Report

Cabinet

Part 1

Date: 11 December 2024

Subject **Half Yearly Report on Treasury Management for the period 2024/25**

Purpose This report is to inform Cabinet of treasury activities undertaken within the first half of the financial year 2024-25 and updates Cabinet on the position in relation to the Treasury Management prudential indicators as at September 2024. The Cabinet is asked to make any comments or observations, as needed, which will be included in this report when subsequently sent to Council.

Author Assistant Head of Finance / Chief Accountant

Ward All

Summary In line with the agreed Treasury Management Strategy, the Council continues to be both a short-term investor of cash and borrower to manage day-to-day cash flows. Within the first half of this financial year, the authority has taken three temporary loans totalling £15m and one long term loan from the PWLB of £10m. This was done at a time when rates reduced in the very short term so the Authority took advantage of slightly favourable rates that were available, as there is a need to borrow within the 2024-25 financial year. This is in line with the agreed 2024-25 Capital and Treasury Strategy

Up to the end of September 2024, the Council’s net borrowing is £115.4m, a decrease from £123.2m on 31 March 2024 levels.

This report has been considered by Governance & Audit Committee who provided no reservations or adverse feedback.

Proposal To note the report on treasury management activities during the first half year period of 2024-25 and provide any feedback as required for the subsequent report to Council.

Action by Head of Finance / Assistant Head of Finance

Timetable Immediate

This report was prepared after consultation with:

- Treasury Advisors
- Head of Finance
- Governance & Audit Committee

Signed

Background

1. Treasury risk management within Newport City Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA Code). The revised edition had a number of key changes which the Authority adopted in the 2023/24 financial year. The key changes are;
   - It particularly highlights the requirement that local authorities must not borrow to invest primarily for financial return.
   - The forward-looking prudential indicators must be monitored and reported to members at least quarterly (currently half-yearly) as part of the normal budget monitoring reports.
   - The Authority will also have to explicitly document a formal and comprehensive knowledge and skills schedule to ensure the effective acquisition and retention of treasury management skills for those responsible for the management, delivery, governance, decision-making and compliance with legislative requirements.

2. CIPFA defines Treasury Management as

   The management of the organisation'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.

   The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

3. The 2024-25 Treasury Management Strategy was approved by the Council as part of the Capital Strategy in February 2024 and can be viewed at the following location. Part 1 Report Template

4. This report presents the following information:

   - details of capital financing, borrowing, any debt rescheduling and investment transactions
   - reports on the risk implications of treasury decisions and transactions
   - details the monitoring position on treasury management transactions
   - compliance with treasury limits set and Prudential Code

BORROWING STRATEGY / ACTIVITY

Short and Long Term Borrowing

5. Whilst the Council has significant long-term borrowing requirements, the Council's current strategy of funding capital expenditure is through the concept of 'internal borrowing', where the Council seeks to use its existing cash balances to afford its capital expenditure prior to taking out external borrowing i.e. deferring taking out new long term borrowing and funding capital expenditure from the Council's own cash resources for as long as is possible, which it has because of its 'cash-backed' reserves and, to a lesser extent, day to day positive cash-flows. However, this capacity is being reduced so, in the first half of the financial year, the Council undertook some early borrowing in the form of three temporary loans totalling £15m and one long term loan totalling £10m. This was done at a time that the interest rates 'dipped' for a very short window of time and the Council, knowing that it has a clear need to borrow by the end of 2024-25, took advantage of the slightly favourable rates available, in line with advice from our treasury advisors.

6. By using an internal borrowing strategy, the Council can also minimise cash holding at a time when counterparty risk remains relatively high, especially within the current economic climate. However, the capacity to internally borrow is planned to reduce over the short to medium term as the level of reserves are being utilised as intended. In addition, some existing sizeable loans are due to mature within the next year. These two factors will mean that some new borrowing will be required simply to

replace existing borrowing, before considering any overall increase in the capital financing requirement as a result of the Council's capital programme.

7. After substantial rises in interest rates since 2021 many central banks have now begun to reduce rates, albeit slowly. With headline inflation lower, the BoE cut Bank Rate from 5.25% to 5.00% at the August Monetary Policy Committee (MPC) meeting. As forecast by Arlingclose, the authority's treasury adviser, the Monetary Policy Committee (MPC) cut Bank Rate again to 4.75% in November. Arlingclose now forecast that the MPC will continue to reduce Bank Rate, but more slowly and by less than what was originally believed. It is expected that there will be another rate cut in February 2025, followed by a cut alongside every Monetary Policy Report publication, to a low of 3.75%.

