EXECUTIVE **27 AUGUST 2024**

SUBJECT:	**TREASURY MANAGEMENT AND PRUDENTIAL CODE – QUARTERLY UPDATE**
DIRECTORATE:	**CHIEF EXECUTIVE & TOWN CLERK**
REPORT AUTHOR:	**LAURA SHIPLEY, FINANCIAL SERVICES MANAGER**

1. Purpose of Report

1.1 The purpose of this report is to summarise and review the Council's treasury management activity and the prudential indicators at 30 June 2024.

1.2 CIPFA's Code of Practice for Treasury Management (2021) recommends that Elected Members should be informed of the Council's Treasury Management activities on a quarterly basis. This report, therefore, ensures this Council is embracing best practice for the scrutiny of capital and investment activity in accordance with the Code of Practice (CIPFA).

2. Executive Summary

2.1 The Treasury Management position and performance results for the 3 months ended 30th June 2024 are set out in the body of the report & Appendix A (prudential Indicators).

2.2 Officers can confirm that the approved limits within the Annual Treasury Management Strategy were not breached during the quarter ended 30 June 2024

3. Background

3.1 The prudential system for capital expenditure is well established. One of the requirements of the Prudential Code is to ensure adequate monitoring of the capital expenditure plans, prudential indicators (PIs) and treasury management response to these plans. This report fulfils that requirement and includes a review of compliance with Treasury and Prudential Limits and the Prudential Indicators at 30 June 2024. The current Treasury Management Strategy and Prudential Indicators were approved by Council on 27 February 2024.

3.2 The Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector and operates its treasury management service in compliance with this Code and the above requirements. These require that the prime objective of treasury management activity is the effective management of risk, and that its borrowing activities are undertaken in a prudent, affordable and sustainable basis.

3.3 This report highlights the changes to the key prudential indicators, to enable an overview of the current status of the capital expenditure plans. It incorporates any new or revised schemes previously reported to Members. Changes required to the residual prudential indicators and other related treasury management issues are also included.

4. Treasury Management Update

4.1 Investment Portfolio

4.1.1 The Council held £18.760m of investments as at 30 June 2024 achieving an average interest rate of 5.30% (5.11% 23/24). Actual interest earned in the 3 months period to 30 June 2024 totalled £302k.

4.1.2 Forecast interest income for the year is £0.891m (£0.356m General Fund & £0.565m HRA), an overachievement of income of £0.230m against the £0.661m budget.

4.1.3 As at 30 June 2024, 84% of the Council's investment portfolio was held in low risk specified investments, the requirement for the year being a minimum of 25% of the portfolio to be specified investments. The remaining 16% of the portfolio was held in non-specified investments (with other local authorities).

4.1.4 Where possible the Council seeks sustainable investments and are working with our advisors on the best way to score banks and funds ESG ratings, whilst balancing this against generating returns that are in the best interest of the tax payer.

4.1.5 Liquidity – The Council seeks to maintain liquid short-term deposits of at least £5m available with a week's notice, and has maintained a balance above this throughout the quarter. At 30 June 2024, the Council held liquid short term deposits of £9.760m

4.1.6 Security - The Council's maximum security risk benchmark for the portfolio as at 30 June 2024 was 0.005%, based on the historic risk of default of the counterparties and types of accounts in which the council's funds are place – this equates to a potential loss of £0.001m on an investment portfolio of £18.760m. This represents a very low risk investment portfolio.

4.1.7 Yield – The Council achieved an average return of 5.30% on its investment portfolio for the 3 months ended 30 June 2024. This is comparable to the average SONIA rate for the quarter, of 5.20%.

4.1.8 The table below highlights the level of investment activity and the rates obtained as at 30 June 2024. Investments were made in line with Link's approved counterparty list.

INVESTMENTS	PRINCIPAL £	RATE %	PERIOD DAYS
Babergh District Council	3,000,000	5.75	364
Goldman Sachs	2,000,000	5.34	91
SMBC Bank International Plc	2,000,000	5.33	92
SMBC Bank International Plc	2,000,000	5.30	92
Total Fixed Short term Investments	**9,000,000**		
Aberdeen Standard Liquidity Fund	1,156,000	5.23	Call
BNP Paribas Insticash Sterling	7,000,000	5.26	Call
Federated Short-Term Sterling Prime Fund	1,604,000	5.23	Call
Total Money Market Fund Investments	**9,760,000**		
Total Investments / Average Rate	**18,760,000**	5.35	

4.2 Borrowing

4.2.1 In accordance with the Local Government Act 2003, the Council has a statutory duty to determine and keep under review how much it can afford to borrow. Therefore, the Council establishes 'Affordable Borrowing Limits' (or Authorised Limit) as part of the Prudential Indicators within the approved treasury management strategy.

