Cheltenham Borough Council

Cabinet – 26th November 2024/Council 16th December

2024/25 Treasury Mid-term Report

Accountable member:

Cllr Alisha Lewis – Cabinet Member for Finance and Assets

Accountable officer:

Gemma Bell - Director of Finance and Assets (Deputy Section 151 Officer)

Accountable scrutiny committee:

Treasury Management Panel

Ward(s) affected:

All

Key/Significant Decision:

No

Executive summary:

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the treasury management activities for the first six months of this financial year and highlights compliance with the Council's policies previously approved by members in March 2024. The Treasury Management Strategy for 2024/25 has been determined by the adoption of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the council to approve treasury management semi-annual and annual reports.

Recommendation: That Cabinet:

1. **notes the contents of this summary report of the treasury management activity during the first six months of 2024/25.**

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1. Implications

1.1 Financial implications

As detailed throughout this report.

Signed off by: Gemma Bell, Director of Finance and Assets (Deputy s151 Officer), 01242 264124

1.2 Legal implications

None arising from the report recommendations.

Signed off by: One Legal legalservices@onelegal.org.uk

1.3 HR implications

None arising from the report recommendations.

Signed off by:

1.4 Environmental and climate change implications

The Council does have some exposure to investments in a pooled fund which has shares with oil and gas companies. This is detailed in Section 5.9 of the report. As a responsible investor, the Council is committed to considering environmental, social, and governance (ESG) issues, and has a particular interest in taking action against climate change and pursuing activities that have a positive social impact.

Signed off by: Louise Forey, Climate Emergency Programme Officer, 01242 264297

1.5 Property/asset implications

None specific directly arising from the recommendations.

Signed off by: Gemma Bell, Director of Finance and Assets, 01242 264124

1.6 Corporate policy framework implications

Taking action to ensure overspends are reduced as far as possible by the end of the financial year will help ensure that the council can continue to deliver its corporate objectives as set out in the 2019-2023 Corporate Plan.

Signed off by: Richard Gibson, Head of Communities, Wellbeing and Partnerships, 01242 264280

2. Economic Background

2.1 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.

2.2 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.

2.3 Arlingclose, the authority's treasury adviser, maintain its central view that Bank Rate would steadily fall from the 5.25% peak, with the first cut in August being followed by a series of further cuts, with November 2024 the likely next one, taking Bank Rate down to around 3% by the end of 2025.

2.4 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.

2.5 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%.

Credit review

2.6 The Council's treasury advisors Arlingclose maintained its advised recommended maximum unsecured duration limit on all banks on its counterparty list at 100 days.

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

3 Treasury Management Summary position as of 31st March 2024

3.1 On 31st March 2024, the Authority had net borrowing of £179.399m 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 usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.24 Actual £m
General Fund CFR	130.309
HRA CFR	73.341
Total CFR	**203.650**
External borrowing	201.326
- General Fund borrowing	*121.948*
- HRA borrowing	*79.378*
Less : Internal borrowing	(2.324)
Less: Balance sheet resources	(21.927)
Net borrowing	**179.399**

Borrowing

3.2 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.

3.3 PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield and this Council intends to avoid this activity in order to retain its access to PWLB loans.

3.4 The Council currently holds £39.222m in commercial investments primarily for financial return that were purchased prior to the change in the CIPFA Prudential Code.

3.5 As outlined in the treasury strategy, the Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective. The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

3.6 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.

3.7 With short term borrowing rates averaging 5.40% for the first six months of this financial year, a decision was made on 24th September to replace £5m of General Fund temporary debt with a 10 year PWLB annuity loan at the rate of 4.30% to help reduce the burden of high interest costs. The following day we replaced a further £15m of HRA temporary debt with a 5 ½ year PWLB Maturity loan at the rate of 3.97%. The PWLB HRA rate which is 0.4% below the certainty rate which the General Fund receives is available up to June 2025. This discounted rate is to support local authorities borrowing for the Housing Revenue Account and for refinancing existing HRA loans. Further opportunities to replace temporary debt with long term debt will be carried out as and when they arise.

3.8 On the 30th of September the Council held £200.761m of loans, a decrease of £565k compared to 31st March 2024. Outstanding loans on 30th September are summarised in table 2 below.

