West Lindsey District Council	**Council**
	Monday, 27th January 2025

Subject: Recommendation from Corporate Policy and Resources Committee – 14th November 2024 - Mid-Year Treasury Management Report 2024-25

Report by:	Director of Corporate Services (S151 Officer)
Contact Officer:	Peter Davy Financial Services Manager peter.davy@west-lindsey.gov.uk
Purpose / Summary:	This report provides the Mid-Year update for Treasury Management Indicators in accordance with the Local Government Act 2003 and stands recommended from the Corporate Policy and Resources Committee

RECOMMENDATION(S):

That Council accept the recommendation from the Corporate Policy and Resources Committee and in doing so note the report, the treasury activity and approve the revised prudential indicators at sections 5.2, 6.1 and 6.2.

IMPLICATIONS

Legal: This report complies with the requirement of the Local Government Act 2003

Financial : FIN/98/25/PD There are no financial implications as a direct result of this report

Staffing : None arising as a result of this report

Equality and Diversity including Human Rights : None arising as a result of this report

Data Protection Implications : None arising as a result of this report

Climate Related Risks and Opportunities: This is a monitoring report only

Section 17 Crime and Disorder Considerations: This is a monitoring report only

Health Implications: This is a monitoring report only

Title and Location of any Background Papers used in the preparation of this report :
CIPFA Code of Treasury Management Practice 2017 CIPFA The Prudential Code Local Government Act 2003 Located in the Finance Department

Risk Assessment :
The Mid Year Treasury Management Report reviews our assessment of Treasury Risks

Call in and Urgency:

Is the decision one which Rule 14.7 of the Scrutiny Procedure Rules apply?

i.e. is the report exempt from being called in due to urgency (in consultation with C&I chairman)	**Yes**		**No**	**x**

Key Decision:

A matter which affects two or more wards, or has significant financial implications	**Yes**		**No**	**x**

1. Executive Summary

1.1 This mid-year report has been prepared in compliance with the Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice on Treasury Management, and covers the following:

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

1.2 The Bank of England Base rate has reduced during 2024/25, with the potential for further reductions. The current rate is 4.75%.

1.3 There have been no changes to the Treasury Management Strategy Statement and Annual Investment Strategy.

1.4 The forecast out-turn for Capital Expenditure is £27.601m against the approved original budget of £28.216m. The budget was revised to £27.601m at the Corporate Policy and Resources committee on 14th November 2024 with a request of £0.594m to be re-phased over future financial years.

1.5 The Council is projected to have circa £13m invested at the year end and have generated £0.907m in investment Interest. The returns on investments are higher than budgeted due to underspends in the capital programme meaning that cash balances are higher than anticipated. The Council's budgeted investment return for 2024/25 is £0.651m, and performance for the year is forecast to be £0.256m above budget at £0.907m.

1.6 It is anticipated that total external borrowing will be up to £24m depending on capital programme expenditure. If the capital programme does not realise the revised budget then the Council's cash balances will remain higher than anticipated and borrowing will be lower.

2 Background

2.1 Capital Strategy

In December 2017, CIPFA issued revised Prudential and Treasury Management Codes. These require all local authorities to prepare a Capital Strategy which is to provide the following:

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

- the implications for future financial sustainability.

2.2 Treasury Management

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low-risk counterparties, providing adequate liquidity initially before considering optimising investment returns.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer- term cash flow planning to ensure the Council can meet its capital spending aspirations. This management of longer-term cash may involve arranging long or short term loans, or using longer-term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly, treasury management is defined as:

"The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2.3 Key Changes to the Treasury and Capital Strategies

There are no changes to report to this committee.

3 Economics and Interest Rates (provided by Link Asset Services)

3.1 The third quarter of 2024 (July to September) saw:

- GDP growth stagnating in July following downwardly revised Q2 figures (0.5% q/q)
- A further easing in wage growth as the headline 3myy rate (including bonuses) fell from 4.6% in June to 4.0% in July;
- CPI inflation hitting its target in June before edging above it to 2.2% in July and August;
- Core CPI inflation increasing from 3.3% in July to 3.6% in August;
- The Bank of England initiating its easing cycle by lowering interest rates from 5.25% to 5.0% in August and holding them steady in its September meeting;
- 10-year gilt yields falling to 4.0% in September.

3.2 The economy's stagnation in June and July points more to a mild slowdown in GDP growth than a sudden drop back into a recession. Moreover, the drop in September's composite activity Purchasing Managers Index, from 53.8 in August to 52.9, was still consistent with GDP growth of 0.3%-0.4% for the summer months. This is in line with the Bank of England's view, and it was encouraging that an improvement in manufacturing output growth could be detected, whilst the services PMI balance suggests non-retail services output grew by 0.5% q/q in Q3. Additionally, the services PMI future activity balance showed an uptick in September, although readings after the Chancellor's announcements at the Budget on 30th October will be more meaningful.

