CABINET

DATE	11 December 2024
REPORT OF	Councillor Stephen Harness Portfolio Holder for Finance, Resources and Assets
RESPONSIBLE OFFICER	Sharon Wroot, Executive Director, Place & Resources
SUBJECT	Treasury H1 Outturn 2024-25
STATUS	Open
FORWARD PLAN REF NO.	CB 12/24/02

CONTRIBUTION TO OUR AIMS

Effective treasury management will provide support towards the achievement of Council Plan aims and objectives. Treasury management is an integral part of the Council's finances providing for cash flow management and financing of capital schemes. It therefore underpins all the Council's aims.

EXECUTIVE SUMMARY

The report contains details of treasury management arrangements, activity and performance during the 2024-25 financial year.

During the period covered, the Council complied with its legislative and regulatory requirements.

The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Prudential and Treasury Indicators	2024-25 Approved Budget £'m	H1 2024-25 £'m	Revised 2024-25 Estimate £'m
Capital Expenditure	128.8	19.0	98.1
Capital Financing Requirement	246.5	225.3	239.1
Authorised Borrowing Limit	250.0	250.0	250.0
Operational Boundary	220.0	220.0	220.0
External Borrowing	212.6	162.0	181.9
Investments >365 days	21.0	0.0	21.0

RECOMMENDATIONS

It is recommended that Cabinet:

1) Receives the report and notes the treasury management activity during 2024-25.
2) Refers the Report to Council for noting in accordance with statutory guidance.

REASONS FOR DECISION

The Council's treasury management activity is guided by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year with interim updates on performance against Prudential Indicators reported quarterly. We therefore report in full after Quarter 2 and year end with Prudential Indicators being reported additionally after Quarters 1 and 3 in the Council Plan Resources and Finance Report.

1. BACKGROUND AND ISSUES

1.1. CIPFA has defined 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.

1.2. The Treasury Management Strategy Statement (TMSS) for 2024-25 was developed in consultation with our treasury management advisors, Link Treasury Services Ltd. This statement also incorporates the Investment Strategy.

1.3 Whilst the Council has appointed advisors to support effective treasury management arrangements, the Council is ultimately responsible for its treasury decisions and activity. No treasury activity is without risk. The successful identification, monitoring and control of risk is therefore an important and integral element of treasury management activities.

1.4 The Council has nominated the Audit & Governance Committee as responsible for ensuring effective scrutiny of the treasury management arrangements.

1.5 Key points to note with specific regard to economic and Treasury activity during the period:

- Central Banks in most developed economies declare a tentative victory over inflation and move toward a more accommodative

monetary environment as they looked to support their respective economies along a hoped-for smooth glide path into a soft landing.
    - Short, medium and long-dated gilts (and therefore our future borrowing rates) have reduced as markets factored in an expectation of a series of rate cuts over the coming months.
    - Moderate growth in Q1 (+0.5%) stalled during Q2 with the economy stagnating in June and July. However, this is viewed as being indicative more of a mild slowdown rather than a sign of an impending sudden drop back into recession.
    - CPI inflation hitting its target in June before edging above it to 2.2% in July and August.

- A small amount (£0.225m) of long-term debt was repaid early during the period as the Authority sought to take advantage of peak rates to exit its more expensive historic debt (priced at 6%+) as efficiently as possible. Further debt rescheduling will continue to be considered if it can deliver (net) long-term savings.

- The continuation of restrictive policy by the Bank of England as it sought to contain inflation, led to strong investment returns but also meant that borrowing remained significantly more expensive than our portfolio average rate. As a result, a strategy of deferring long-term commitment through use of reserves and short-term borrowing arrangements was adopted.

- Higher investment returns, even with our cautious approach, has generated surplus income (above budget) of £0.471m during the period, and we are on course to generate of £1m of investment income during the full financial year which is available to fund frontline services.

- The Treasury Management Strategy covers the Council's treasury aims and principles. The Council also considers direct 'commercial' investments from time-to-time with the aim of generating financial return. Although reference is made to these types of investments in the TMSS' these transactions are guided and limited by the Capital Strategy document.

2. RISKS AND OPPORTUNITIES

2.1 No Treasury activity is without risk. Specific risks include, but are not limited to, Counterparty Credit Risk (the risk of an investment not being repaid), liquidity risk (the risk that the Authority does not have its funds in the right place, at the right time and in the right amount to make it's payments as they fall due), interest rate risk (the risk that future rate movements have a revenue implication for the Authority) and reputational risk (see Section 4 below).

2.2 The attached Appendices define our approach toward mitigating these risks.

2.3 Treasury is an Authority-wide function and therefore its environmental sustainability and equalities implications are the same as for the Council itself.

2.4 The Authority will have regard to the environmental and equality activities of its Counterparties (where reported) but

- Prioritises Security, Liquidity and Yield,
- Recognises that as large, global institutions our high-quality counterparties operate across the full range of marketplaces in which they are legally able to, and such exposures are small parts of their overall business.
- Excluding any one counterparty will likely mean others will similarly have to be avoided and thus impact the Authority's capacity to mitigate risk through diversification.

2.5 **General Data Protection Regulation 2018** – Relationships with external providers covered by the Treasury management Practices are governed by and operated in accordance with the Act.

3. OTHER OPTIONS CONSIDERED

These were set out on Page 29 of the Treasury Management Strategy Statement.

4. REPUTATION AND COMMUNICATIONS CONSIDERATIONS

As you would expect, with large sums of public money involved, any treasury activity carries a high degree of reputational risk. Any losses have not just financial but also significant, ongoing resource implications for the Council.

5. FINANCIAL CONSIDERATIONS

The report confirms that all investment and borrowing transactions were in line with the Approved 2024-25 Treasury Management Strategy. No changes to the Strategy were necessary during the 2024-25 financial year despite a volatile interest rate and geopolitical environment.

6. CHILDREN AND YOUNG PEOPLE IMPLICATIONS

As an Authority-wide corporate function, the immediate impacts of day-to-day Treasury operations on children and young people are the same as for the Council as a whole. However, certain Treasury decisions, most notably those relating to Long-Term Borrowing transactions, will place a greater burden on young residents, over time, relevant to other demographics.