8. The following table compares the borrowing levels at the end of September with the equivalent from March 2024 and the position from the mid year report to the end of the year for the financial years 2023-24 and 2022-23. As noted above, the Council have taken out £25m of new loans, both temporary and long term. However, the Council's overall borrowing only increased by £20.1m during the first half of 2024-25. This was due to the redemption of two PWLB loans at the beginning of the financial year, plus there are a number of loans which are Equal Instalments of Principal (EIP) loans, which pays back principal over the life of the loan, so the borrowing levels decline naturally over the life of the loan as an alternative to maturity based loans where the amount borrowed is only repaid when the loan period expires.

Comparison	Sept 2024-25	March 2023-24	Sept 2023-24	March 2022-23	Sept 2022-23
Public Works Loan Board	111,276,386	104,531,704	90,552,301	93,089,897	95,793,799
Interest Free Borrowing	10,950,057	11,263,988	9,947,012	9,905,757	9,814,568
LOBOs	15,000,000	15,000,000	30,000,000	30,000,000	30,000,000
Ex LOBO	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000
Temporary borrowing	15,000,000				
Accrued Interest		1,338,047		606,212	
	157,226,443	137,133,739	135,499,313	138,601,866	140,608,367

9. As well as traditional external borrowing via the Public Works Loans Board (PWLB), the Council has LOBO (Lender Option / Borrower Option) borrowing. One of the features of a LOBO is that the lender can volunteer a change in rate at certain intervals, and this is more probable in an environment of rising interest rates, as recently experienced. Within 2023/24 three of the six LOBOs that the Authority held gave notice that they were intending to increase the interest rate, therefore the Council decided to repay the loan at no additional cost as accepting the revised terms would mean the Authority would still have refinancing risk for those loans in later years. Therefore, the authority took out £15m of new long term borrowing in PWLB loans to repay the LOBOs loans, which has had no impact on the Council's overall borrowing at the time.

The other three LOBOs also have call dates within the next 12 months. Again, if the option is exercised and an increased rate proposed, a decision on how to proceed considering other financing options would be made in conjunction with our treasury advisors.

INVESTMENTS ACTIVITY / POSITION

10. The Council's strategies in this area of Treasury Management are:

- to be a short term and relatively low value investor, consistent with the pursuit of an ‘internal borrowing strategy’ and

- investment priorities should follow the priorities of security, liquidity and yield, in that order.

11. The following table compares the investment levels at the end of September with the equivalent from March 2024 and the position from the mid year report to the end of the year for the financial years 2023-24 and 2022-23. This indicates a net increase in investment activity of £27.9m since March 2024. This is because the Council undertook borrowing in advance of need, and the Authority have been able to reinvest this on a short term basis, although it is anticipated that investment balances will reduce as the year progresses.

Comparison	Sept 2024-25	March 2023-24	Sept 2023-24	March 2022-23	Sept 2022-23
Investment	- 41,800,000	- 13,675,000	- 54,680,000	- 47,231,574	- 500,000
Accrued Interest		- 269,735			
	- 41,800,000	- 13,944,735	- 54,680,000	- 47,231,574	- 500,000

12. The January 2018 saw the implementation in the UK of the second Markets in Financial Instruments Directive (MiFID II), where treasury consulting firms were obliged to treat all local authorities as retail clients unless they opted up to professional client status and met certain criteria. Those criteria included holding a minimum of £10m investment balance and employing knowledgeable and experienced staff to carry out investment transactions. In February 2023, the Council invested in three covered bonds to satisfy this requirement; Santander (£3.5m), Lloyds (£4m) and Cie de Financement Foncier (£2.5m). These are longer term investments which helps diversify our investment portfolio and provide a high level of investment security.

NON-TREASURY INVESTMENTS

13. The definition of investments in CIPFA’s revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in the Investment Guidance issued by Ministry of Housing, Communities and Local Government’s (MHCLG) and Welsh Government, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

14. The Authority held such investments in:

    - directly owned property such as office and commercial units of £10.6m
    - loans to developers £10.3m
    - shareholding in subsidiaries £0.3m (Newport Transport)

15. Directly held property is subject to annual valuation review which can change the value of the holding.

16. The developer loans activity reflects those regenerative partnership projects that are included within the capital programme to assist developers with cash flow loans on particular projects and which are required to be repaid plus interest.