3.3 The 1.0% m/m increase in retail sales in August was stronger than the consensus forecast for a 0.4% m/m increase. The rise was reasonably broad based, with six of the seven main sub sectors recording monthly increases, though the biggest gains came from clothing stores and supermarkets, which the ONS reported was driven by the warmer-than-usual weather and end of season sales. As a result, some of that strength is probably temporary.

3.4 The government's plans to raise public spending by around £16bn a year (0.6% GDP) have caused concerns that a big rise in taxes will be announced in the Budget, which could weaken GDP growth in the medium-term. However, if taxes are raised in line with spending (i.e., by £16bn) that would mean the overall stance of fiscal policy would be similar to the previous government's plan to reduce the budget deficit. Additionally, rises in public spending tend to boost GDP by more than increases in taxes reduce it. Our colleagues at Capital Economics suggest GDP growth will hit 1.2% in 2024 before reaching 1.5% for both 2025 and 2026.

3.5 The further easing in wage growth will be welcomed by the Bank of England as a sign that labour market conditions are continuing to cool. The 3myy growth rate of average earnings fell from 4.6% in June to 4.0% in July. On a three-month annualised basis, average earnings growth eased from 3.0% to 1.8%, its lowest rate since December 2023. Excluding bonuses, the 3myy rate fell from 5.4% to 5.1%.

3.6 Other labour market indicators also point to a further loosening in the labour market. The 59,000 fall in the alternative PAYE measure of the number of employees in August marked the fourth fall in the past five months. And the 77,000 decline in the three months to August was the biggest drop since November 2020. Moreover, the number of workforce jobs fell by 28,000 in Q2. The downward trend in job vacancies continued too. The number of job vacancies fell from 872,000 in the three months to July to 857,000 in the three months to August. That leaves it 34% below its peak in May 2022, and just 5% above its pre-pandemic level. Nonetheless, the Bank of England is still more concerned about the inflationary influence of the labour market rather than the risk of a major slowdown in labour market activity.

3.7 CPI inflation stayed at 2.2% in August, but services inflation rose from a two-year low of 5.2% in July to 5.6%, significantly above its long-run average of 3.5%. Food and fuel price inflation exerted some downward pressure on CPI inflation, but these were offset by the upward effects from rising furniture/household equipment inflation, recreation/culture inflation and a surprisingly large rise in airfares inflation from -10.4% in July to +11.9% in August. As a result, core inflation crept back up from 3.3% to 3.6%. CPI inflation is also expected to rise in the coming months, potentially reaching 2.9% in November, before declining to around 2.0% by mid-2025.

3.8 The Bank initiated its loosening cycle in August with a 25bps rate cut, lowering rates from 5.25% to 5.0%. In its September meeting, the Bank, resembling the ECB more than the Fed, opted to hold rates steady at 5.0%, signalling a preference for a more gradual approach to rate cuts. Notably, one Monetary Policy Committee (MPC) member (Swati Dhingra) voted for a consecutive 25bps cut, while four members swung back to voting to leave rates unchanged. That meant the slim 5-4 vote in favour of a cut in August shifted to a solid 8-1 vote in favour of no change.

3.9 Looking ahead, CPI inflation will likely rise in the coming months before it falls back to its target of 2.0% in mid-2025. The increasing uncertainties of the Middle East may also exert an upward pressure on inflation, with oil prices rising in the aftermath of Iran's missile attack on Israel on 1 October. China's recent outpouring of new fiscal support measures in the latter stages of September has also added to the upshift in broader commodity prices, which, in turn, may impact on global inflation levels and thus monetary policy decisions. Despite these recent developments, our central forecast is still for rates to fall to 4.5% by the end of 2024 with further cuts likely throughout 2025. This is in line with market expectations, however, although a November rate cut still looks likely, December may be more problematic for the Bank if CPI inflation spikes towards 3%. In the second half of 2025, though, we think a more marked easing in inflation will prompt the Bank to speed up, resulting in rates eventually reaching 3.0%, rather than the 3.25-3.50% currently priced in by financial markets.

3.10 Our forecast is next due to be updated around mid-November following the 30 October Budget, 5 November US presidential election and the 7 November MPC meeting and the release of the Bank of England Quarterly Monetary Policy Report.