7. CLIMATE CHANGE AND ENVIRONMENTAL IMPLICATIONS

7.1 In line with the Authority's declaration of a Climate Emergency, the S151 Officer will aim to assess and monitor, not just Environmental but all, Environmental, Social and Governance (ESG) factors when selecting investment options. Full assessment is however restricted by the fact that, at the time of writing, there is no consistent rating framework with which to measure and benchmark specific counterparty ESG metrics. Until this market data gap is fully resolved, our approach to managing the risks associated with the Environmental activities of our Counterparties is as follows:-

- As the Ratings Agencies headline ratings on our Counterparties now incorporate ESG risk assessments alongside more traditional financial risk metrics and so provide both an holistic risk measure and a proxy for ESG 'scoring' in the absence of anything more robust

- The Council will continue to Prioritise Security, Liquidity and Yield, in that order

- The Council recognises that as large, global institutions our high-quality counterparties operate across the full range of marketplaces in which they are legally able to, and as a result climate change considerations are an increasingly important and heavily-scrutinised part of their overall business.

- Excluding any one counterparty will likely mean others will similarly have to be avoided and thus impact the Authority's capacity to mitigate risk through diversification.

- The Council notes that bonds issued by Supranational institutions offer strong ESG credentials, combined with the explicit underwriting support of all major developed countries. This results in excellent ratings (typically AA+ - AAA) being applied. As such, the Council actively seeks exposure to these assets (commensurate with its investment horizon) and in doing so, contributes to market liquidity and therefore capital raising abilities of these bodies who then deploy that capital in ESG positive schemes.

8. CONSULTATION WITH SCRUTINY

This Report was taken to Audit and Governance Committee on 7 November 2024 and duly recommended to Cabinet.

9. FINANCIAL IMPLICATIONS

As set out in the appendix.

10. LEGAL IMPLICATIONS

There are no direct legal implications arising from the recommendations in this report which are not covered in the body of the report. The Council has complied with its statutory obligations arising from the Local Government Act, the Local Government Finance Act and all relevant CIPFA guidance.

11. HUMAN RESOURCES IMPLICATIONS

There are no immediate HR implications arising from the recommendations contained in this report.

12. WARD IMPLICATIONS

All wards indirectly affected.

13. BACKGROUND PAPERS

13.1 CIPFA Treasury Management Code and Guidance Notes

13.2 Treasury Management Strategy Statement 2024-25

13.3 Capital Strategy Statement 2024-25

14. CONTACT OFFICER(S)

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Councillor Stephen Harness
Portfolio Holder for Finance, Resources and Assets

Appendix 1

Treasury Half-year Report 2024/25

Contents

Abbreviations Used In This Report

CDS: Credit Default Swaps. Financial contracts in which the buyer purchases protection against loses on default of a counterparty. The price of the 'insurance premium' is therefore a good guide to perceived risk
CFR: capital financing requirement - the council's annual underlying borrowing need to finance capital expenditure and a measure of the council's total outstanding indebtedness.
CIPFA: Chartered Institute of Public Finance and Accountancy – the professional accounting body that oversees and sets standards in local authority finance and treasury management.
ESG: environmental, social, and governance. A set of non-financial aspects considered when evaluating investments with counterparties
Gilts: bonds issued by the UK Government to borrow money on the financial markets. The yields on Gilts change inversely to the price of gilts i.e. a rise in the price of a gilt will mean that its yield falls.
LOBO: a loan carrying provision for the lender to periodically amend the interest rate applicable. If the lender chooses to exercise this option the borrow then receives the secondary option to choose to repay the loan without penalty.
MHCLG: The Ministry of Housing, Communities and Local Government
MRP: minimum revenue provision - a statutory annual minimum revenue charge to reduce the total outstanding CFR, (the total indebtedness of a local authority).
PWLB: Public Works Loan Board – the section within H.M. Treasury which provides loans to local authorities to finance capital expenditure.
S151 Officer: an Officer appointed under section 151 of the Local Government Act to carry out the duties of 'Responsible Financial Officer' as defined by CIPFA
SONIA: Sterling Overnight Index Average, the 'risk-free' rate for market transactions.
TMSS: the annual treasury management strategy statement reports that all local authorities are required to submit for approval by the full council before the start of each financial year.

Key Messages:

All investment and borrowing transactions were in line with the Approved 2024-25 Treasury Strategy.

There are no necessary in-year policy changes to the TMSS; the details in this report update the half-year position against the updated economic environment and budgetary changes already approved.

Our revised central case for rates is now for short-term interest rates to fall steadily from their current level of 5% to somewhere in the range 3-4% over the next 18 months. Uncertainty remains however and the implications for both investment income and borrowing cost will be closely monitored.

S151 Officer Overview

The Council operates a balanced budget, which broadly means cash raised during the year will meet its non-capital expenditure, however there will always be timing differences in how funds are received, and expenses settled. A fundamental element of treasury management is to ensure this cash flow is adequately planned, with surplus monies being invested in low-risk counterparties, whilst retaining adequate liquidity and finally seeking appropriate investment return, consistent with those two primary objectives.

Our 2024-25 Treasury Strategy was tailored to allow the Council to manage risks related to cash investments and has, once again, stood up well to the ongoing pressures seen as a result of persistent inflation and rapidly rising interest rates, even though both surpassed our default expectations going into the period. Managing circumstances a standard deviation or two beyond that expected is a key determinant of successful Treasury Management delivery. Rare or ‘once in a generation/lifetime’ events happen all the time. The role of Treasury Management at North East Lincolnshire Council is to ensure those occurrences do not endanger the larger mission of the Authority.

To deliver that high level brief, the main functions of Treasury are divided into 4 main elements:-

1. The arrangement of funding for the Council’s capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending plans as they fall due. This management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses. Occasionally, debt previously drawn may be restructured to meet Council risk or cost objectives.
2. Safeguarding surplus funds – investing the Council’s funds in line with the principles of Security, Liquidity and Yield orders of priority.
3. Day-to-day cash flow management – ensuring the Authority has funds available in the right place, at the right time, in the right size to meet its payment obligations as they fall due.
4. Horizon scanning of financial data and market intelligence and sharing this with the wider organisation as appropriate.

