

Treasury Management Half Yearly Report – 2025/26

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 1st April 2023, regarding the reporting of the treasury management prudential indicators.

The Council's treasury management strategy for 2025/26 was approved by Council on 12 February 2025. 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 12 February 2025.

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

The first quarter was dominated by the fallout of from the US trade tariffs and their impact on equity and bond markets. The second quarter saw equity markets making gains and a divergence in US and UK bond yields, which had been moving relatively closely together.

From late June, amid a UK backdrop of economic uncertainty, concerns around the government's fiscal position and speculation around the Autumn Budget, yields on medium and longer-term gilts increased, including the 30 year gilt which hit its highest level for almost 30 years.

UK headline annual consumer price inflation (CPI) increased over the period, rising from 2.6% in March to 3.8% in August. This is well above the Bank of England's 2% target. Core inflation for general goods rose from 3.4% to 3.8% between March and July, before falling back to 3.6% in August. Services inflation decreased from 5% in July to 4.7% in August.

The UK economy expanded by 0.7% in the first quarter of the calendar year and by 0.3% in the second quarter. Annual growth was revised upwards to 1.4%. However, monthly figures showed zero growth in July, in line with expectations, indicating a sluggish start to Q3.

Labour market data continued to soften throughout the period, with the unemployment rate rising and earnings growth easing, but probably not to an extent that would make the more hawkish MPC members comfortable with further rate cuts. In addition, the employment rate rose while the economic inactivity rate and number of vacancies fell.

The Bank of England's Monetary Policy Committee reduced interest rates from 4.5% to 4.25% in May and to 4.0% in August after an unprecedented second round of voting. The final 5-4 vote was for a 0.25% cut, with the minority wanting no change. In September, seven MPC members voted to hold rates, while two preferred a 0.25% cut. The Committee's views still differ on whether the upside risks from inflation expectations and wage setting outweigh downside risks from weaker demand and growth.

The August BoE Monetary Policy Report highlighted that after peaking in Q3 of 2025, inflation is projected to fall back to target by mid-2027. GDP is expected to remain weak in the near term, while over the medium-term outlook will be influenced by domestic and global developments.

Arlingclose, the Council's treasury adviser, maintained its central view that interest rates would be cut further as the Bank of England focused on weak growth more than higher inflation. One more cut is currently expected during 2025/26, taking interest rates down to 3.75%. The risks to the forecast are balanced in the near-term, but weighted to the downside further out as weak consumer sentiment and business confidence and investment continue to constrain growth. There is also considerable uncertainty around the Autumn Budget and the impact this will have on the outlook.

Against a backdrop of uncertain US trade policy and pressure from President Trump, the US Federal Reserve held interest rates steady for most of the period, before cutting rates to 4.00%-4.25% in September. Fed policymakers also published their new economic projections at the same time. These pointed to 0.5% lower rate by the end of 2025 and 0.25% lower in 2026, alongside GDP growth of 1.6% in 2025, inflation of 3% and an unemployment rate of 4.5%.

The European Central Bank cut rates in June, reducing its main refinancing rate from 2.25% to 2.0%, before keeping it on hold through to the end of the period. New ECB projections predicted inflation averaging 2.1% in 2025, before falling below target in 2026, alongside improving GDP growth.

After the sharp declines seen early in the period, sentiment in financial markets improved, but risky assets have remained volatile. Early in the period bond yields fell, but ongoing uncertainty, particularly in the UK, has seen medium and longer yields rise.

Over the period, the 10-year UK benchmark gilt yield started at 4.65% and ended at 4.7%. However, these six months saw significant volatility with the 10-year yield hitting a low of 4.45% and a high of 4.82%. It was a broadly similar picture for the 20-year gilt which started at 5.18% and ended at 5.39%, with a low and high of 5.10% and 5.55% respectively. The Sterling Overnight Rate (SONIA) averaged 4.19% over the six months to 30th September.

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

Arlingclose maintained its recommended maximum unsecured duration limit on the majority of the banks on its counterparty list at 6 months. The other banks remain on 100 days.

Early in the period, Fitch upgraded Natwest Group and related entities from AA- to A+ and gave a positive outlook on Clydesdale Bank. Moody's downgraded the long-term rating on the United States sovereign to Aa1 in May and affirmed OP Corporate's rating at Aa3.

In the second quarter, Fitch upgraded Clydesdale Bank and HSBC, but downgraded Lancashire CC and Close Brothers. Moody's upgraded Transport for London, Allied Irish Banks, Bank of Iceland and Toronto-Dominion Bank.