OTHER TREASURY CONSIDERATIONS FOR 2024-25

Economic background and Counter Party Update

17. Appendix A outlines the underlying economic environment as provided by the Council's Treasury Management Advisors, Arlingclose. This is very useful context in informing annual strategy and assisting in effective treasury decisions.

18. Having completed a review of its credit advice on suspended UK Local Authorities, Arlingclose continues to advise against lending to Birmingham City Council, London Borough of Croydon, Nottingham City Council, Slough Borough Council, Thurrock Council, Warrington Borough Council and Woking Borough Council.

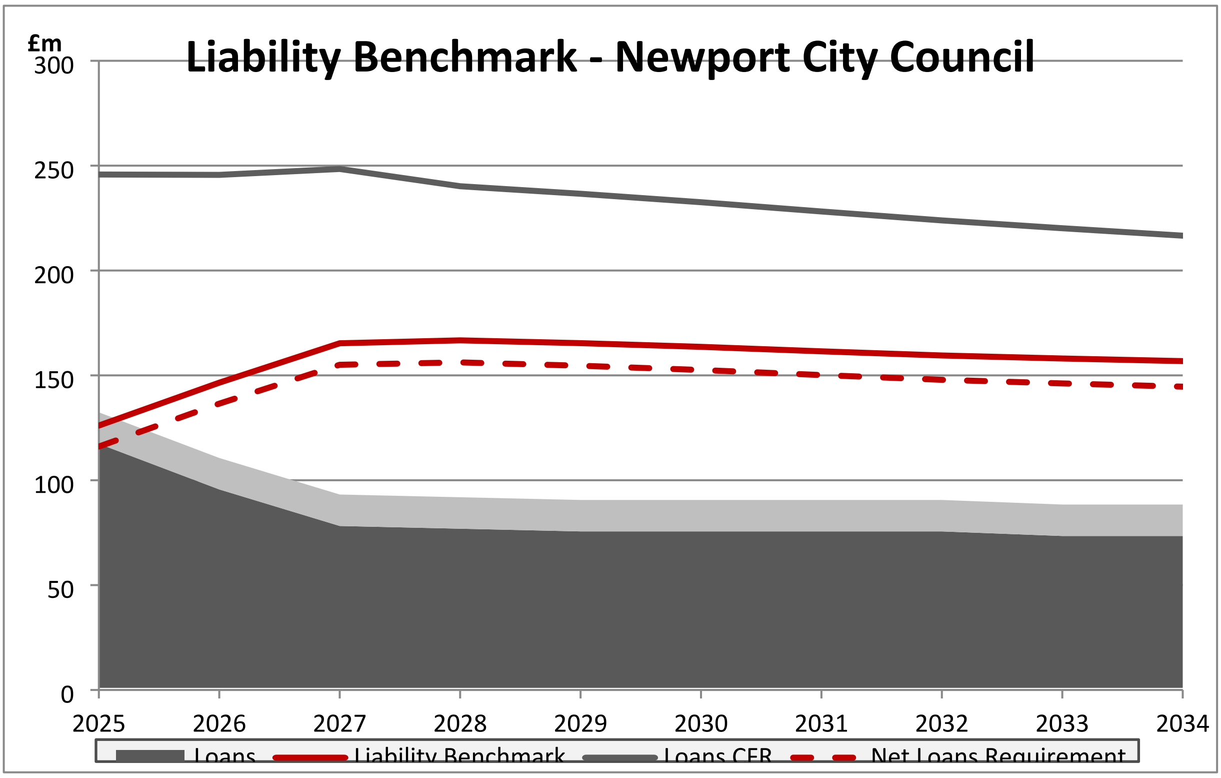
Compliance with Prudential Indicators approved by Council

19. The Authority measures and manages its exposures to treasury management risks using various indicators which can be found in Appendix B. The Authority has complied with the Prudential Indicators for the first half of 2024/25, set in February 2024, except for one – the 'percentage of the Councils capital financing budget of its net budget'. This has arisen due to a technical/accounting aspect associated with this indicator and has no financial cost or impact. The capital financing budget is inclusive of annual lease costs which are currently changing in terms of their accounting treatment so that they are classed as capital financing costs and not any other revenue budget type. This is a change in the accounting for leases and does not represent an additional cost to the Council. The breach therefore does not represent a significant financial impact and will be reported to the full Council as part of this monitoring report.