In an elevated rate environment, such as that seen over the last two years, we have opted for shorter term borrowing, to ‘ride out’ the cycle before locking in loans for the long-term. Our long-held preference for liquidity over yield has also meant that we have been able to capture rate rises promptly as they have occurred, boosting our investment return. Income that is now available to support services. At the time of writing, rates were expected to reduce gradually from their current level of 5%, meaning our income generated will decline but borrowing will become less expensive. We continue to monitor rate paths and develop a borrowing strategy that best meets the requirements of the Authority’s plans.

Sharon Wroot, S151 Officer

Oct 2024

Key Messages:

No Treasury activity is without risk. These risks include, but are not limited to, Credit Risk, Liquidity Risk, Interest Rate Risk, Inflation Risk and Reputational Risk.

The Council uses in-house knowledge, advisors (Link Treasury Services), treasury management software (Treasury Live) and the CIPFA Treasury Management Code to manage these risks.

Scrutiny of Treasury activity is undertaken by Audit and Governance Committee and reported twice-yearly to Full Council. Updates on Prudential Indicators are also provided as part of quarterly budget updates Reports.

Introduction and External Context

This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2021) to provide a review of treasury management activities and the actual prudential and treasury indicators for 2024-25. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

This report covers the following:

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

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 regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides an updated position for treasury activities and highlights compliance with the Council's policies previously approved by members.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to the above treasury management report by the Audit Committee before they were reported to the full Council. Member training on treasury management issues was undertaken during 2023-24 to support members' scrutiny role.

Key Messages:

The Council has taken a cautious approach to investing but is also fully appreciative that the external risk environment is very much shaped by developments around inflationary pressures and economic outlooks.

As of September 2024 our advisors, Link Group are forecasting that Bank Rate has now commenced a cycle of easing from its prior peak of 5.25%. Central Banks globally remain committed to taming inflation but have now also shifted to maintaining a close watch on growth slowdowns which, were they to materialise, would likely precipitate a swifter reduction in rates. In summary, the picture over the next 12 months is one of lower rates but retains uncertainty around pace.

Introduction and External Context

Having risen from historic lows since the end of 2021, rates peaked at 5.25% following 14 consecutive increases by the Bank of England before the first cut of what is believed to be a gradual loosening cycle came in August.

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. Link's expectation for interest rates within the treasury management strategy for 2024-25 was that Bank Rate would fall to 4.25% by Dec 2024. Subsequent data led to a small revision in their forecast with Dec 2024 rates now projected slightly higher at 4.50%. Link now expect that rates will continue to decline steadily through subsequent periods to a cycle low of 3% in 2027. We are cognisant that a) our longer PWLB term rates are built on forecast rate paths and so lead actual Bank of England announcements, b) historic data show that markets often under-estimate the pace of rate changes over a full cycle, opening the possibility that longer-term rates will have to 'catch-up' and c) rates are not likely to revert to near zero and so the Authority's borrowing costs are expected to rise sharply over the next 3 years as capital spend is committed and existing debt matures and is replaced. .

Falling rates will hit our investment returns but savings – on budgeted debt cost – may appear if material capital items are re-profiled (into a cheaper rate environment)
.
Key economic data during the period saw:-

- Interest rates peak and then begin to ease, taking Bank Rate from 5.25% down to 5.00%.
- Short, medium and long-dated gilt yields remain elevated but now reflect a period of looser monetary policy.
- Stalling GDP growth, although forward-looking external forecasts were bullish for UK growth vs other major economies.
- CPI hit the Bank of England's 2% target before ticking slightly higher in Q2 on the back of sticky services data.
- A cooling in labour market conditions, but no evidence yet that it has led to an easing in wage growth (as average earnings rose at an annual rate of 5.1% in July, excluding bonuses).

The Authority does not typically have sufficient surplus cash balances to be able to place deposits for more than around six months so as to earn higher rates from longer deposits. In a declining rate environment this has the negative effect of rates rate reductions applying more quickly.

Key Messages:

The Treasury Management Strategy Statement, (TMSS), for 2024-25 was approved by this Council in February 2024. No changes are considered necessary during the year despite the continued uncertainty around inflation and rate forecasts.

The Authority has an increasing CFR over the next three years due to the capital programme, and with reduced investments will therefore need to borrow up to £54m over the next few years. An additional £35m will be required to replace maturing loans.

Since the Global Financial Crisis, the Authority has adopted a cautious approach whereby investments are framed by low counterparty risk considerations, the trade-off being lower overall returns.

Local Context

The Treasury Management Strategy Statement, (TMSS), for 2024-25 was approved by this Council on 22 February 2024.

No in-year policy changes to the TMSS are necessary – pleasing to note in the face of volatile economic circumstances; the Strategy did its job in protecting public funds whilst allowing sufficient flexibility to cope with exceptional operational demands.

Gross borrowing and the Capital Financing Requirement (CFR) - to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council must ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This means that the Council is not borrowing to support revenue expenditure.

The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator and we are on target to achieve the original forecast.

	31 March 2024 Principal	Rate/ Return	Average Life yrs		30 September 2024 Principal	Rate/ Return	Average Life yrs
Total debt	£160.2m	3.72%	24.8		£162.0m	3.74%	25.2
Capital Financing Requirement (CFR)	£211.6m				Est £225.3m		
Over / (under) borrowing	(£51.4m)				(£63.3m)		
Total investments	£11.9m	5.15%	0.1		£22.3m	4.98%	0.1
Net debt	£148.3m				£139.7m		

The overall level of investment balances fluctuated during the period as the Authority utilised a mix of internal borrowing and short-term loans to both defer more expensive long-term borrowing and minimise its credit risk exposure. The growing under-borrowed position is typical for similar authorities but still represents increased interest rate risk to be managed.

Key Messages:

When undertaking new borrowing the Council will review both the source and tenure of loans it seeks to take.

At 30/09/2024 the Authority held £162m of loans, (up £2m in the period) as a consequence of funding previous years' capital programmes.

Other Liabilities shown across reflect the impact of lease liabilities being brought 'on-balance sheet' under IFRS16 and are not new liabilities entered into during the period

The Council's current borrowing portfolio is predominantly of a long-term and fixed nature. Whilst this provides certainty of cost it can restrict flexibility to restructure debt as plans and finances change.