After spiking in early April, following the US trade tariff announcements, UK credit default swap prices, which indicate the risk of default, have generally trended downwards and ended the period at levels broadly in line with those in the first quarter of the calendar year and throughout most of 2024. The CDS prices for Europe, Singapore and Australia followed a similar path to the UK, while Canadian prices remained modestly elevated compared to earlier in 2025 and in 2024.

At the end of the period, CDS prices for all banks on Arlingclose's counterparty list remained within limits deemed satisfactory for maintaining credit advice at current durations.

Financial market volatility is expected to remain a feature, at least in the near term. As ever, the institutions and durations on the Council's counterparty list recommended by Arlingclose remain under constant review.

5. Arlingclose's Economic Outlook for the remainder of 2025/26

	Curren t	Dec- 25	Mar- 26	Jun- 26	Sep- 26	Dec- 26	Mar- 27	Jun- 27	Sep- 27	Dec- 27	Mar- 28	Jun- 28	Sep- 28
Official Bank Rate													
Upside risk	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	4.00	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75
Downside 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

In line with Arlingclose's forecast, the Monetary Policy Committee (MPC) held the Bank Rate at 4.0% in September.

The MPC's sensitivity to higher inflation is partly offsetting the effect of the weak economic environment on Bank Rate expectations. However, Arlingclose continue to forecast one more 0.25% rate cut in Q4 of 2025 to 3.75%, while recognising that uncertainty over the timing of this move has increased.

While downside risks to Arlingclose's forecast remain, the MPC's stance argues against further downward moves in their central forecast at this time. Arlingclose expect the UK Budget to be an event that may materially change the interest rate outlook.

Long-term gilt yields remain elevated for various reasons, both domestic and international. These issues may not be resolved quickly, but the UK Budget will be a key market driver.

6. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy for 2025/26 was approved by Council on 12 February 2025. 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 2025/26 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 12 February 2025 is still fit for purpose in the current economic climate.

7. Investment Portfolio 2025/26

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 4.50% to 4.00%, with one more cut expected later in 2025/26.

Investments Held

Investments as at 30 September 2025:

Total investments: £4.20m

Lloyds Current Account: £4.20m

Investments as at 31 March 2025:

Total investments: £3.05m

£3.05m in Lloyds

Cash Flow

Available funds for investment have fluctuated, peaking at £15.810m, 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 2025/26: 3.81%

Interest earned (first 6 months): £122,736

Budgeted investment return: £0

Key Rates

Lloyds Current Account: Started at 2.70%, reduced to 2.31%

DMADF: Started at 4.45%, reduced to 3.95% by 30 September 2025

Money Market Funds: Up to 4.54%, down to 4.04%

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 2025/26

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 2025/26 one short-term loan was taken out with another local authority for cash flow purposes. It is envisaged that further 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 2025/26 reports presented to Council on 12 February 2025. The impact of borrowing is included in the Medium Term Financial Strategy pressures for 2025/26 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 2025/26 Maximum	30.09.25 Actual	2025/26 Operational Boundary	2025/26 Authorised Limit	Complied?
Borrowing	£3m	£3m	£80m	£100m	Yes

Compliance with investment limits

	Q1 & Q2 2025/26 Maximum	30.09.25 Actual	2025/26 Limit	Complied?
The UK Government	£9.75m	£0m	Unlimited	Yes
Local authorities & other government entities	£0m	£0m	£7m	Yes
Secured investments	£0m	£0m	£7m	Yes
Banks (unsecured)	£5.01m	£4.20m	£7m	Yes
Building societies (unsecured)	£0m	£0m	£7m	Yes
Registered providers (unsecured)	£0m	£0m	£10m	Yes
Money market funds	£2m	£0m	£7m	Yes
Other Investments	£0m	£0m	£7m	Yes

10. Prudential Indicators 2025/26

Treasury management activity during the first half year has been carried out within the parameters set by the prudential indicators contained in the approved 2025/26 Treasury Management Strategy. Consequently, there is no intention to revise any of the indicators or forecasts 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.

	31.3.25 Actual	31.3.26 Forecast	31.3.27 Forecast	31.3.28 Forecast
Loans CFR	19.9m	22.8m	25.4m	28.8m
Less: Balance sheet resources	(23.0m)	(10.3m)	(22.8m)	(25.4m)
Net loans requirement	(3.1m)	12.5m	2.6m	3.4m
Plus: Liquidity allowance	-	1m	1m	1m
Liability benchmark	(3.1m)	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	2025/26	2026/27	2027/28	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	2025/26 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	2025/26 Target
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	(£137,000)
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£137,000

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.
- **SONIA** – The Sterling Overnight Index Average is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors. It is administered by the Bank of England.