Table 2: Treasury Management Summary

	31.3.24 Balance £m	Movement £m	30.9.24 Balance £m	30.9.24 Rate %
Long-term Borrowing - GF	81.153	2.835	83.988	3.01
Long-term Borrowing - HRA	53.773	15.000	68.773	3.66
Temp Borrowing – GF	40.794	(13.390)	27.404	5.05
Temp Borrowing -HRA	25.606	(5.010)	20.596	5.05
Total borrowing	**201.326**	**(0.565)**	**200.761**	**3.82**
Long-term investments	16.927	0.538	17.465	5.71
Short-term investments	0.000	4.000	4.000	5.05
Cash and cash equivalents	5.000	0.348	5.348	5.02
Total investments	**21.927**	**4.886**	**26.813**	**5.27**
Net borrowing	**179.399**	**(5.451)**	**173.948**	

3.9. The balance as can be seen in Table 2 shows a reduced figure of £5.451m as of 30th September 2024 compared with the balance held on 1st April 2024 due to the repayment of principal annuity loans of over £1m, a reduction in capital spends of £1.6m between April and September 2024 compared to the same period in 2023 and cashflow balances being higher at 30th September 2024 compared with last year.

3.10 Short-term borrowing costs have started to fall since the start of the financial year where rates were close to 7% but since the first Base Rate reduction in August, the shorter term rates reverted to generally around 5%. Arlingclose predict interest rates to fall over the next 6 months to 4.50% or even lower. For the first half of this financial year the Council has borrowed an average of £61.188m at a rate of 5.40%. As at the September 2024 the amount of short term debt was reduced by £25m by replacing it with PWLB Long term debt.

3.11. The Housing Revenue Account (HRA) will re-imburse the General Fund for their share of the debt costs, which will see a re-alignment to the revised budget for 2024/25.

3.12. The outstanding loans on 30th September 2024 are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.24 Balance £m	2024/25 Movement £m	30.9.24 Balance £m	30.9.24 Rate %
PWLB- GF	81.539	5.000	86.539	2.97
PWLB- HRA	39.487	12.835	52.322	3.61
Banks (LOBO)- GF	1.519	0	1.519	3.95
Banks (LOBO) - HRA	3.481	0	3.481	3.95
Banks (fixed-term) -GF	8.900	0	8.900	3.85
LA's (short-term) – GF	40.794	(13.390)	27.404	5.05
LA's (short-term) - HRA	25.606	(5.010)	20.596	5.05
Total borrowing	**201.326**	**(0.565)**	**200.761**	**3.81**

3.13. LOBO loans: The Council currently holds £5m 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 Council has the option to either accept the new rate or to repay the loan at no additional cost.

4 Investments

4.1 The CIPFA Treasury Management Code now defines treasury management investments as those investments which arise from the Council's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use during business.

4.2 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held and money borrowed in advance of need. During the six-month period the council's investment balance ranged between £15m and £30m due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.24 Balance £m	**Net Movement £m**	**30.9.24 Balance £m**	**30.9.24 Rate of Return %**
Money Market Funds/ Call Accounts	5.000	0.348	5.348	5.02
Local Authority Fixed Deposit	0	4.000	4.000	5.05
Pooled Funds	7.000	-	7.000	4.86
Other investments	10.233	0.232	10.465	5.39
Total Investments	**22.233**	**4.580**	**26.813**	**5.23**

4.3 Both the CIPFA Code and Government Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment.

4.4 As demonstrated by the liability benchmark in this report, the Council expects to be a long-term borrower and new 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.

4.5 The first six months of 2024/25 were marked by ongoing market volatility, with global bond yields remaining elevated, although trending downward as policymakers kept rates at a restrictive level in light of persistent core inflation until nearly the end of the period, when the MPC, Federal Reserve, and ECB began to deliver rate cuts and signal a shift towards loosening monetary policy.

4.6 After a sustained period of high interest rates, central banks began to reverse course towards second half of the year. The European Central Bank began to cut rates in June, the Bank of England delivered its first rate cut in August, and the Federal Reserve surprised markets with an outsized rate cut of 50bps in September. The stabilisation in interest rates and well telegraphed move towards rate cuts, albeit at a much more conservative pace than previously expected, has allowed fund managers to position for a falling rate environment. This in turn has led to some improvement in capital values of the Council's longer-dated bond funds during the six-month period and, to a lesser extent, the multi-asset funds.