Borrowing Strategy

The first key control over treasury activity is the Capital Financing Requirement (CFR), a prudential indicator designed to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2024-25 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if such borrowing proves prudent, meets the CFR criteria above and after due evaluation is believed to represent a Value for Money proposition.

	2023/24 Outturn Original Estimate £m	Mid-year Position 30/09/2024 £m	Revised 2024-25 Final Position £m
Borrowing	212.6	162.0	181.9
Other Long Term liabilities	0.0	4.0	4.0
Total debt	212.6	166.0	185.9
CFR (year end position)	246.5	225.3 (est)	239.1 (est)

The structure of our debt portfolio as at 30.09.2024 is shown below

Type of Loan	Amount	% of Portfolio
PWLB Fixed	£74.7m	46%
LOBO	£21.0m	13%
Market Fixed	£42.3m	26%
Short-term Fixed	£24.0m	15%
Variable Rate	£0.0m	0%
Total	£162.0m	

*Figures are rounded so may not aggregate to total shown

Key Messages:

Affordability and the "cost of carry" remained strong influences on the Authority's borrowing strategy. As interest rates rose, we arranged £34m of new loans over several start dates and periods of up to a year (details on P11) to secure sufficient funding to meet the Council's cash flow needs whilst deferring long-term borrowing until the peak in the cycle passed.

Borrowing short-term from other local authorities provides a useful source of funding below current long-term rates and with the ability to exit loans within a reasonable timeframe.

It remains true though that future borrowing will now be more expensive than current portfolio average rates (at current rates/projections)

Borrowing Strategy (continued)

- During the period, the Council maintained an under-borrowed position. This means that the capital borrowing need, (the Capital Financing Requirement), was not fully drawn in loan debt, as cash supporting the Council's reserves and cash flow was used as an interim measure. This strategy was prudent as it minimises cost of carry. Reduced counterparty risk is also a factor.

- The policy of delaying new borrowing by utilising spare cash balances and securing short-term loans from other local authorities, has served well in recent years. However, with long term rates now declining in anticipation of future Bank of England rate cuts, we are aware that the Authority retains a significant long-term borrowing requirement to finance its capital spend and so will be assessing whether a proportionate amount of new long-term borrowing is merited over the coming months, in order capture the reductions so far. While no-one knows where rates will ultimately settle, it is not anticipated that we return to a scenario where rates are near zero for another decade without another seismic exogenous shock akin to the Global Financial crisis or Covid-19. All types of borrowing will therefore be kept under review, with a default view that a 'mix' of short and long-term now makes some economic sense, certainly more so now than over the last 10-15 years.

- It is anticipated that further borrowing will be undertaken during the 2024-25 financial year.

- Whatever the economic background there are risks within any forecast, so caution is adopted within treasury operations. The S151 Officer therefore monitors interest rates in financial markets and will adopt a pragmatic strategy based upon the following general principles to manage interest rate risks :

- where there was a significant perceived risk of a sharp FALL in long and short term rates, (e.g. due to a marked increased risk of recession or risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing may be considered.

- if it was felt that there was a significant risk of a sharp RISE in long and short term rates, perhaps arising from 'sticky' inflation or Sterling weakness, then the portfolio position would be re-appraised. Our starting point in such circumstances would be to shorten the length of any loans arranged and re-profile once rates showed signs of declining.

- Clearly there is a window between the two scenarios above where rates fall sufficiently to make a proportionate amount of new long-term borrowing warranted.

Key Messages:

The Authority's traditional source of long-term borrowing is the Public Works Loan Board (part of HM Treasury).

The rate at which the Authority can borrow is determined by the Gilt Market (the Government's own primary source of borrowing) and fluctuates with market conditions. On top of this 'core rate' PWLB apply a margin, typically 0.8% for NELC.

In the first half of 2024-25 rates first plateaued, then declined, as future cuts in Bank Rates were anticipated by markets. By period end rates were reflective of a steady programme of rate reductions over the next 2 years, but volatility is expected to remain a feature across many financial markets for some time.

Borrowing Strategy (continued)

PWLB rates are based on gilt (UK Government bonds) yields through H.M.Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields, as well as Defined Benefit Pension Scheme liabilities.

The current margins over gilt yields are as follows: -.

- PWLB Standard Rate is gilt plus 100 basis points (G+100bps)
- PWLB Certainty Rate is gilt plus 80 basis points (G+80bps)
- Local Infrastructure Rate is gilt plus 60bps (G+60bps) for targeted schemes
- UK Infrastructure Bank is gilt plus 40bps (G+40bps) – subject to scheme criteria being met

with rates being revised twice daily.

At the close of the day on 30 September 2024, all PWLB Maturity Certainty Rate loans from 1 to 5 years were between 4.55% – 4.95% while the 10-year and 25-year yields were at 4.56% and 5.33% and the market had remained more volatile than in previous years.

At period end a 'goldilocks' scenario remained priced into yields, whereby there was an expectation that the Bank of England had delivered *just* the right amount of tightening to deal with inflation but not too much so as to completely eliminate growth. Any negative news on the latter front going forward could therefore lead to emergent recession fears and suppress PWLB rates over the coming months. Clearly, this is just one possible outcome, and the opposite could be true i.e. inflation remains above target and therefore the Bank of England needs to do more. but, after the progress made over the last 18 months, it feels like the risk is not symmetrical and former view remains slightly more feasible. Our core strategy, therefore, remains to defer the majority of long-term borrowing as long as possible, while maintaining a keen eye on any data/rates that could signal a meaningful move in either direction. If rates do move down more swiftly, we may choose to 'lock-in' some of those lower costs by securing a limited amount of new longer-term funding. If rates move higher, long-term borrowing will be limited to essential cash flow requirements that cannot be covered off from other sources.

Borrowing in advance of need

The Council has not borrowed more than, or in advance of its needs, purely to profit from the investment of the extra sums borrowed, so expects to retain access to PWLB. The forward starting loans recently arranged were secured to meet a portion of the anticipated requirement over the next year, while lower rates remained accessible.

Key Messages:

Several loans were agreed during 2024-25 to support the Council's Capital Plans and refresh maturing loans.