4.2.2 The 'authorised limit' and 'operational boundary' indicators govern the maximum level of external borrowing to fund the capital programme and short-term cash flow. See Appendix A.

4.2.3 At 30 June 2024, the Council held £107.406 million of external borrowing, of which 100% were fixed rate loans (See table below).

Borrowing Type	Lender	Outstanding Loans (£)	No Of Loans	Ave Rate %
PWLB	PWLB	95,405,738	32	3.55
LA Borrowing	North Kesteven District Council	2,000,000	1	2.05
Market Loans	Barclays	10,000,000	4	4.24
Total/ Ave Rate		**107,405,738**	**37**	**3.59**

4.3 Treasury Indicators

4.3.1

Maturity structure of fixed rate borrowing	Upper Limit %	Lower Limit %	Actual %	Estimated position 31/03/25 £'000
Under 12 months	40%	0%	1%	1,578
12 months to 2 years	40%	0%	0%	0
2 years to 5 years	60%	0%	9%	9,552
5 years to 10 years	80%	0%	11%	11,952
10 years and above	100%	10%	79%	85,486
Total				**108,568**

Limits for long-term treasury management investments	£7m

4.3.2 As at 30 June 2024, the average rate of interest paid during the first quarter of the year on external borrowing was 3.26%.

4.3.3 As part of the Treasury Management Strategy, the Council established a range of Prudential Indicators (in accordance with professional practice) to monitor both Treasury and Capital as the two are intrinsically linked. Details of the performance against the Prudential Indicators can be found at Appendix A. See comments below.

i. Capital Expenditure – Appendix A shows the revised estimates for capital expenditure that have been approved by or are subject to approval since the Council approved the original budget in February 2024.

ii. The Capital Financing Requirement (CFR) – Appendix A shows the Capital Financing Requirement, which is the Council's underlying need to borrow for a capital purpose. It also shows the expected debt position over the period (Operational Boundary).

iii. Financing costs to net revenue stream – improved position anticipated due to reprofiling and deferring forecast borrowing, utilising internal funds.

iv. Actual External Debt – Currently forecasting actual external debt at year end to be in line with the original budget, albeit additional borrowing pushed to the end of the financial year. The need for borrowing will be continuously monitored in line with the Councils cashflow and spending requirements.

4.3.4 The Council is currently under-borrowed against the CFR, and whilst the Council has adequate cash balances it employs internal resources until cash flow forecasts indicate the need for additional borrowing or rates are available that reduce the cost of carrying debt. PWLB borrowing offers preferential rates when compared with market loans, with higher discounts for those with a Housing Revenue Account. Bank of England base rates have increased during the last couple of years and forecasts show that they will remain elevated in comparison with what we have seen over the last decade or so with slight reductions forecast towards the back end of the year.

4.3.5 Following a demand for an increased rate, a LOBO loan of £1.5m was repaid during Q4 of 2023/24. Due to the current high cost of borrowing this loan has not yet been replaced. Available resources and interest rates will continue to be monitored to assess the need for further borrowing / reborrowing.

4.3.6 The HRA borrowing requirement is considered independently from that of the General Fund. Further borrowing is anticipated and will be reported as part of the MTFS and Treasury Management Strategy.

4.4 Economic Update

The current economic update from the Council's treasury advisors (LINK) can be found in Appendix B.

5. Strategic Priorities

5.1 One Council

Through its Treasury Management Strategy, the Council seeks to reduce the amount of interest it pays on its external borrowing and maximise the interest it achieves on its investments.

6. Organisational Impacts

6.1 Finance

The financial implications are covered in the main body of the report.

6.2 Legal Implications including Procurement Rules

The powers for a local authority to borrow and invest are governed by the Local Government Act 2003 (LGA 2003) and associated Regulations. A local authority may borrow or invest for any purpose relevant to its functions, under any enactment, or for the purpose of the prudent management of its financial affairs. The Regulations also specify that authorities should have regard to the CIPFA Treasury Management Code and the DLUCH Investment Guidance when carrying out their treasury management functions.