3.11 Looking at gilt movements in the first half of 2024/25, the 10-year gilt yield declined from 4.32% in May to 4.02% in August as the Bank's August rate cut signalled the start of its loosening cycle. Following the decision to hold the Bank Rate at 5.0% in September, the market response was muted, with the 10-year yield rising by only 5bps after the announcement. This likely reflected the fact that money markets had priced in a 25% chance of a rate cut prior to the meeting. The yield had already increased by about 10bps in the days leading up to the meeting, driven in part by the Fed's "hawkish cut" on 18 September. There is a possibility that gilt yields will rise near-term as UK policymakers remain cautious due to persistent inflation concerns, before declining in the longer term as rates fall to 3.0%.

3.12 The FTSE 100 reached a peak of 8,380 in the third quarter of 2024, but its performance is firmly in the shade of the US S&P500, which has breached the 5,700 threshold on several occasions recently. Its progress, however, may pause for the time being whilst investors wait to see who is elected the next US President, and how events in the Middle East (and Ukraine) unfold. The catalyst for any further rally (or not) is likely to be the degree of investors' faith in AI.

4. Interest Rate Forecasts

4.1 The Council's treasury advisor, Link Group, have provided the following forecasts on 3rd October 2024. The latest forecast sets out a view that both short and long-dated interest rates will be elevated for some little while, as the Bank of England seeks to reduce inflation in the economy.

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

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

Additional notes by Link on this forecast table: -

Our latest forecast on 28 May sets out a view that short, medium and long-dated interest rates will fall back over the next year or two, although there are upside risks in respect of the stickiness of inflation and a continuing tight labour market, as well as the size of gilt issuance.

4.3 **PWLB Rates (provided by Link Asset Services)**

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

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

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

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

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

5. Treasury Management Strategy Statement and Annual Investment Strategy update

5.1 The Treasury Management Strategy Statement (TMSS) for 2024/25, which includes the Annual Investment Strategy, was approved by the Council on 4 March 2024.

5.2 The underlying TMSS approved previously requires revision in the light of economic and operational movements during the year. The proposed changes and supporting detail for the changes are set out below:

Prudential Indicator 2024/25	Original £'000	Revised Prudential Indicator £'000
Authorised Limit	29,155	29,155
Operational Boundary	24,155	24,155
External Debt	19,155	19,000
Investments	(13,000)	(13,000)
Net Borrowing	**6,155**	**6,000**

Capital Financing Requirement	36,340	36,070

6 The Council's Capital Position (Prudential Indicators)

This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow;
- Compliance with the limits in place for borrowing activity.

6.1 Prudential Indicator for Capital Expenditure

This Table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed in March. It draws together the main strategy elements of the capital expenditure plans, highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure by Cluster £'000	2024/25 Original Estimate £'000	2024/25 Revised Estimate £'000
Our People	10,802	8,488
Our Place	19,114	18,453
Our Council	800	660
Total capital expenditure	**30,716**	**27,601**
Financed by:		
Capital receipts	450	740
Capital grants	19,526	15,521
Earmarked Reserves	9,393	9,579
S106	1,204	1,761

Total Financing	**30,573**	**27,601**
Borrowing need	**143**	**0**

6.2 **Changes to the Prudential Indicators for the Capital Financing Requirement (CFR)**

The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary.

During the half year ended 30 September 2024, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy. The Director of Corporate Services (S151) reports that no difficulties are envisaged for the current or future years in complying with prudential indicators.

	2024/25 Original Estimate £'000	2024/25 Revised Estimate £'000
Prudential Indicators		
Capital Expenditure	30,716	27,601
Capital Financing Requirement (CFR)	**36,340**	**36,070**
Of Which Commercial Property	19,099	19,099
Annual Change in CFR	**-866**	**-952**
In year Borrowing Requirement	**19,155**	**19,000**
Under/(Over) Borrowing	**17,185**	**17,070**
Ratio of financing costs to net revenue stream	**9.55%**	**9.16%**
Incremental impact of capital investment decisions		
Increase/ Reduction(-) in Council Tax (band change per annum)	**0**	**-£3.30**

Please note the above prudential indicators assume a revenue provision will be made for the repayment of debts in 2024/25 of £0.952m.

6.3 **Limits to Borrowing Activity**

The first key control over the treasury activity is a prudential indicator 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 this proves prudent.