Liability Benchmark Indicator

20. CIPFA recommends that the optimum position for external borrowing should be at the level of the Liability Benchmark (i.e. all balance sheet resources should be used to maximise internal borrowing). If the outputs show future periods where external loans are less than the Liability Benchmark, then this indicates a borrowing requirement thus identifying where the authority is exposed to interest rate, liquidity and refinancing risks. Conversely, where external loans exceed the Liability Benchmark then this will highlight an over borrowed position which will result in excess cash in the organisation requiring investment thus exposing the authority to credit and reinvestment risks and a potential cost of carry. The treasury strategy should explain how the treasury risks identified by the Liability Benchmark are to be managed over the coming years.

21. The Liability Benchmark is effectively the Net Borrowing Requirement of a local authority plus a liquidity allowance. In its simplest form, it is calculated by deducting the amount of investable resources available on the balance sheet (reserves, cash flow balances) from the amount of outstanding external debt and then adding the minimum level of investments required to manage day-to-day cash flow. It is often denoted in pictorial form using the following graph:



22. In the chart above, the blue line reflects the accumulated value of historic, and future, unfunded capital expenditure – i.e. expenditure initially funded by borrowing and then funded via the revenue budget, over time, in the form of MRP (Minimum Revenue Provision). In effect, this line represents the gross amount of borrowing required.

The solid red line is the calculated actual/real level of borrowing required, taking into account the Council's internal borrowing capacity (i.e. the value of balance sheet resources at any point in time). The gap between the blue and red lines represents the internal borrowing capacity.

The grey shaded areas represent the actual borrowing undertaken by the Council as of 30th September 2024 and shows how these loans reduce as they are scheduled for repayment.

The white gap between the solid red line and the grey shaded areas represents the estimated amount of new borrowing required over the next ten years. A large proportion of this new borrowing would be to replenish existing maturing borrowing, with the remainder being required as a result of the Council's capital expenditure plans.

Outlook for short to medium term

23. As outlined in the Liability Benchmark graph, and elsewhere in the report, the Council has a longer term underlying need to borrow. This is driven by the increasing expenditure on the Capital Programme, with a significant peak expected towards the second half of 2024-25, as well as the need to refinance existing borrowing, which the Council has already done through undertaking some early borrowing to take advantage of some favourable rates. This position will be reviewed on a regular basis in conjunction with the treasury advisors, especially in light of the volatile economic context and the regularly changing borrowing rates.

24. Aside from LOBOs, which could potentially see interest rate rises, all of the external borrowing is on a fixed rate basis.

Risks

Risk	Impact of Risk if it occurs* (H/M/L)	Probability of risk occurring (H/M/L)	What is the Council doing or what has it done to avoid the risk or reduce its effect	Who is responsible for dealing with the risk?
Investment counterparty not repaying investments	High, but depending on investment value.	Low	The Council only invests with institutions with very high credit scores. It employs advisors to monitor money market movements and changes to credit scores and acts immediately should things change adversely. The lower levels of funds available for investment will also alleviate the risk. Colleagues also monitor financial circulars and Treasury consultants advice to be able to respond in a timely fashion, and withdrew its investment from one local authority recently.	Members, Head of Finance, Treasury staff, based on advice from treasury advisors
Interest Rates moving adversely against expectations	Medium	Medium	Interest rates are currently volatile, however the Council's external borrowing is based on fixed interest rates, although there is a degree of risk in relation to LOBOs. The Council will continue to monitor interest rates in anticipation of a medium term need to borrow and will work with its treasury advisors to identify the optimum time to undertake any new borrowing.	Head of Finance, Treasury staff, treasury advisors

* Taking account of proposed mitigation measures

Links to Council Policies and Priorities

It is the Council's policy to ensure that the security of the capital sums invested is fully recognised and has absolute priority. The Council follows the advice of the Welsh Government that any investment decisions take account of security, liquidity and yield in that order.

Options Available and considered

The Prudential Code and statute requires that, during and at the end of each financial year, reports on these matters are presented to Council for approval.