6.3 Equality, Diversity and Human Rights

The Public Sector Equality Duty means that the Council must consider all individuals when carrying out their day-to-day work, in shaping policy, delivering services and in relation to their own employees.

It requires that public bodies have due regard to the need to:

- Eliminate discrimination;
- Advance equality of opportunity;
- Foster good relations between different people when carrying out their activities.

Due to the nature of the report, there are no direct equality, diversity, or human rights implications.

7. Risk Implications

7.1 The Local Government Act 2003, the Prudential Code and the Treasury Management Code of Practice include a key principle that an organisations appetite for risk is included in their annual Treasury Management Strategy and this should include any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and liquidity when investing.

8. Recommendation

8.1 The Executive are asked to note the Prudential and Treasury Indicators and the actual performance against the Treasury Management Strategy 2024/25 for the quarter ended 30 June 2024.

Is this a key decision?	No
Do the exempt information categories apply?	No
Does Rule 15 of the Scrutiny Procedure Rules (call-in and urgency) apply?	No
How many appendices does the report contain?	Two
List of Background Papers:	Treasury Management Strategy 2024/25 (Approved by Council February 2024)
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Appendix A

PRUDENTIAL INDICATORS

Indicator No.	Indicator	2024/25 Original Estimate (OE) £'000	2024/25 OE inc. Year End Adj 's £'000	2024/25 Q1 Revised Estimate £'000
1 & 2	Capital Expenditure - General Fund	17,527	23,151	23,455
1 & 2	Capital Expenditure - HRA	21,043	22,763	17,650
	Capital Expenditure Total	**38,570**	**45,914**	**41,105**
3 & 4	Capital Financing Requirement (CFR) - General Fund	76,810	76,701	76,701
3 & 4	Capital Financing Requirement (CFR) - HRA	79,913	80,278	80,261
	Capital Financing Requirement Total	**156,723**	**156,979**	**156,962**
5	Estimated Actual External Debt (As at 31st March 2025)	113,017	113,017	108,568
6	Gross Debt and the CFR – Under Borrowing	(43,706)	(43,962)	(43,945)
7	Authorised Limit for External Debt	130,165	130,773	128,593
8	Operational Boundary for External Debt	124,217	124,217	124,217
9 &10	Financing Costs to Net Revenue Stream - General Fund	15.39%		13.59%
9 &10	Financing Costs to Net Revenue Stream - HRA	28.79%		28.41%
Local 5	Net Income from Commercial and Service Investments to Net Revenue Stream	10.45%		10.53%

Glossary Of Terms

The Authorised Limit – This represents the limit beyond which borrowing is prohibited and needs to be set and revised by members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

The Operational Boundary – This indicator is based on the probable external debt during the course of the year; it is not a limit and actual borrowing could vary around this boundary for short times during the year. CIPFA anticipate that this should act as an indicator to ensure the authorised limit is not breached.

Appendix B

Economic Update from LINK (the Council's treasury advisors)