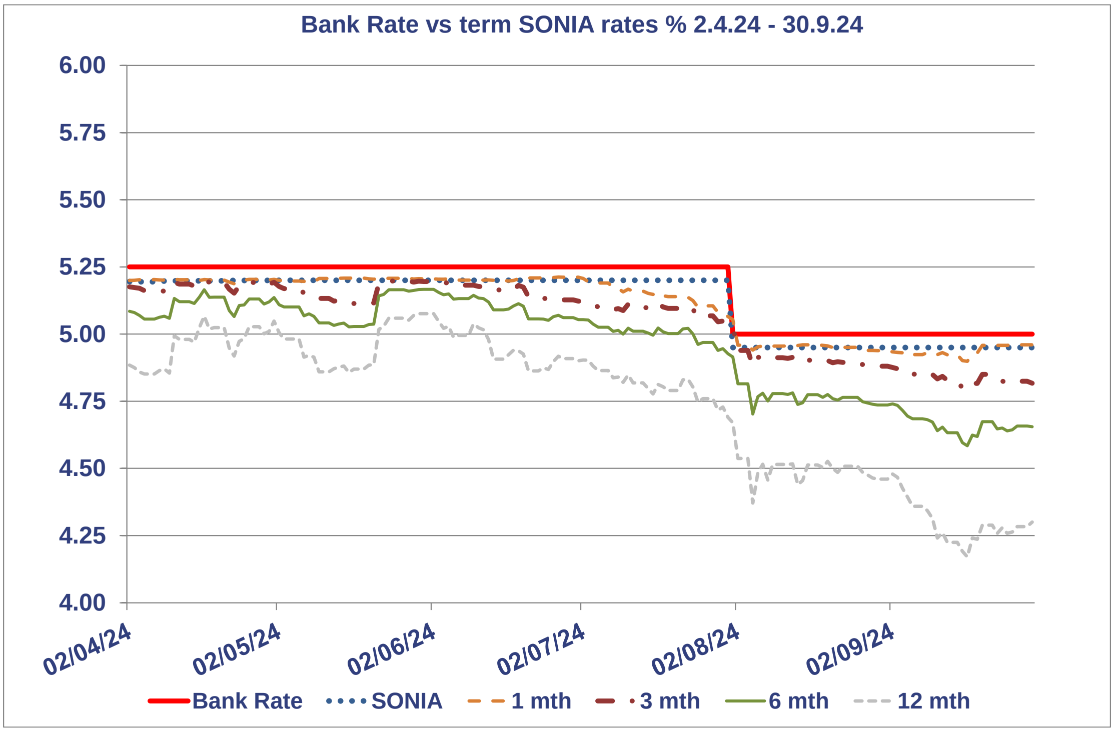
A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short 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.

7. Investment Portfolio 2024/25

7.1 In accordance with the CIPFA Treasury Management Code of Practice, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs.

7.2 As shown by the interest rate forecasts in section 4.2, rates are at levels not seen since before the financial crash of 2008 and the austerity measures which followed. It is anticipated rates will now decrease slowly and settle around 3% in the medium term. This means investment returns are higher than in previous years and this combined with larger investment balances than expected means increased investment income in 2024/25 is anticipated.

7.3 The Council held £21.7m of investments as at 30 September 2024 (£20.2m at 1st April 2024). The annualised investment rate for the first six months of the year is 5.233% against the Sterling Overnight Indexed Average (SONIA) average rate of 5.12%. The weighted average interest rate is 5.218%.



7.4 The Council's budgeted investment return for 2024/25 is £0.651m, and performance for the year is forecast to be £0.256m above budget at £0.907m, this is due to higher balances than expected.