Preferred Option and Why

The approach required by statute is quite prescriptive, such that there aren't many choices/options. This report is a regular half yearly event. The Governance & Audit Committee acts as the main scrutiny mechanism before a similar report is received by Cabinet/Council. Cabinet are asked to note the contents of the report in relation to Treasury activities and indicators and provides endorsement or feedback pertinent to add to the subsequent Council report.

Comments of Chief Financial Officer

Decisions made on treasury matters will be made with a view to complying with the Treasury Management Strategy, Prudential Indicators, taking advice, where needed, from our treasury advisors.

The report reflects the expected change, from a treasury management perspective, in that the Council have undertaken significant borrowing, both short term and long term to cover the refinancing requirement which was going to crystalise at the end of 2024-25. As the Council undertook borrowing in advance of need to take advance of favourable rates, the Council have also been able to reinvest this, in the short term. The need to borrow was expected to happen, in line with the intended use of reserves and consequent reduction in internal borrowing capacity, coupled with the continuation of the capital programme delivery. As highlighted in previous reports, and confirmed by the Liability Benchmark indicator, there remains an underlying, short to medium-term, need to borrow, which is currently anticipated to crystallise during 2024/25.

The indications are that interest rate volatility has now calmed, with our treasury advisors forecasting that the next cut will be in February 2024. Rates will continue to be closely monitored on a regular basis, to identify any change in circumstances.

It may be necessary to undertake some short-term borrowing to assist with managing day to day cashflow requirements and, if that is required, I have the necessary delegated authority to undertake this. The same also applies should any further existing LOBOs be repaid and require refinancing. Should that eventuality arise, the Council would liaise with its treasury advisors and carefully consider the best option for refinancing those loans, unless they could be afforded from within existing investment balances.

Comments of Monitoring Officer

It is a function of the Cabinet to consider the Annual Report on Treasury Management and Prudential Indicators and make recommendations to Council. The report has been prepared in line with the Council's 2024-25 Treasury Management Strategy. There are no legal implications.

Comments of Head of People, Policy & Transformation

The Well-being of Future Generations Act requires public bodies to balance short-term needs with the needs to safeguard the ability to meet long-term needs as demonstrated in the Council's approach to treasury management.

There are no direct HR implications associated with the report.

Local issues

N/A

Scrutiny Committees

N/A

Fairness and Equality Impact Assessment:

- **Wellbeing of Future Generation (Wales) Act**
- **Equality Act 2010**
- **Socio-economic Duty**
- **Welsh Language (Wales) Measure 2011**

For this report, a full Fairness and Equality Impact Assessment has not been undertaken. This is because this report is not seeking any strategic decisions or policy changes, with its purpose being to update on the treasury management activities for the year retrospectively. However, fairness and equality are considered as part of service delivery and will feature in annual finance reports, such as the Treasury and Capital Strategy.

In terms of the Wellbeing of Future Generations (Wales) Act, and the five ways of working contained within it, this report highlights examples of these being supported. This report is a backwards looking report of the treasury management activities of the Council. It shows that we followed the treasury management strategy and the compliance with prudential code and treasury management indicators. This links into the long-term objectives of the authorities and ensures that the Councils' activities are carried out in an affordable, prudent and sustainable manner.

In the case of the Welsh Language, the service will continue to ensure that, wherever possible, services or information is available in the medium of Welsh.

The Equality Act 2010 contains a Public Sector Equality Duty, which came into force on 06 April 2011. The Act identifies a number of 'protected characteristics', namely age; disability; gender reassignment; pregnancy and maternity; race; religion or belief; sex; sexual orientation; marriage and civil partnership. The new single duty aims to integrate consideration of equality and good relations into the regular business of public authorities. Compliance with the duty is a legal obligation and is intended to result in better-informed decision-making and policy development and services that are more effective for users. Nothing in this report is considered to have a direct equality impact.

Consultation
N/A

Background Papers
Report to Council February 2024: Capital Strategy and Treasury Strategy.

Dated: 4 December 2024

APPENDIX A

Introduction

The Authority's treasury management strategy for 2024/25 was approved at a meeting on 29th February 2024. The Authority 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 Authority'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.

As forecast by Arlingclose, the authority's treasury adviser, the Monetary Policy Committee (MPC) cut Bank Rate to 4.75% in November. Arlingclose now forecast that the MPC will continue to reduce Bank Rate, but more slowly and by less than what was originally believed. It is expected that there will be another rate cut in February 2025, followed by a cut alongside every Monetary Policy Report publication, to a low of 3.75%.

