

Appendix A

**Treasury Management Strategy Statement and Annual
Investment Strategy**

Mid-Year Review 2024/25

Report of Chief Finance Officer

1. Background

Capital Strategy

In December 2021, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. These require all local authorities to prepare a Capital Strategy which is to provide the following:

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

A report setting out our Capital Strategy was taken to Council on 28 February 2024.

Treasury Management

The Council operates a balanced budget, which broadly means that 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 liquidity initially before considering optimising investment return.

The second main function of the treasury management services is the funding of the Council'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 occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly, treasury management is defined as:

“The management of the local authority's borrowing, 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.”

2. Introduction

This report has been written in accordance with the requirements of CIPFA's Code of Practice for Treasury Management (revised 2021).

The primary requirements of the Code are as follows:

- (i) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

- (ii) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- (iii) Receipt by full Council of an annual Treasury Management Strategy Statement – including the Annual Investment Strategy and Minimum Revenue Provision Policy – for the year ahead, a Mid-year Review Report and an Annual Report, covering activities during the previous year.
- (iv) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- (v) Delegation by the council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Budget and Performance Panel.

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first part of the 2024/25 financial year
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators
- A review of the Council's investment portfolio for 2024/25
- A review of the Council's borrowing strategy for 2024/25
- A review of any debt rescheduling undertaken during 2024/25
- A review of compliance with Treasury and Prudential Limits for 2024/25

3. Economics update (provided by Link Asset Services)

- *The third quarter of 2024/25 (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.*
- ❖ *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.

- ❖ 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.
- ❖ 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.
- ❖ 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%.
- ❖ 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.
- ❖ 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.
- 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.

- 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.
- 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.
- 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%.
- 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.

MPC meetings: 9 May, 20 June, 1 August, 19 September 2024

- On 9 May, the Bank of England's Monetary Policy Committee (MPC) voted 7-2 to keep Bank Rate at 5.25%. This outcome was repeated on 20th June.
- However, by the time of the August meeting, there was a 5-4 vote in place for rates to be cut by 25bps to 5%. However, subsequent speeches from MPC members have supported Governor Bailey's tone with its emphasis on "gradual" reductions over time.
- Markets thought there may be an outside chance of a further Bank Rate reduction in September, following the 50bps cut by the FOMC, but this came to nothing.
- Nonetheless, November still looks most likely to be the next month to see a rate cut to 4.75% but, thereafter, inflation and employment data releases, as well as geo-political events, are likely to be the determinant for what happens in the remainder of 2024/25 and into 2025/26.

4. Interest Rate Forecast

The Council's treasury advisors, Link Group, provided the following forecast on 28 May 2024. This sets out a view that, short, medium and long-dated interest rates will fall back over the next year or two, although there are upside risks in respect of the stickiness of inflation and a continuing tight labour market, as well as the size of gilt issuance.

The PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1st November 2012.

Link Group Interest Rate View		28.05.24									
		Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE		4.50	4.00	3.50	3.25	3.25	3.25	3.25	3.00	3.00	3.00
3 month ave earnings		4.50	4.00	3.50	3.30	3.30	3.30	3.30	3.00	3.00	3.00
6 month ave earnings		4.40	3.90	3.50	3.30	3.30	3.30	3.30	3.10	3.10	3.20
12 month ave earnings		4.30	3.80	3.50	3.40	3.40	3.40	3.40	3.20	3.30	3.40
5 yr PWLB		4.50	4.30	4.10	4.00	3.90	3.90	3.90	3.90	3.90	3.80
10 yr PWLB		4.60	4.40	4.30	4.10	4.10	4.10	4.00	4.00	4.00	3.90
25 yr PWLB		5.00	4.80	4.70	4.50	4.50	4.40	4.40	4.40	4.30	4.30
50 yr PWLB		4.80	4.60	4.50	4.30	4.30	4.20	4.20	4.20	4.10	4.10

5. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy (TMS) for 2024/25, which includes the Annual Investment Strategy was approved by Council on 28 February 2024. There are no policy changes to the TMS; the details in this report update the position in light of the updated economic position and budgetary changes already approved or considered in the Capital Programme Mid-Year Review

6. Investment Portfolio

In accordance with the CIPFA Treasury Management Code of Practice the Council's investment priorities are set out as being:

- Security of capital
- Liquidity
- Yield

The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

The UK's sovereign rating has proven robust through the first half of 2024/25. The new Labour Government is expected to outline in detail its future fiscal proposals in the Budget scheduled for 30 October 2024.

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

It is noted that sentiment in the current economic climate can easily shift, so it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances.

The average level of funds available for investment purposes during the period was **£25.0M**. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept and business rate related payments, the receipt of grants and progress on the Capital Programme.

