Appendix 1

Treasury Management Half Yearly Report – 2024/25

1. Background

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low-risk counterparties, providing adequate security and liquidity initially before considering optimising investment return (yield).

Accordingly, Treasury Management is defined as:

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

The second main function of a treasury management service is the funding of an authority's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer-term cash may involve arranging long or short-term loans, or using longer term cash flow surpluses, and on occasions any debt previously drawn may be restructured to meet Council risk or cost objectives.

2. Introduction

In February 2010 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 treasury management semi-annual and annual reports.

This report includes the new requirement in the 2021 Code, mandatory from 1 April 2023, regarding the reporting of the treasury management prudential indicators.

The Council's Treasury Management Strategy for 2024/25 was approved by Council on 14 February 2024. The Council has 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.

The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital Strategy, complying with CIPFA's requirement, was approved by Council on 14 February 2024.

This half yearly report to members is intended to provide an update of the Treasury Management Strategy and performance for the period April to September of this financial year.

3. Economic Update – summary of the economic update provided by the Council's Treasury Management Advisors, Arlingclose

UK inflation fell to around the Bank of England's target, dropping from 3.2% in March to 2.0% in May, then rising slightly to 2.2% in July and August. Core inflation remained higher at 3.6% for general goods and 5.6% for services.

The UK economy grew more slowly, expanding by 0.5% in the second quarter, down from 0.7% in the first, and showed no growth in July. The job market is easing, with unemployment dropping to 4.1% and employment rising to 74.8%. Average regular earnings increased by 5.1%, leading to real pay rises when adjusted for inflation.

In response to lower inflation, the Bank of England reduced interest rates from 5.25% to 5.00% in August, maintaining this rate in September, though concerns about persistent inflation remain. They expect the economy to grow through 2024 but predict inflation will rise again before falling below 2% by 2025.

The US Federal Reserve cut interest rates to a range of 4.75% to 5.00% in September, with plans for further cuts in the coming years. Meanwhile, the European Central Bank reduced its main interest rates to 3.65% in September, but hasn't provided a clear future path for rates, anticipating inflation to stay above 2% until 2026.

Investor sentiment in financial markets mostly improved, but bond yields remained quite unpredictable. While yields generally increased early on, they later settled close to where they began. This meant bond investors faced a lot of ups and downs due to various economic and global events.

For example, the yield on the 10-year UK government bond started at 3.94% and ended at 4.00%, peaking at 4.41% in May and dropping to 3.76% in mid-September. Similarly, the 20-year bond yield rose from 4.40% to 4.51%, reaching a high of 4.82% in May and a low of 4.27% in mid-September. Throughout this period, the average overnight interest rate was 5.12%.

4. Credit Review – summary of the credit review provided by the Council's Treasury Management Advisors, Arlingclose

Arlingclose kept its recommendation for banks to limit unsecured lending to 100 days.

In July, Moody's improved Transport for London's credit rating from A3 to A2, while the National Bank of Canada was put on watch for a possible upgrade. They also gave a positive outlook for Standard Chartered but a negative one for Toronto Dominion Bank, and downgraded Close Brothers from Aa3 to A1.

S&P raised the National Bank of Canada's rating to A+, and both S&P and Fitch gave Lancashire County Council ratings of AA- and A+, respectively.

Overall, credit default swap prices, which indicate the risk of default, were lower at the end of the period compared to the beginning, showing less price volatility than before. However, financial market fluctuations are expected to continue in the near future, and credit default swap levels will be monitored for any signs of financial stress. The recommended banks and lending durations are regularly reviewed.

5. Arlingclose's Economic Outlook for the remainder of 2024/25

	Current	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27
Official Bank Rate													
Upside risk	*0.00*	*0.25*	*0.50*	*0.75*	*1.00*	*1.00*	*1.00*	*1.00*	*1.00*	*1.00*	*1.00*	*1.00*	*1.00*
Arlingclose Central Case	5.00	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Downside risk	*0.00*	*-0.25*	*-0.50*	*-0.50*	*-0.50*	*-0.50*	*-0.50*	*-0.50*	*-0.50*	*-0.50*	*-0.50*	*-0.50*	*-0.50*

In line with Arlingclose's forecast, the Monetary Policy Committee (MPC) held the Bank Rate at 5.0% in September.

The MPC will continue to cut rates to stimulate the UK economy but will initially be cautious given lingering domestic inflationary pressure. Arlingclose predicts another rate cut in 2024 (Q4), but more significant monetary easing in 2025, with the Bank Rate falling to a low of around 3%.

Upside risks to inflation remain which could limit the extent of monetary easing.

Long-term gilt yields have fallen alongside US monetary policy expectations. Arlingclose's central case is for yields to be volatile around a relatively narrow range, reflecting the likelihood for monetary policy loosening in the Eurozone, UK, and US.

6. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy for 2024/25 was approved by Council on 14 February 2024. The Council's annual Investment Strategy, which is incorporated in the Treasury Management Strategy, outlines the Council's investment priorities as follows:

- Security of Capital
- Liquidity

The Council will also aim to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate, it is considered appropriate to keep investments short term, and only invest with highly credit rated financial institutions using the Arlingclose suggested creditworthiness matrices. Currently investments are only being made with UK financial institutions.

Investments during the first six months of the 2024/25 financial year have been in line with the strategy, and there have been no deviations from the strategy.

It is considered that the strategy approved on 14 February 2024 is still fit for purpose in the current economic climate.

7. Investment Portfolio 2024/25

Investment Priorities
The Council focuses on security, liquidity, and earning a return that aligns with its risk tolerance, in line with the CIPFA Code.

Interest Rates
The Bank of England has reduced the official rate from 5.25% to 5.00%, with more cuts expected later in 2024/25.