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

APPENDIX B

Local Context

On 30th September 2024, the Authority had net borrowing of £115.4m 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

	31.03.24 Actual £m	**31.03.25 Forecast £m**
General Fund CFR	282.0	330.3
Less: *Other debt liabilities	36.1	84.7
Borrowing CFR	**246.0**	**245.6**
Less: Usable reserves	-125	-104
Less: Working capital	2.7	-4
Net borrowing	**123.7**	**137.9**

* finance leases, PFI liabilities and transferred debt that form part of the Authority's total debt

The treasury management position on 30th September 2024 and the change over the six months is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.03.24 Balance £m	**Movement £m**	**30.9.24 Balance £m**	**30.9.24 Rate %**
Long-term borrowing	125.9	5.4	131.3	16.3
Long term interest free borrowing	11.3	(0.3)	11.0	0.4
Short-term borrowing	0.0	15.0	15.0	0.1
Total borrowing	**137.1**	**20.1**	**157.2**	**16.8**
Long-term investments	(10.0)	-	(10.0)	3.1
Short-term investments	(3.9)	(27.9)	(31.8)	0.1
Cash and cash equivalents	-	-	-	-
Total investments	**(13.9)**	**(27.9)**	**(41.8)**	**3.1**
Net borrowing	123.2	(7.8)	115.4	19.9

Three temporary loans totalling £15m and one long term loan totalling £10m was taken out in the first half of the financial year. The temporary borrowing was from other local authorities and a fire authority, and the long term loan was taken from the PWLB. However, the Council also have a number of other loans with PWLB and Salix which are EIPs which is why total borrowing has only increased by £20.1m. The Council have also redeemed two small PWLB loans at the beginning of the financial year.

Short term investments have increased during the period, and this was due to undertaking the £25m of borrowing in advance of need which the authority have been able to reinvest in the short term.

Borrowing Strategy and Activity

As outlined in the treasury strategy, the Authority'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 Authority's long-term plans change being a secondary objective. The Authority'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 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. The Authority has no new plans to borrow to invest primarily for financial return.

Loans Portfolio: At 30th September the Authority held £157.2m of loans, (an increase of £20.1m to 31st March 2024, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30th September are summarised in Table 3A below.

Table 3A: Borrowing Position

	31.3.24 Balance £m	**Net Movement £m**	**30.9.24 Balance £m**	**30.9.24 Weighted Average Rate %**	**30.9.24 Weighted Average Maturity (years)**
Public Works Loan Board	104.5	6.7	111.3	3.9	11.4
Banks (LOBO)	15.0	-	15.0	15.0	3.2
Banks (fixed-term)	5.0	-	5.0	3.8	1.7
Local authorities (long-term)	-	-	-	-	-
Local authorities (short-term)	-	15.0	15.0	2.0	0.1
Other inc. WG loans	11.3	(0.3)	11.0		0.4
Accrued interest	1.3	(1.3)	-		
Total borrowing	**137.1**	**20.1**	**157.2**	**3.6**	**21.3**

The Authority's borrowing decisions are not predicated on any one outcome for interest rates.

LOBO loans: On 30th September, the Authority held £15m of 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 Authority has the option to either accept the new rate and terms or to repay the loan at no additional cost.

As market interest rates rose, there was increased probability of call options on the LOBOs being exercised by lenders. £30m of LOBO loans had annual/semi-annual call option dates during the six-month period to September 2023, no LOBO loans were called.

The Authority has £15m LOBO loans with call dates within the next 12 months, some of which will occur during the remainder of the financial year. The Authority has liaised with treasury management advisors Arlingclose over the likelihood of the options being exercised. If the option is exercised and an increased rate proposed, [the Authority plans to repay the loan at no additional cost as accepting the revised terms would mean the Authority would still have refinancing risk in later years.]. If required, the Authority will repay the LOBO loans with available cash or by borrowing from other local authorities or the PWLB.

Other Debt Activity

Although not classed as borrowing, the Authority previously raised capital finance to afford Glan Usk School and the Southern Distributor Road. The Accounts for 2023-24 show an outstanding liability of £36m to pay to the operator.