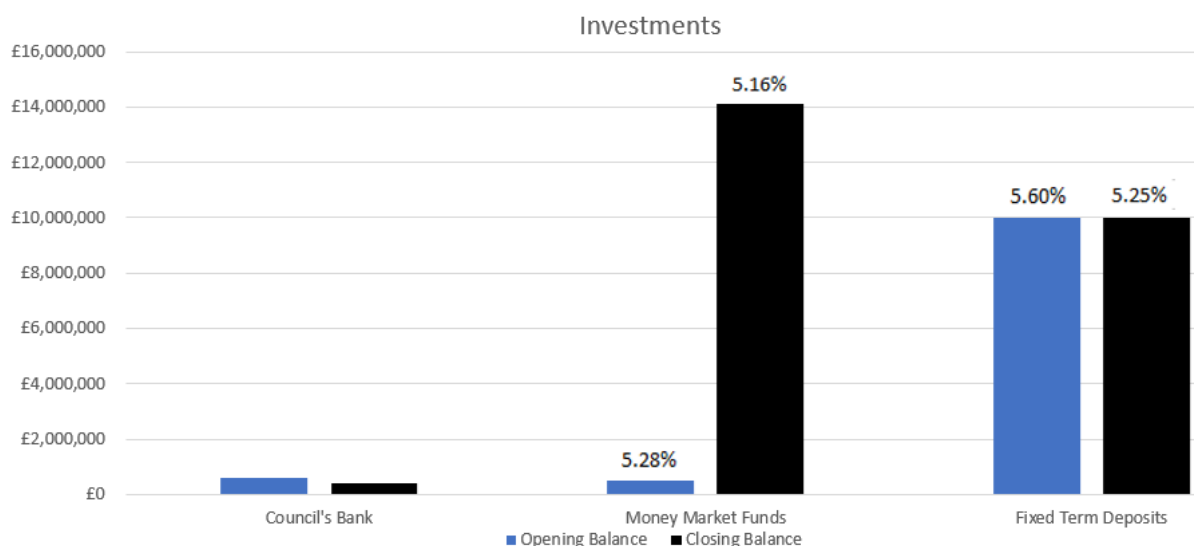
In terms of performance against external benchmarks, the return on investments compared to the SONIA (average) and bank rates at the end of the period is as follows. This is viewed as positive performance, especially given the need to prioritise security of investments, and liquidity (i.e. making sure that the Council's cashflow meets its needs):

Base Rate	5.00%
SONIA (average)	5.12%
Lancaster City Council investments	5.19%

Investment Balances – quarter ended 30 September 2024

At the start of the year investments totalled £10.5M rising to £24.1M by 30 September. Fixed term investments remained at £10M whilst Money Market Fund balances increased from £0.5M to £10.1M.

Other Investments	Term	Maturity Date	Opening 1.4.24 £	Closing 30.09.24 £	Indicative Rate (YTD)	Current Fixed Rate	Interest to Date £
Call Accounts							
Natwest (Cash Manager Plus)			610,437	408,484	5.20%		13,271
Money Market Funds							
Aberdeen Life Investments			0	6,000,000	5.16%		139,287
Blackrock Sterling Liquidity First Fund LGIM			0	1,600,000	5.09%		38,411
Insight			500,000	6,000,000	5.17%		148,085
Goldman Sachs			0	500,000	5.15%		55,367
			0	0	5.01%		6,109
Fixed Term Deposits							
Halton Borough Council	134 days	20/11/2024	0	5,000,000		5.25%	96,370
West Dunbartonshire	182 days	22/05/2024	5,000,000			5.55%	38,774
West Dunbartonshire	120 days	03/12/2024	0	5,000,000		5.25%	86,301
Waltham Forest Council	189 days	30/05/2024	5,000,000			5.65%	45,664
Sub-total			11,110,437	24,508,484			667,640
Budgeted income							273,243
							394,398



Approved Limits

Officers can confirm that, with one exception where funds held in the Council's bank account overnight exceeded the £1.5M specified limit, the approved limits within the Annual Investment Strategy were not breached during the period ended 30th September 2024.

Borrowing

The Council's capital financing requirement (CFR) for 2024/25 was forecast as £103.52M as set out in **Annex A**. The current forecast CFR at quarter 2 is, £101.13M. This is principally due to slippage identified as part of the Capital Programme Mid-Year Review. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing), or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The Council currently has borrowings of £57.97M and has utilised £43.06M of cash flow funds in lieu of borrowing. This is a prudent and cost-effective approach in the current economic climate but will require ongoing monitoring if gilt yields remain elevated, particularly at the longer-end of the yield curve (25 to 50 years).

No new external borrowing has, to date, been undertaken. The capital programme is being kept under regular review due to the effects of ongoing budgetary pressures. Our borrowing strategy will, therefore, also be regularly reviewed and then revised, if necessary, to achieve optimum value and risk exposure in the long-term.

Gilt yields and PWLB certainty rates were less volatile than at this time last year. Overall, the 10, 25 and 50-year part of the curve endured a little volatility but finished September very much as it started in April.