Debt rescheduling opportunities have increased as rates have risen. A small amount (£0.225m) of long-term debt was repaid early during the period as the Authority sought to take advantage of peak rates to exit its more expensive historic debt (with rates above 6%) as efficiently as possible. Further debt rescheduling will continue to be considered if it can deliver (net) long-term savings.

Rates are currently expected to decline gradually over the next 2 years to settle above 3%

Borrowing Strategy (continued)

Borrowing – the following loans were arranged during the period:

Counterparty	Start Date	Maturity Date	Amount	Rate
London Borough of Redbridge	05/04/2024	05/07/2024	£5,000,000	5.30%
City and County of Swansea	11/04/2024	25/09/2024	£5,000,000	5.40%
Blackburn and Darwen Borough Council	15/05/2024	15/10/2024	£5,000,000	5.35%
Notts Police and Crime Commissioner	20/08/2024	19/08/2025	£2,000,000	4.60%
Hertsmere Borough Council	02/09/2024	01/09/2025	£5,000,000	4.60%
Middlesborough Council	12/09/2024	14/10/2024	£5,000,000	4.95%
Causeway Coast & Glens Borough Council	27/09/2024	27/11/2024	£2,000,000	4.90%
East Lothian Council	30/09/2024	28/11/2024	£5,000,000	4.90%

No longer-term loans were taken during the period as rates remained elevated. For the time being we are arranging loans to meet cash flow as and when required at terms out to 12-months.

Debt rescheduling

A small amount (£0.225m) of long-term debt was repaid early during the period as the Authority sought to take advantage of peak rates to exit its more expensive historic debt (priced at above 6%) at an efficient point in the cycle. Further debt rescheduling will continue to be considered if it could deliver (net) long-term savings.

Our expectation for interest rates going forward

Whilst rates have started to move lower, it is not our current base case that they revert to the ultra-low levels of the last decade. Indeed, the current view is that reductions in rates will be gradual and 'bottom out' above 3% as the Bank of England battles sticky core inflation. Should inflation not trend back down to the target of 2% rate cuts will need to be paused, or even reversed. Conversely, if signs of faster than desired contraction appear then the bank will have to increase the pace of cuts to stimulate activity again. At the time of writing, a series of steady cuts to Bank rate were already baked into longer-term rates (the one the Authority ultimately accesses) and so we will be watching data closely. History suggests that 'soft-landings' (the taming inflation without causing a recession and job losses), whilst not impossible, is a difficult trick to pull off. We shall see. More clarity should be forthcoming in the next few months, including the Bank's next update to its own forecasts in November.

Key Messages:

The Authority has held significant invested funds, representing income received in advance of expenditure plus balances and reserves held. These funds are temporarily invested to generate a return until they are needed.

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

All other things being equal we would expect to see balances fall each year by the amount of corporately funded capital expenditure less any new borrowing.

The Authority is on course to generate £1m of income from its temporary financial investments during 2024-25.

Investment Activity

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. These funds are temporarily invested to generate a return until they are needed.

During 2024-25 total investment balances ranged between £14.3m and £38.2 million. The average balance maintained was £27m with a weighted average maturity of 16 days. During the period our target rate of 7-day SONIA was 5.08%. We out-performed the benchmark (achieving an average return of 5.11%). This reflects the slightly longer average maturities (mainly T-Bills) maintained during the period which garners higher yields – without jeopardizing liquidity. At period end we were earning an average yield of 4.98% vs 7-day SONIA at 4.95%.

Our investments generated £0.696m of income during the first half of 2024-25 and are on target to generate £1m of income for the Authority in the full year to 31 March 2025.

Investment Policy – the Council's investment policy is governed by MHCLG guidance, which has been implemented in the annual investment strategy approved by the Council. Investment activity during the year conformed to the Investment Strategy for 2024-25 which aimed to reduce risk by;

- Setting value and term limits for counterparties based on Credit rating, available collateral and sector.
- Utilising data tools available online and Link Treasury Services to monitor risk.
- Ensuring a minimum level of liquidity was maintained to allow payments to be made as they fell due

The Council aims to achieve an adequate return (yield) on its investments commensurate with having prioritised security and liquidity. It is considered appropriate to keep investments short term to cover cash flow needs using our suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

Creditworthiness – Credit metrics for the financial institutions we interact with remained robust during the period. US Regional Banks and Credit Suisse aside the 'damage' resulting from global rates going from zero to 5% in short order has been remarkably light. No changes to TMSS limits, or indeed (more restrictive) operational limits were necessary during the period. Even so in a post 'Bail-in' regulatory environment NELC seeks to largely avoid direct bank exposure.

Key Messages:

Eliminating Credit Risk by maintaining lower balances whilst still ensuring adequate liquidity therefore remains a key strand of operational activity. It also reduces 'cost of carry' i.e., the spread between the rates we can obtain from investments versus those payable on our borrowing.

Investment Activity

Investments	Balance on 31/03/2024 £m	Investments Made £m	Maturities/ Investments Sold £m	Balance on 30/09/2024 £m	Avg Rate/Yield (%) and Avg Life (years)
UK Government: - DMADF - Treasury Bills/Gilts	5.5 0.0	195.7 7.6	(194.0) (1.7)	7.2 5.9	5.14% 8 days 5.16% 88 days
Bonds issued by Multilateral Development Banks	0.0	0.0	(0.0)	0.0	N/A
Direct Unsecured Investments (call accounts, deposits) with financial institutions - rated A- or higher - rated below A-	0.6 -	21.3	(21.5)	0.4	4.18% at Call
Tradable Investments with Financial institutions Corporates (CDs) rated A- or higher	0.0	-	-	0.0	N/A
Money Market Funds	5.8	29.5	(26.5)	8.8	5.10% at Call
TOTAL INVESTMENTS	11.9	254.1	(243.7)	22.3	5.11% 16 days
Increase/ (Decrease) in Investments £m				10.4	

Given the relatively poor risk-reward returns from short-term unsecured bank investments, but lacking funds available for longer-term investment, the Authority is unable to simply diversify into more secure and/or higher yielding asset classes such as repurchase agreements or covered bonds which are secured on financial assets. Eliminating Credit Risk by maintaining lower balances whilst still ensuring adequate liquidity therefore remains a key strand of operational activity. It also reduces 'cost of carry' i.e., the spread between the rates we can obtain from investments versus those payable on our borrowing.