Treasury Investment Activity

The CIPFA Treasury Management Code now defines treasury management investments as those investments which arise from the Authority'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 Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the half year, the Authority's investment balances ranged between £11.6 and £68.1 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.03.24 Balance £m	Movement £m	30.09.24 Balance £m	30.09.24 Income Return %	30.09.24 Weighted average maturity Years
Banks & building societies (unsecured)	-	-	-		
Government (incl. local authorities)	(3.7)	(28.1)	(31.8)	5.2	0.7
Money Market Funds	-	-	-		On Call
Covered Bonds	(10.0)	-	(10.0)	5.0	0.0
Accrued Interest	(0.3)	0.3	-		
Total investments	**(13.9)**	**(27.9)**	**(41.8)**	**5.0**	**0.8**

As demonstrated by the liability benchmark in this report, the Authority 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.

Bank Rate increased by 1%, from 4.25% at the beginning of April to 5.25% by the end of September. Short-dated cash rates rose commensurately, with 3-month rates rising to around 5.25% and 12-month rates to nearly 6%. The rates on DMADF deposits also rose, ranging between 4.8% and 5.4% by the end of June and Money Market Rates between 4.1 and 5.2%.

The £10m that is available for longer-term investment is invested in covered bonds, which has been maintained since the last report and no change is expected in the medium term.

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

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.

Non-Treasury Investments

The definition of investments in the Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority 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 Authority also held investments in

- directly owned property such as office and commercial units of £10.6m
- loans to developers £10.3m
- shareholding in subsidiaries £0.3m

These investments generated £1.02m in 2023/24 of investment income for the Authority after taking account of direct costs.

Compliance

The Head of Finance reports that all treasury management activities undertaken during the quarter complied fully with the principles in the Treasury Management Code and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in Table 7 below.

Table 7: Investment Limits

Sector	**Time limit**	**Counterparty limit**	**Sector limit**	**30.09.24 Actual**	**Complied? Yes / No**
The UK Government	50 years	Unlimited	n/a		Yes
Local authorities & other government entities	25 years	£10m	Unlimited	31.8	Yes
Secured investments *	25 years	£10m	Unlimited		Yes
Banks (unsecured) *	13 months	£5m	Unlimited	10.0	Yes
Building societies (unsecured) *	13 months	£5m	£10m		Yes
Registered providers (unsecured) *	5 years	£5m	£25m		Yes
Money market funds *	n/a	£10m	Unlimited		Yes
Strategic pooled funds	n/a	£10m	£25m		Yes
Real estate investment trusts	n/a	£10m	£25m		Yes
Other investments *	5 years	£5m	£5m		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

	2024/25 Maximum	**30.09.24 Actual**	**2024/25 Operational Boundary**	**2024/25 Authorised Limit**	**Complied? Yes / No**
Borrowing	157.2	157.2	165	259	Yes
PFI and Finance Leases	84.2	84.7	92	92	Yes
Total debt	**241.4**	**241.9**	**257**	**351**	