Investments Held
Investments as at 30 September 2024:
    Total investments: £11.90m
    Debt Management Account (DMADF): £9.25m
    Public Sector Deposit Fund: £2m
    Lloyds Current Account: £0.65m

Investments as at 31 March 2024:
    Total investments: £18.05m
    £17.5m in DMADF
    £0.55m in Lloyds

Cash Flow
Available funds for investment have fluctuated, peaking at £28.09m, largely due to inflows like council tax, business rates, and government grants.

Major outflows include precept payments, salaries, business rates, and construction projects.

Portfolio Performance
    Yield for the first six months of 2024/25: 4.94%
    Yield as of 30 September 2024: 4.93%
    Interest earned (first 6 months): £507,443
    Budgeted investment return: £0

Key Rates
    Lloyds Current Account: 3.1%
    DMADF: Started at 5.2%, reduced to 4.94% by 30 September 2024
    Money Market Funds: Up to 5.23%, down to 4.99%

Risk Management
All investments are with institutions rated A+ or higher, exceeding the Council's minimum requirement of A. The Council prioritizes security and liquidity over maximizing returns.

8. Borrowing Position 2024/25

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. During the first six months of 2024/25 no external borrowing has taken place, however it is envisaged that external borrowing will be required to cover short-term cash flow deficits together with the capital programme.

The Council consider it to be more cost effective in the near term to use internal resources or borrow on a short-term basis. This is also in line with advice provided by Arlingclose Ltd.

However, a need to borrow in order to fund the Council's capital programme was included within the Revenue and Capital Budgets and Strategies 2024/25 reports presented to Council on 14 February 2024. The impact of borrowing is included in the Medium Term Financial Strategy pressures for 2024/25 and future years.

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 (Public Works Loan Board) 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 not invested in assets primarily for financial return or that are not primarily related to the functions of the Authority. It has no plans to do so in future.

9. Compliance

The Service Director for Finance (Section 151 Officer) reports that all treasury management activities undertaken during the year to date have complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

Compliance with debt limits

	Q1 & Q2 2024/25 Maximum	**30.09.24 Actual**	**2024/25 Operational Boundary**	**2024/25 Authorised Limit**	**Complied?**
Borrowing	£0m	£0m	£95m	£100m	Yes

Compliance with investment limits

	Q1 & Q2 2024/25 Maximum	**30.09.24 Actual**	**2024/25 Limit**	**Complied?**
The UK Government	£24.5m	£9.25m	Unlimited	Yes
Local authorities & other government entities	£0m	£0m	£7m	Yes
Secured investments	£0m	£0m	£7m	Yes
Banks (unsecured)	£5.44m	£0.65m	£7m	Yes
Building societies (unsecured)	£0m	£0m	£7m	Yes
Registered providers (unsecured)	£0m	£0m	£10m	Yes
Money market funds	£2m	£2m	£7m	Yes
Other Investments	£0m	£0m	£7m	Yes

10. Prudential Indicators 2024/25

Treasury management activity during the first half year has been carried out within the parameters set by the prudential indicators contained in the approved 2024/25 Treasury Management Strategy. Consequently, there is no intention to revise any of the indicators for the remainder of the year.

Liability Benchmark

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 £1m 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	10.3m	22.8m	25.4m	28.8m
Less: Balance sheet resources	(30.1m)	(10.3m)	(22.8m)	(25.4m)
Net loans requirement	**(19.8m)**	**12.5m**	**2.6m**	**3.4m**
Plus: Liquidity allowance	-	1m	1m	1m
Liability benchmark	**(19.8m)**	**13.5m**	**3.6m**	**4.4m**

Maturity Structure of Borrowing

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:

Refinancing Rate Risk Indicator	Upper Limit	Lower Limit
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%

Principal Sums Invested for Periods Longer Than One Year

Price Risk Indicator	2024/25	2025/26	2026/27	No fixed date
Limit on principal invested beyond year end	£25m	£25m	£25m	£25m

Security

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.

Credit Risk Indicator	2024/25 Target
Portfolio average credit rating	A

Liquidity

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:

Liquidity Risk Indicator	Target
Total cash available within 3 months	£1m

Interest Rate Exposures

This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates are:

Interest rate risk indicator	2024/25 Target
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	(£107,000)
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£107,000

Annex A

Treasury Management – Glossary of Terms

- **CIPFA** – the Chartered Institute of Public Finance and Accountancy, is the professional body for accountants working in Local Government and other public sector organisations.

- **CPI** – a measure that examines the weighted average of prices of a basket of consumer goods and services. The Consumer Price Index is calculated by taking price changes for each item in the predetermined basket of goods/services and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.

- **DMADF** –is provided by the DMO as part of its cash management operations and in the context of a wider series of measures designed to support local authorities' cash management.

- **DMO** – The Debt Management Office is an Executive Agency of Her Majesty's Treasury responsible for debt and cash management for the UK Government, lending to local authorities and managing certain public sector funds.

- **GDP** – Gross Domestic Product is the market value of all officially recognised final goods and services produced within a country in a given period of time.

- **Liquidity** – relates to the amount of readily available or short term investment money which can be used for either day to day or unforeseen expenses. For example Call Accounts allow instant daily access to invested funds.

- **MPC** – the Monetary Policy Committee (MPC) is a committee of the Bank of England, which meets for three and a half days, eight times a year, to decide the official interest rate in the United Kingdom (the Bank Rate).

- **PWLB** – Public Works Loan Board (PWLB) is a statutory body operating within the United Kingdom Debt Management Office. PWLB's function is to lend money from the National Loans Fund to local authorities, and to collect the repayments.

- **Yield** – Yield is the income returned on an investment, such as the interest from holding a security. The yield is usually expressed as an annual percentage rate based on the investment's cost, current market value, or face value.