Key Messages:

Counterparty credit quality is assessed and monitored with reference to credit ratings (the Authority's minimum long-term counterparty rating for institutions defined as having "high credit quality" is A-); credit default swap prices, financial statements, and reports from quality financial news feeds.

Figuratively the Authority's risk profile remained stable during the period, (with a narrow set of counterparties our risk profile primarily moves with UK sovereign rating where there were no changes during the period).

Our strategy to favour holding short-term Multi-lateral Bank Bonds hasn't been possible during the period as availability in tenors that suited hasn't been sufficient.

Investment Activity (contd.)

Credit Risk

Counterparty credit quality as measured by credit ratings is summarised below:

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating
31/03/2024	2.63	AA
30/06/2024	2.66	AA
30/09/2024	2.85	AA

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 26
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

Credit risk (as defined by Credit Swap premia) remained low during the period as it became clearer that the series of rapid global rate rises on bank Balance Sheets was being successfully accommodated. The table above suggests that our own average risk also remained very low. Several factors contributed to this:-

- The scores above reflect Credit Rating Agencies ratings. These are far less 'agile' than Credit Default Swap (CDS) rates, so there may be Outlook changes and Watch changes prior to ratings being changed in a deteriorating financial environment. Changes to the UK Sovereign Rating in either direction can directly affect banks own ratings due to country exposure.
- Our strategy to favour holding short-term Multi-lateral Bank Bonds hasn't been possible during the period as availability in tenors that suited hasn't been sufficient. These instruments are typically AAA-rated thanks to their callable capital claims on the World's major developed countries. They have the additional positive characteristic of possessing strong ESG credentials.
- NELC largely seeks to avoid direct bank exposure and where we do invest it is generally on a call or tradeable basis.

Key Messages:

In an environment where direct unsecured bank deposits present increased uncompensated risk, NELC sought to avoid this imbalance by utilising UK Government based investments and diversified funds.

Ultimately, we seek to minimise counterparty risk by limiting our cash levels whilst still maintaining adequate liquidity.

There were no operational breaches of the limits set in the TMSS during the period.

Investment Activity (contd.)

Benchmarking

- Comparisons are made to other Authorities using the Treasury Live database which looks at almost £12Bn of local Authority investments. As at the period end this showed that other Authorities:-
  - Hold more cash than NELC. Average balance £132m (estimated) vs £22m at NELC
  - Invest for longer periods. 111 days on average vs only 16 days at NELC
  - Take more risk than us collectively.
  - Deliver lower return than us. 4.57% vs 4.98 at NELC%
- The above shows how the Council has been able to take advantage of rising rates more quickly due to its shorter average investment term. NELC is of the view that, in a post Bail-in environment elimination of credit risk through lower balances is worth potential lower overall return. To ensure this strategy does not replace credit risk with liquidity risk NELC maintains a liquid balance at least £10m (roughly equivalent to peak weekly cash outflows).
- Also important to note that the benchmarking group pays an average rate of 3.9% on its aggregated £17.1Bn of debt vs an average rate of 3.7% on £0.2Bn at NELC.
- Whilst we monitor performance against data on 80 other Authorities' activity (as summarised above) on a monthly basis, we have previously obtained some additional specific data on what Unitary Authorities (like NELC), were investing in, to ensure we are not 'missing out' on anything those 'peers' are doing. Data was shared with us (confidentially and anonymised) by our Advisors, Link Treasury Services. Against this narrower group we were 'in the bunch' with the only difference being those who lent (sometimes long-term) to other Authorities. We reviewed the data and considered LA lending but for the time being the S151 Officer has taken the decision not to do so.

Operational Breaches

- There were no operational breaches of the limits set in the TMSS during the period.

Key Messages:

The Authority confirms compliance with its Prudential Indicators for 2024-25, which were set in February 2024 as part of the Authority's Treasury Management Strategy Statement.

Compliance with Prudential Indicators

Treasury Management Indicators

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

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

	2024-25	2025-26	2026-27
Upper limit on fixed interest rate exposure	£300m	£310m	£320m
Actual*	£139m	£185m (est)	£194m (est)
Upper limit on variable interest rate exposure	£90m	£90m	£90m
Actual*	£24m	£35m (est)	£35m (est)

*= Peak position for 2024-25

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 fixed rate borrowing were:

	Upper	Lower	Actual
Under 12 months	70%	10%	29%
12 months and within 24 months	30%	0%	5%
24 months and within 5 years	30%	0%	5%
5 years and within 10 years	30%	0%	9%
10 years and within 20 years	30%	0%	9%
20 years and within 30 years	50%	0%	24%
Over 30 years	75%	10%	19%

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. Note: LOBO option dates are included as potential repayment dates.

Key Messages:

A minimum cash balance of £10m will be maintained to ensure forecast liquidity needs are met.

The gap between the blue columns and green line in the Liability Benchmark chart shown here depicts the additional borrowing need the Authority currently projects – a peak requirement of £89m new loans by the end of 2026-27 – including replacement of maturing debt.