Where there was some movement downwards, this came in the shorter part of the curve as markets positioned themselves for Bank Rate cuts in the second half of 2024 and into 2025, although the continued stickiness of inflation and the prevailing tight labour market is a concern for those looking for more sizeable falls ahead.

At the beginning of April, the 5-year certainty rate was the cheapest part of the curve at 4.72% whilst the 25-year rate was relatively expensive at 5.28%. May saw yields at their highest across the whole curve.

Conversely, 17 September saw the low point for the whole curve, with the 5-year certainty rate falling to 4.31% before rebounding to 4.55% by the end of the month. Similarly, the 50-year certainty rate fell to 4.88% but finished the month at 5.13%, slightly higher than at the start of April.

At this juncture, we still forecast rates to fall back over the next two to three years as inflation dampens, although there is upside risk to our Bank Rate forecast at present. The CPI measure of inflation is expected to fall below 2% in the second half of 2025, however, and we forecast 50-year rates to stand at 4.20% by the end of September 2026. The major caveats are that there is considerable gilt issuance to be digested by the market over the next couple of years, and geo-political uncertainties – which are generally negative for inflation prospects – abound in Eastern Europe and the Middle East, in particular.

It is anticipated that further borrowing may need to be undertaken during this financial year. The original estimate was that we would need to borrow around £9M in quarter 4 of 2024/25. However, this is currently expected to be in the region of £6M, however, the potential for further slippage within the Capital Programme and unknown large cashflows relating to the Eden Project make this difficult to quantify with certainty and the actual amount of borrowing may be lower. Consideration also needs to be given to the recent volatility in the markets leading to high PWLB interest rates. In light of this, it may be prudent to delay borrowing or consider the use of short-term borrowing as an interim measure.

7. Debt Rescheduling

Debt rescheduling opportunities have increased over the course of the past six months and will be considered if giving rise to long-term savings. However, no debt rescheduling has been undertaken to date in the current financial year.

8. Compliance with Treasury and Prudential Limits

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the half year ended 30th September 2024, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2024/25. The Chief Finance Officer reports that no difficulties are envisaged for the current or future years in complying with these indicators.

All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

9. Other Issues

Changes in risk appetite

The 2021 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or to other types of investment instruments this change in risk appetite and policy should be brought to members' attention in treasury management update reports. There are no such changes to report.

Prudential Indicator for Capital Expenditure

This table shows the current estimates for the General Fund and Housing Revenue Account capital programmes, compared to the original estimates.

Capital Expenditure by Fund	2024/25	
	Original Estimate £m	Quarter 2 Position £m
General Fund	17.01	17.34
Council Housing (HRA)	4.77	7.47
Total Capital Expenditure	21.78	24.81

Changes to the Financing of the Capital Programmes

This table shows the changes in the financing of the capital programmes, and the level of borrowing required.

Capital Expenditure	2024/25	
	Original Estimate £m	Quarter 2 Position £m
Total capital expenditure	21.78	24.81
Financed by:		
Capital receipts	0.16	1.34
Capital grants	10.73	11.80
Reserves	4.32	5.16
Revenue	0.04	0.00
Total Financing	15.25	18.30
Borrowing Requirement	6.53	6.51

Changes to the Capital Financing Requirement

Capital Financing Requirement	2024/25	
	Original Estimate £m	Quarter 2 Position £m
General Fund	70.47	68.09
HRA	33.05	33.04
Total Capital Financing Requirement	103.52	101.13
Net movement in CFR	2.48	-2.39

Limits to Borrowing Activity

A key control over treasury management activity is to ensure that over the medium term, net borrowing (borrowings less investments) will only be for capital purposes. Gross external borrowing should not, except in the short term, exceed the total capital financing requirement.

External Debt v Borrowing Need (CFR)	2024/25	
	Original Estimate £m	Quarter 2 Position £m
External Debt	63.97	57.97
Expected Change in Other long term liabilities	7.96	7.96
Total Debt	71.93	65.93
Compared to current :		
Capital Financing Requirement	103.52	101.13
Operational Boundary:-		
Debt	104.52	104.52
Authorised Limit:-		
Debt	120.00	120.00

Definitions:

Operational Boundary

The limit beyond which external debt is not normally expected to exceed is known as the operational boundary.

Authorised Limit for External Debt

A further prudential indicator controls the overall level of borrowing. This is the authorised limit which represents the limit beyond which borrowing is prohibited. It reflects the level of borrowing which, whilst not desired, could be afforded in the short term, but it is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements.

Liability Benchmark

The Council's liability benchmark reflecting the mid-year position is set out below. This charts the following four key components:

1. **Existing loan debt outstanding:** the Authority's existing loans that are still outstanding in future years.
2. **Loans CFR:** this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned MRP.

3. **Net loans requirement:** this will show the Authority's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned MRP and any other major cash flows forecast.
4. **Liability benchmark (or gross loans requirement):** this equals net loans requirement plus short-term liquidity allowance.

Liability Benchmark