4.7 UK commercial property values started to stabilise, then improve slightly towards the end of the period, with interest rates being cut from their peak and investor attention turning to the timing of further interest rate cuts. Transaction activity remains somewhat subdued but signs of recovery in the occupier and rental markets as well as moderate economic growth and further falling interest rates are hoped to be favourable for an improving property sector outlook over the medium term. Capital growth is expected to be gradual while income levels remain strong for many sub-sectors

4.8 £7m of the Council's investments are held in externally managed strategic pooled equity, multi-asset and property funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds have generated an average total return of 4.86% for the first 6 months of this financial year which is used to support services in year. Because the Council's externally managed funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rate.

4.9 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. The Council may need to set aside a reserve to mitigate the impact of the statutory override not being extended and unrealised losses on pooled investment funds are required to be recognised.

4.10 Table 5: Pooled Funds

FUND NAME	Initial Investment	1 April 2024 Fund Value	30th Sept 24 Fund Value	Dividends paid out in 2024/25 as at 30 Sept	Gain / (Loss) for 2024/25	% Returns For 2024/25	Gain / (Loss) to Initial Principal
	£	£	£	£	£	%	£
CCLA Property Fund	3,000,000	2,599,133	2,630,635	68,590	31,502	4.57	(369,365)
Schroders Income Maximiser Fund *	2,000,000	1,535,497	1,615,345	68,457	79,848	6.85	(384,655)
CCLA BW Cautious Fund	2,000,000	1,977,682	1,975,010	35.408	(2,672)	3.54	(24,990)
Total	**7,000,000**	**6,112,312**	**6,220,990**	**172,455**	**108,678**	**4.93**	**(779,010)**

* The Schroders Income Maximiser Fund has purchased shares within the oil and gas industry, which accounts 3.04% of the total amount invested in the fund (6.01% Sept 2023). This equates to £60,800 of the original £2m invested into the fund by this council (£120,200 Sept 2023). The Fund Manager is looking to ease out of investing within the oil and gas industries which has reduced from 14% in September 2021. The dividend returns are currently returning over 6.73% for the first half of this financial year. There are no plans at present to sell this investment as the fund is valued below the initial investment, which would need to be funded by revenue. As opportunities to support the

climate ambitions of the Council arise, they will be considered. However, the treasury management function is controlled by statute and by professional guidelines and the first priorities of treasury must remain security, liquidity, and yield.

Economic Outlook for the rest of 2024/2025

4.11 Table 7: Interest rate forecast

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

4.12 The move from a seemingly stable global outlook through the summer until mid-September has been replaced by more uncertainty. While the economic growth outlook appears to have improved, which makes the path for interest rates less clear, the uncertainty may largely stem from upcoming political events that could have significant consequences for growth, inflation, fiscal and monetary policy. Recent movements in gilt yields represent investors seeking compensation for the less certain outlook for interest rates

4.13 The next MPC meeting is on 7th November, and it is expected the Committee will vote for a further reduction in Bank Rate to 4.75% in line with Arlingclose's long-held interest rate view. They remain of the opinion that inflation will remain under control, with underlying measures, particularly services inflation, easing, amid a relatively tame growth environment, prompting the Bank of England to loosen monetary policy. At the same time, it also noted that the risks to their forecast for Bank Rate and gilt yields were weighted to the upside due to geo-political uncertainty, potentially higher fiscal spending, and resilient US economic growth.

4.14 The gilt market is likely to remain volatile after the UK Budget and the US Election have taken place, at which point there may be greater certainty over the interest rate path. Given the heightened volatility and potential for significant movements in yields, we should be ready to make treasury decisions in relatively short timeframes.

5 Compliance

5.1 The Director of Finance and Assets reports that all treasury management activities undertaken during the first six months of 2024/25 complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy.