- The first quarter of 2024/25 saw:
  - GDP growth flatlining in April following positive Q4 2023/24 growth figures of 0.7% q/q.
  - A stalling in the downward trend in wage growth, with the headline 3myy rate staying at 5.9% in April.
  - CPI inflation falling from 2.3% in April to 2.0% in May.
  - Core CPI inflation decreasing from 3.9% in April to 3.5% in May.
  - The Bank of England holding rates at 5.25% in May and June.
  - 10-year gilt yields climbing to 4.35% in April, before closing out at 4.32% in May.
- The news that the economy grew by 0.7% q/q in Q4 2023/24 confirmed that it moved out of its very mild technical recession that prevailed at the back end of 2023. However, data released for April and May so far shows a slight stalling in the recovery, with GDP data for April coming out at 0.0% m/m, as inclement weather weighed on activity. Moreover, the fall in the composite Purchasing Manager Index output balance from 53.0 in May to 51.7 in June confirms tepid growth.
- On a more positive note, the 2.9% m/m increase in retail sales volumes in May more than reversed the 1.8% m/m drop in April as rainfall returned to seasonal norms. The strength was broad-based across the retail sector, including online, (+5.9% m/m) suggesting an underlying strengthening in sales beyond weather effects. With inflation falling back to target, Bank Rate likely to be reduced soon and with consumer confidence improving, retail sales may well continue to strengthen.
- Stronger consumer spending, as low inflation allows households' real incomes to strengthen and the drag from higher interest costs fades, suggests that real consumption will strengthen substantially over the next two years. However, investment will only make a modest contribution to GDP growth. With the industrial sector still 12% smaller than in 2019, excess capacity will continue to cap the need for industrial firms to invest. But improving business sentiment should raise investment by services' firms. Further, a fall in mortgage rates should trigger a recovery in residential investment. Overall, strong consumer spending is likely to be the backbone of GDP growth, along with government consumption. Our colleagues at Capital Economics forecast that following GDP growth of 1.0% in 2024, activity will continue to surprise to the upside with GDP growth of 1.5% for both 2025 and 2026 (consensus forecasts are 1.2% and 1.4% respectively).
- Nonetheless, the on-going stickiness of wage growth in April will be a lingering concern for the Bank of England. The 3myy rate of average earnings growth stayed at 5.9% in April (consensus 5.7%), whilst the more timely 3m annualised rate rebounded from 5.9% to 9.3%. This stickiness partly reflected April's 9.8% increase in the minimum wage. This leaves the Bank of England's forecast for a fall back in regular private sector pay growth from 5.8% in April to 5.1% in June looking a challenge.
- Despite the stickiness of wage growth in April, sharp falls in employment and a move up in unemployment suggests that wage growth will soon be back on a downward path. The 139,000 fall in employment in the three months to April was accompanied by a rise in the unemployment rate from 4.3% to 4.4%. This was the fourth increase in a row and took it

to its highest level since September 2021. The rise would have been larger were it not for the 132,000 increase in inactivity in the three months to April as the UK's disappointing labour market participation performance since the pandemic continued. The vacancies data also paint a picture of a slowly cooling labour market. The number of job vacancies fell from an upwardly revised 908,000 to 904,000, leaving vacancies 31% below the peak in May 2022, but 11% above the pre-pandemic level.

- The fall in CPI inflation in May back to the Bank's 2% target for the first time since July 2021 will have come as welcome news to the Bank. Furthermore, with CPI inflation of 3.3% in the US and 2.6% in the Euro-zone in May, the UK appears to have won the race to get CPI inflation back to 2.0%. A further easing in food inflation from 2.8% in April to 1.6% in May played a part in the fall in overall CPI inflation and with food producer price inflation at just 0.2% in May, food price inflation will probably soon fall to zero.
- The core rate also fell back from 3.9% to 3.5%. Within that, core goods CPI inflation slipped below zero for the first time since October 2016. As expected, clothing/footwear, recreation/culture and restaurants/hotels categories inflation declined, reflecting base effects from big increases last May. While services inflation fell from 5.9% to 5.7%, this decline was smaller than the Bank of England expected (forecast 5.3%). And the timelier three-month annualised rate of services prices has rebounded from 8.5% to 9.2%. This suggests that the persistence in domestic inflation that the Bank is worried about is fading more slowly than it thought. Even so, there is scope for inflation to fall further.
- There was little chance that the Bank would cut rates at its June meeting, given upside surprises on services CPI inflation and wage growth. But several developments implied a rate cut is getting closer (August?). First, two members of the MPC, Ramsden and Dhingra voted again to reduce rates immediately to 5.00%. Second, despite the recent run of stronger inflation and activity, the minutes noted "indicators of inflation persistence had continued to moderate" and that a range of indicators suggest pay growth had continued to ease. And there was new wording that members of the MPC will consider all the information available and how this affects the assessment that the risks from inflation persistence are receding "as part of the August forecast round."
- Throughout the quarter there was a degree of volatility in the gilt market and, by way of example, the 10-year gilt yield rose from 4.05% on 2nd April to finish at 4.15% on 28th June but it has exceeded 4.30% on several occasions. Overall, investors judged that interest rates will need to remain high for longer to keep inflation around the 2.0% target.
- Meanwhile, the FTSE 100 broke through the 8,000 mark in April for the first time since its brief three-day flutter in February last year and reached a record closing high of 8,446 on 15th May. However, by the end of the quarter, despite AI-fuelled rises in the US S&P500, it finished rather tamely and had fallen back to 8,164. Arguably, significant interest rate cuts and an on-going UK economic recovery will be required for a further resurgence to take hold.