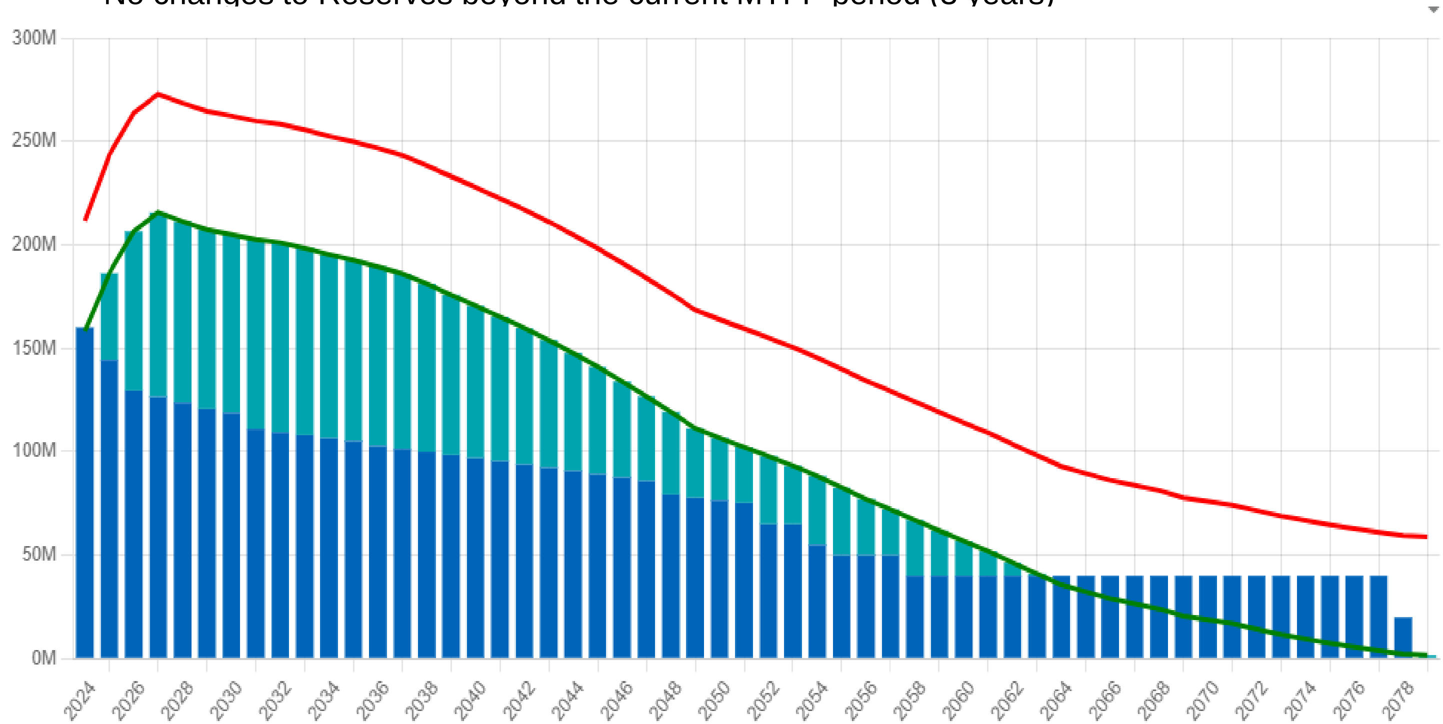
Before new long-term borrowing is entered into the Authority will have regard to the Liability Benchmark and its underlying assumptions will be assessed for their continuing prudency, with revisions made where necessary.

Prudential Indicators (The Liability Benchmark.)

CIPFA Guidance requires the use of the **Liability Benchmark** tool as a formal Prudential Indicator. NELC used, reported and provided Member training on this Benchmark for several years prior to its adoption by CIPFA.

The Benchmark forecasts our need to borrow over a 50+ year period. This aids decision making when it comes to the quantum and term to be chosen, the aim being to avoid cost of carry revenue implications and avoid the trap of defaulting to ultra-long tenors just because the yield curve tail slopes downward. It represents the level of our anticipated borrowing and in the ordinary course of business would not be expected to be exceeded. It therefore should closely mirror the Operational Boundary. The benchmark assumes:

- lower future capital expenditure funded by borrowing beyond the current programme on average
- minimum revenue provision on new capital expenditure based on an annuity profile of c30 years average
- No changes to Reserves beyond the current MTFP period (3 years)



Key Messages:

For 2024-25 a minimum cash level of £10m was targeted and there were no breaches of this, or other Indicators.

Compliance with Prudential Indicators (contd.)

Principal Sums Invested for Periods Longer than 365 days: 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 limits on the total principal sum invested to final maturities beyond the period end will be:

	2024-25	2024/25	2025/26
Limit on principal invested beyond 365 days	£21m	£21m	£21m
Actual	£0m	£0m	£0m

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

	Target	Actual
Portfolio average credit rating	A	AA

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling one-week period, without additional borrowing.

	Target	Actual (Low)
Total cash available within 1 month	£10m	£15m

Key Messages:

Borrowing remains comfortably below control levels as a result of continued internal borrowing support for the Capital Programme.

Borrowing levels were projected to be £212m at the end of 2024-25 when the TMSS was set in Feb 2024. Half-way through the year this outturn is now projected to be £182m due to changes in anticipated delivery of the Capital Programme.

Work is continuing during 2024-25 to establish lease liabilities under IFRS16 Accounting Rules. Current indications are that the 'additional borrowing' figure will be around £4m – well within current limits across. Once confirmed the 'Other Liabilities' Limits will be updated through the annual Treasury Strategy refresh.

Compliance with Prudential Indicators (contd.)

Other Prudential Indicators

The following prudential indicators are relevant to the treasury function as they concern limits on borrowing and the adoption of the CIPFA Treasury Management Code.

Operational Boundary for External Debt: The operational boundary is based on the Authority's estimate of most likely, i.e. prudent, but not worst-case scenario for external debt.

Operational Boundary	2023/24 £m	2024/25 £m	2025/26 £m	2026/27 £m
Borrowing	£220m	£230m	£240m	£250m
Other long-term liabilities	£30m	£30m	£25m	£25m
Boundary for Total Debt	£250m	£260m	£265m	£275m

Authorised Limit for External Debt: The authorised limit is "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2024-25 the Council has maintained gross borrowing within its authorised limit.

Authorised Limit	2023/24 £m	2024/25 £m	2025/26 £m	2026/27 £m
Borrowing Limit	£250m	£260m	£270m	£280m
Other long-term liabilities	£40m	£40m	£40m	£40m
Total Debt Limit	£290m	£300m	£310m	£320m
Projected Peak Debt levels	£176m	£182m	£206m	£216m

Adoption of the CIPFA Treasury Management Code: The Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition in February 2023.

Key Messages:

The Local Government Act 2003 requires the Authority to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow.

The Authority confirms compliance with its Capital Finance Prudential Indicators for 2024-25, which were set in February 2024 as part of the Authority's Treasury Management Strategy Statement.

Changes to the 2024-25 and later programmes may occur as these are progressed in the coming months.