Table 8: Debt Limits

	30.9.24 Actual £m	2024/25 Operational Boundary £m	2024/25 Authorised Limit £m	Complied? Yes/No
Total debt	**201.326**	***290.000***	**300.000**	Yes

5.2 Council approved in March 2024 the authorised borrowing limit and operational boundary limit are increased to the new levels as shown above in table 8. 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 Indicators

5.3 The Council measures and manages its exposures to treasury management risks using the following indicators.

5.4 **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	30.9.24 Actual	2024/25 Target	Complied?
Portfolio average credit rating	A+	A-	Yes

5.5 **Maturity Structure of Borrowing:** This indicator is set to control the Council's exposure to refinancing risk. This indicator covers the risk of replacement loans being unavailable, not interest rate risk. The upper and lower limits on the maturity structure of all borrowing were:

	30.9.24 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	16.89%	50%	0%	YES
12 months and within 24 months	8.18%	50%	0%	YES
24 months and within 5 years	6.51%	100%	0%	YES
5 years and within 10 years	23.83%	100%	0%	YES
10 years and above	44.59%	100%	0%	YES

5.6 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.

5.7 Liability Benchmark - This new indicator compares the Council'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 £m	31.3.25 Forecast £m	31.3.26 Forecast £m	31.3.27 Forecast £m
Loans CFR- GF	130.309	142.083	138.331	134.726
Loans CFR- HRA	73.341	90.385	108.296	138.153
Total Loans CFR	**203.650**	**232.468**	**246.627**	**272.879**
External borrowing	201.326	214.864	239.641	268.160
Internal (over) borrowing	2.324	17.604	6.986	4.719
Less: Balance sheet resources	(21.927)	(32.755)	(22.986)	(21.719)
Investments (new borrowing)	19.603	15.151	16.000	17.000
Net loans requirement	181.723	199.713	223.641	251.160
Plus: Liquidity allowance	10.000	10.000	10.000	10.000
Liability benchmark	**191.723**	**209.713**	**233.641**	**261.160**
Existing Net Borrowing	**179.399**			

6 Consultation

6.1 Arlingclose the Council's treasury advisors have supported officers in preparing the treasury activities over the first 6 months of this financial year.

7 Performance management – monitoring and review

7.1 The budget position will continue to be monitored by the Finance team throughout the year and a revised budget will be presented to the December Cabinet with the 2024/25 draft budget proposal.

Report author: Andrew Sherbourne, Treasury Management Accountant

Appendices:

1. Risk Assessment

Appendix 1: Risk Assessment

Risk ref	Risk description	Risk owner	Impact score (1-5)	Likelihood score (1-5)	Initial raw risk score (1 - 25)	Risk response	Controls / Mitigating actions	Control / Action owner	Deadline for controls/ actions
	LOBO Loans - If £5m of these loans is recalled by the banks if they choose to exercise their option then we would need to have the resources on the day to repay. Alternative borrowing arrangements at today's current rates would be favourable for the Council	Gemma Bell, Director of Finance and Assets	1	2	2	Accept and Monitor	If the loans are recalled the council could take out temporary borrowing/ new long term borrowing through the PWLB or sale of units held in Pooled Funds. Any capital receipts available could also be used to repay debt.	Gemma Bell, Director of Finance and Assets	Ongoing
	If the assumptions made within the strategies change, then the aspirations within the capital programme may become unaffordable	ED Finance and Assets	3	2	6	Accept and Monitor	The Treasury Management Strategy and Prudential and Treasury Indicators reflect various assumptions of future interest rate movements and Government support for capital expenditure. These will be continually monitored and any necessary amendments will be made in accordance with the Strategy	ED Finance and Assets	Ongoing
	If the assumptions made within the strategies change, then the projected returns and the return of the initial investments may not be	ED Finance and Assets	3	2	6	Accept and Monitor	The Treasury Management Strategy and Prudential and Treasury Indicators reflect various	ED Finance and Assets	Ongoing

Risk ref	Risk description	Risk owner	Impact score (1-5)	Likelihood score (1-5)	Initial raw risk score (1 - 25)	Risk response	Controls / Mitigating actions	Control / Action owner	Deadline for controls/ actions
	received.						assumptions of future interest rate movements and Government support for capital expenditure. These will be continually monitored and any necessary amendments will be made in accordance with the Strategy		
	If thorough due diligence is not undertaken when pursuing PRS schemes, the Council may not meet all of the criteria set out within its capital and investment strategies.	ED Finance and Assets	4	2	8	Accept & Monitor	Due diligence is of paramount importance. All of our investments have individual business cases that are subject to thorough risk assessment and stress testing and we also stress test the whole housing to ensure all risks are captured and properly controlled. Where appropriate to the size and scale of the project we also commission independent technical, legal, accounting, risk management, property, taxation advice	ED Finance and Assets	Ongoing