MPC meetings 9th May and 20th June 2024

- On 9th 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.
- Nonetheless, with UK CPI inflation now back at 2% and set to fall further over the coming months, Ramsden and Dhingra – who voted again to reduce rates immediately to 5.00% in June – may shortly be joined by some members in the no-change camp, for whom the June decision was "finely balanced" as the upside news on services price inflation was

more likely to be a reflection of one-off effects and volatile components rather than factors that would push up "medium-term inflation".

Interest rate forecasts

The Council has appointed Link Group as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. 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. For Housing Revenue Account authorities, the lower Housing Revenue Account (HRA) PWLB rate has also been available since 15 June 2023 (standard rate minus 60 bps) but is available for HRA borrowing only.

The latest forecast, updated on 28th May, sets out a view that both short and long-dated interest rates will start to fall once it is evident that the Bank of England has been successful in squeezing excess inflation out of the economy, despite a backdrop of a stubbornly robust economy and a tight labour market.

Moreover, whatever the shape of domestic data, recent gilt market movements have been heavily influenced by the sentiment pertaining to US monetary policy. Again, inflation and labour data has proven sticky and the market's expectation for rate cuts has gradually reduced throughout the course of the year, so that possibly rates may not be cut more than once, or possibly twice, before the end of 2024. In any event, even if the Bank of England starts to cut rates first, it may mean that the medium and longer parts of the curve take longer to fully reflect any such action until the US yield curve shifts lower too. Given the potential inflationary upside risk to US treasuries if Trump wins the presidential election in November (increased tariffs on imports from China for example), therein lies a further risk to yields remaining elevated for longer.

Closer to home, the General Election is not expected to have a significant impact on UK monetary policy. There is minimal leeway for further tax cuts or added spending without negatively impacting market sentiment. It may even be the case that the Bank of England will steer clear of an August rate cut – should that be supported by the inflation data – in favour of weighing up fiscal policy implications and market sentiment in the aftermath of the election.

Accordingly, Link's central case is still for a rate cut before the end of September, but we are not committed to whether it will be in August or September. Thereafter, the path and speed of rate cuts is similar to that which we previously forecast, with Bank Rate eventually falling to a low of 3% by H2 2026.

However, given the increased uncertainty surrounding Link's central gilt market forecasts, and the significant issuance that will be on-going from several of the major central banks, it has marginally increased its PWLB forecasts by c20 to 30 basis points across the whole curve since the previous quarter.

In summary, regarding PWLB rates, movement in the short-end of the curve is expected to reflect Link's Bank Rate expectations to a large degree, whilst medium to longer-dated PWLB rates will remain influenced not only by the outlook for inflation, domestically and globally, but also by the market's appetite for significant gilt issuance (£200bn+ for each of the next few years). As noted at the Link March Strategic Issues webinars, there is upside risk to that part of our forecast despite the Debt Management Office skewing its issuance to the shorter part of the curve.

Link Group Interest Rate View	28.05.24											
	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	5.25	5.00	4.50	4.00	3.50	3.25	3.25	3.25	3.25	3.00	3.00	3.00
3 month ave earnings	5.30	5.00	4.50	4.00	3.50	3.30	3.30	3.30	3.30	3.00	3.00	3.00
6 month ave earnings	5.30	4.90	4.40	3.90	3.50	3.30	3.30	3.30	3.30	3.10	3.10	3.20
12 month ave earnings	5.10	4.80	4.30	3.80	3.50	3.40	3.40	3.40	3.40	3.20	3.30	3.40
5 yr PWLB	4.90	4.70	4.50	4.30	4.10	4.00	3.90	3.90	3.90	3.90	3.90	3.80
10 yr PWLB	5.00	4.80	4.60	4.40	4.30	4.10	4.10	4.10	4.00	4.00	4.00	3.90
25 yr PWLB	5.30	5.20	5.00	4.80	4.70	4.50	4.50	4.40	4.40	4.40	4.30	4.30
50 yr PWLB	5.10	5.00	4.80	4.60	4.50	4.30	4.30	4.20	4.20	4.20	4.10	4.10

- Money market yield forecasts are based on expected average earnings by local authorities for 3 to 12 months.

The Link forecast for average earnings are averages i.e., rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short-term cash at any one point in time.

NOTE

The economic update above was provided by the Council’s advisors early July, prior to the reduction in the Bank of Englas Base rate reduction on 1st August 2024 (from 5.25% to 5%).

Rate reductions were expected due to inflation dropping down to more manageable levels. The council’s investment income forecast has prudently accounted for reductions in the base rate.