Compliance with Capital Finance Prudential Indicators

The Local Government Act 2003 requires the Authority to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure

The Authority's planned capital expenditure and financing as at 30.9.2024 may be summarised as follows.

Capital Expenditure and Financing	2024-25 Original £m	2024-25 Changes £m	2024-25 Draft Outturn £m	2025-26 Estimate £m	2026-27 Estimate £m
Total Expenditure	128.8	-30.7	98.1	91.8	23.1
Capital Receipts	12.0	-	12.0	2.0	2.0
External Grants	70.9	-20.4	50.5	55.2	0.2
Other External Funding (S106 etc)	2.4	-	2.4	0.0	0.0
Borrowing	43.5	-10.3	33.2	34.6	20.9
Total Financing	128.8	-30.7	98.1	91.8	23.1

Key Messages:

The percentage of the Council's income required to service its debt came in below projections due to a combination of slippage in the capital programme and the effect of using short-term lenders which offered lower interest rates and delivered in-year cost-savings.

Future year projections on the other hand have been adversely affected by the sharp rise in rate expectations during the period. Maintaining debt costs within 10% of the Council's overall budget now presents a challenge with several factors being beyond the Authorities control (rates (cost of borrowing) and inflation (cost of schemes being financed)).

Compliance with Capital Finance Prudential Indicators (contd.)

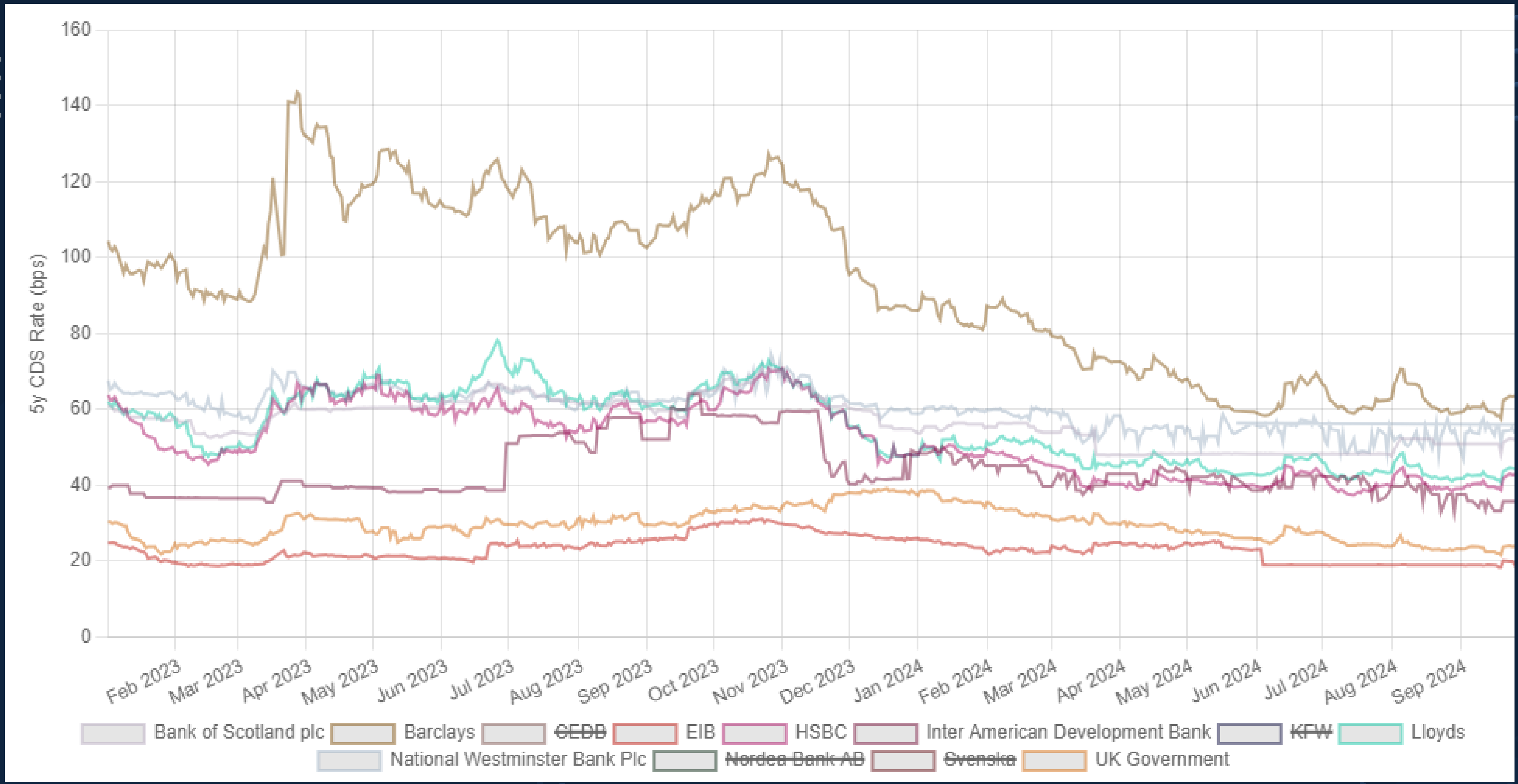
Ratio of Financing Costs to Net Revenue Stream

This is a voluntary indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2024-25 Original Estimate %	2024-25 Revised Estimate %	2025-26 Revised Estimate %	2026-27 Revised Estimate %
General Fund	7.8%	7.3%	8.7%	9.3%

There are a range of factors that affect these future estimates, some internal, such as what is delivered by capital investment in terms of future income, and others which are external and largely out of the Authority's control, such as the impact of interest rate changes. Any future borrowing must be in accordance with prudential borrowing principles. In other words, borrowing must always be affordable, sustainable and prudent.

Future year projections have improved slightly as rate expectations softened during the period. This meant that any slippage of schemes came with an assumption of lower attributable borrowing costs. Maintaining debt costs within 10% of the Council's overall budget now presents a challenge while rates remaining elevated beyond those levels in the original forecast.



Appendix 2 - Credit Default Swap Rates

Credit Default Swaps are effectively insurance premiums to cover company debt. The higher the premium the higher the perceived risk of the counterparty covered. The Authority does not buy Credit Default Swaps directly but instead uses their pricing to monitor risk trends among its counterparties.