shown in the table below.

		31-Mar-24	2024-25	30-Sep-24	30-Sep-24	
Investment Fund	**Book cost**	**Market Value**	**Movement**	**Market Value**	**6 months return**	
					Income	**Total**
	£m	**£m**	**£m**	**£m**	**%**	**%**
CCLA LAMIT Property Fund	60.0	54.2	-0.2	54.0	2.44	2.12
CCLA Diversified Income Fund	5.0	5.0	0.0	4.9	0.43	0.29
Pyrford Global Total Return Sterling Fund	5.0	5.4	0.1	5.5	1.66	4.07
Fidelity Global Multi Asset Income Fund	25.0	23.0	-0.9	22.1	2.36	-1.25
Ninety-One (Investec) Diversified Income Fund	10.0	9.1	0.1	9.2	2.33	3.69
Aegon (KAMES) Diversified Monthly Income Fund	20.0	18.7	0.5	19.2	2.95	5.60
M&G Global Dividend Fund	10.0	15.1	0.9	16.0	3.12	12.55
Schroders Income Maximiser Fund	25.0	20.5	1.1	21.5	3.07	7.35
Threadneedle Global Equity Fund	10.0	13.0	0.0	13.0	2.06	2.30
Threadneedle UK Equity Income Fund L	10.0	10.7	0.7	11.4	2.23	9.50
Total Externally Managed Investments	**180.0**	**174.6**	**2.4**	**177.0**	**2.49**	**3.85**

7.5 **Performance since inception:** KCC initially invested in pooled funds in 2013. By the end of September 2024 they had achieved a total income return of £54.1m, 29.98%, with a fall in the capital value of the portfolio of £3.0m, -1.69%. Total returns since inception have been far in excess of the returns available from cash and these instruments are an effective way of managing the Council's longer term cash balances. The following chart tracks the returns earned on the pooled funds over the period from inception.



7.6 **IFRS 9 Statutory Override:** Under the current accounting requirements governing local authorities, movements in the fair value of pooled fund investments are removed from the general fund and recognised on the Council's balance sheet. This effectively ensures the impact of volatility in the capital value of such investments does not affect the annual revenue outturn. However, the relevant accounting provision (known as the "IFRS 9 statutory override") is temporary in nature and is due to expire on 31 March 2025 and therefore (in the absence of any future regulatory changes), the Council will begin to recognise movements in the fair value of pooled fund investments from 2025/26, including the cumulative position to date. Given the uncertainty surrounding the impact of the expiry of the override, the Council recogises this risk on the Budget Risk Register.

8. Actual and forecast outturn

8.1 Forecast net debt costs are lower than budget as yields from short-term and variable long-term cash investments have increased.

9. Treasury Management Group

9.1 The Treasury Management group (TMG) is an informal, non-decision-making body whose role is to support the County Council in oversight and assurance of the treasury management strategy and implementation of it. The TMG last met on 13 November 2024, where it reviewed a quarterly activity report, alongside other matters. A summary of the meeting discussion is included at Appendix 3.

10. Compliance

10.1 The Interim Corporate Director – Finance reports that all treasury management activities undertaken during the quarter complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

11. Treasury Management Indicators

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

11.2 **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its internally managed 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.

Credit risk indicator	**Actual 30/09/2024**	**Minimum**
Portfolio average credit rating	AA+	AA-

11.3 **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.

Liquidity risk indicator	**Actual 30/09/2024**	**Minimum**
Total cash available within 3 months	£215.8m	£100m

11.4 **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 will be:

Interest rate risk indicator	**Actual 30/09/2024**	**Upper Limit**
One-year revenue impact of a 1% rise in interest rates	£3.1m	£10m
One-year revenue impact of a 1% fall in interest rates	-£3.1m	-£10m

11.5 **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 borrowing will be:

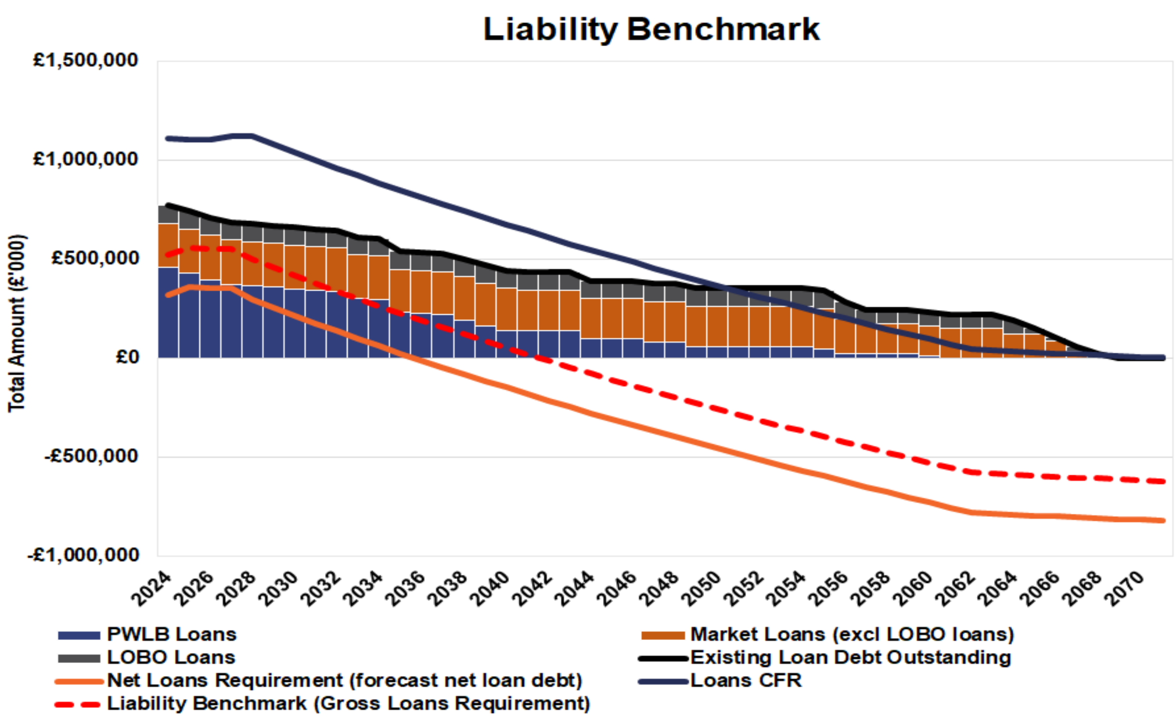
	Actual 30/09/2024	Upper limit	Lower limit
Under 12 months	0.01%	100%	0%
12 months and within 5 years	5.49%	50%	0%
5 years and within 10 years	6.56%	50%	0%
10 years and within 20 years	35.59%	50%	0%
20 years and within 40 years	26.84%	50%	0%
40 years and longer	25.51%	50%	0%

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.

11.6 **Principal sums invested for periods longer than a year:** 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 limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price risk indicator	2024/25	2025/26	2026/27	No Fixed Date
Limit on principal invested beyond year end	£150m	£100m	£50m	£250m
Actual as at 30 September 2024	£70.7m	£49.8m	£9.5m	£195.1m

11.6 Liability Benchmark



The liability benchmark chart shows the Council should be able to accommodate the movement in Loans CFR through additional internal borrowing given the resources on the balance sheet if it wants to maintain treasury investments at the £200m liquidity allowance. However, this is based on the current assumption with regards to movement in reserves and that the working capital position remains at the 31/03/2024 level of £300m. It also assumes that the liquidity allowance of £200m remains appropriate given the £177.00m of external investments currently invested with fund managers over a long-term investment time horizon.

12. Recommendation

Members are asked to endorse this report and recommend that it is submitted to Council.

Appendices

Appendix 1 – Investments as at 30 September 2024
Appendix 2 – Glossary of Terms
Appendix 3 – TMG Meeting Notes, 13 November 2024

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26 November 2024