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

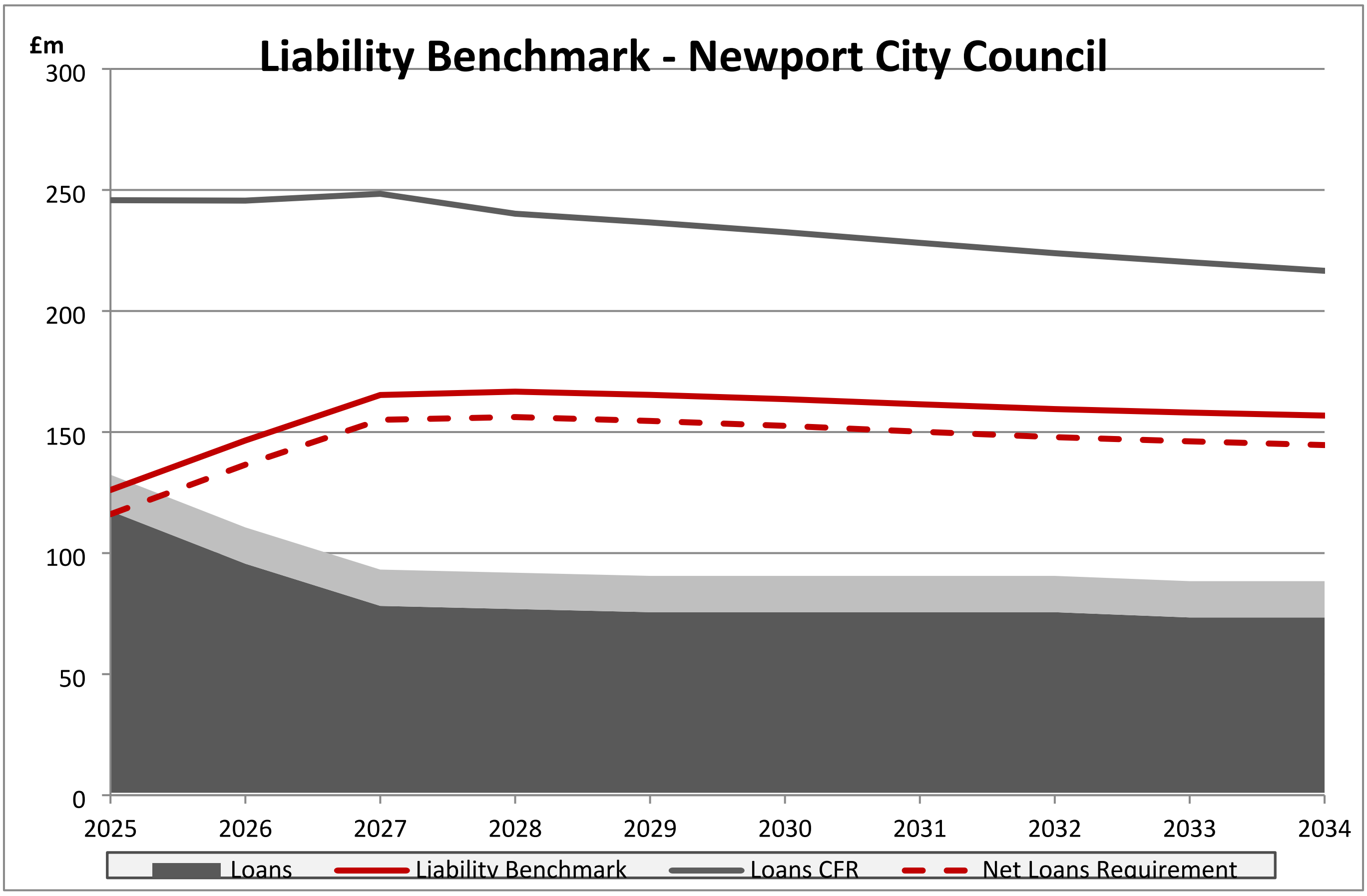
As required by the 2021 CIPFA Treasury Management Code, the Authority monitors and measures the following treasury management prudential indicators.

1. 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 £10m 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	246.0	245.6	248.4	244.4
Less: Balance sheet resources	-123.6	-109.1	-102.4	-98.7
Net loans requirement	122.4	136.5	146.1	145.7
Plus: Liquidity allowance	10	10	10	10
Liability benchmark	**132.4**	**146.5**	**156.1**	**155.7**
Existing borrowing	**-137.2**	**-159.3**	**-135.4**	**-130.9**

Following on from the medium-term forecast above, the long-term liability benchmark assumes no new capital expenditure funded by borrowing until 2027/28 (other than that already approved as part of the Capital Programme or contained within the existing capital headroom), minimum revenue provision on new capital expenditure based on a 25 year asset life and income, expenditure and reserves all increasing by inflation of 2.5% p.a. This is shown in the chart below together with the maturity profile of the Authority'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 Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	30.09.24 Actual	**Upper limit**	**Lower limit**	**Complied**
Under 12 months	35%	60%	0%	Yes
12 months and within 24 months	5%	40%	0%	Yes
24 months and within 5 years	10%	40%	0%	Yes
5 years and within 10 years	19%	40%	0%	Yes
10 years and within 20 years	12%	40%	0%	Yes
20 years and within 30 years	3%	30%	0%	Yes
30 years and within 40 years	12%	30%	0%	Yes
40 years and within 50 years	0%	20%	0%	Yes
50 years and above	3%	20%	0%	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 Authority'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
Limit on principal invested beyond year end	£10m	£10m	£10m
Actual principal invested beyond year end	£10m	£10m	£10m
Complied?	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.

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. Bank Rate was maintained at 5% at 30th September.

Interest rate risk indicator	**Limit**	**30.09.24 Actual**	**Complied**
Upper limit on one-year revenue impact of a 1% rise in interest rates	£250,000	227,241	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	£150,000	-137,241	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.