7.5 The Director of Corporate Services (S151) confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2024/25.

8 Investment Counterparty criteria

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

8.2 Treasury Officers continue to mitigate investment risk in accordance with Treasury Management Practices.

9. Borrowing

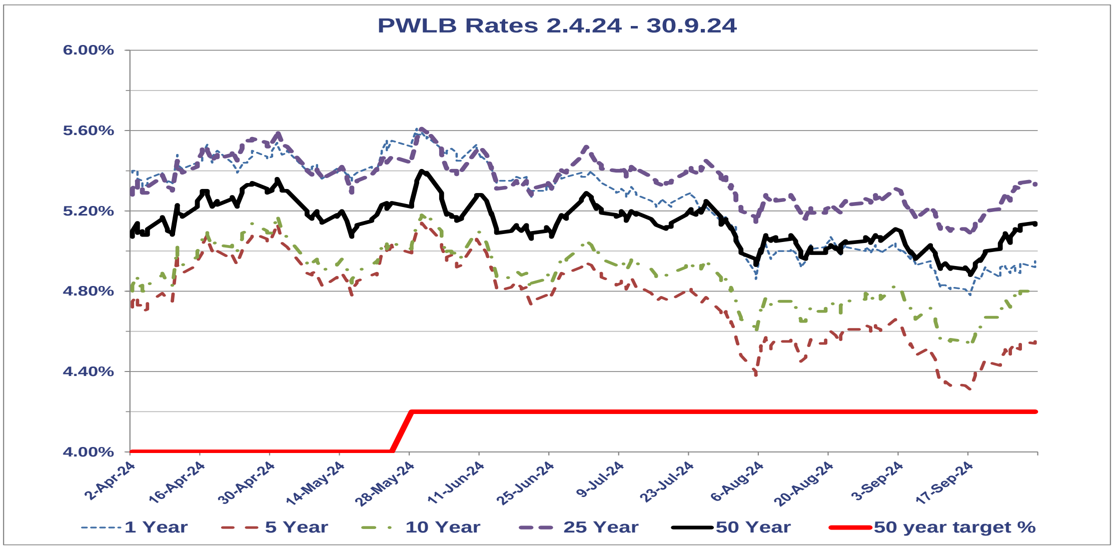
9.1The Council's capital financing requirement (CFR) for 2024/25 was originally forecast to be £36.340m which has now changed to £36.070m after the Council closed its accounts for 2023/24. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.

9.2 Due to the overall financial position and the underlying need to borrow for capital purposes (the capital financing requirement - CFR), new external borrowing of £10m was undertaken in the first six months of the financial year. As this was short term temporary borrowing for cashflow purposes, £5m was also repaid. External borrowing is at £19m at the end of quarter two. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

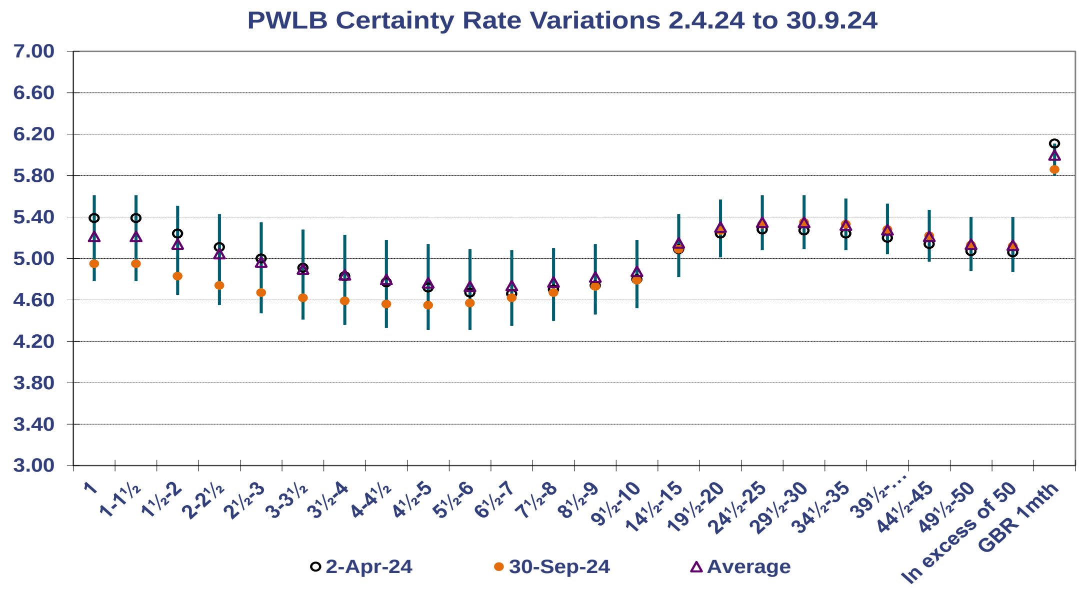
9.3 **INTERNAL BORROWING**: The Council forecasts that by the end of the financial year it will have cumulatively £17.070m of internal borrowing

9.4 It is anticipated that further short-term external borrowing may be undertaken early next year to smooth peaks and troughs in cashflow.

9.5 The graph and table below show the movement in PWLB certainty rates for the first six months of the year:



	1 Year	5 Year	10 Year	25 Year	50 Year
02/04/2024	5.39%	4.72%	4.80%	5.28%	5.07%
30/09/2024	4.95%	4.55%	4.79%	5.33%	5.13%
Low	4.78%	4.31%	4.52%	5.08%	4.88%
Low date	17/09/2024	17/09/2024	17/09/2024	17/09/2024	17/09/2024
High	5.61%	5.14%	5.18%	5.61%	5.40%
High date	29/05/2024	01/05/2024	01/05/2024	01/05/2024	01/05/2024
Average	5.21%	4.76%	4.88%	5.35%	5.14%
Spread	0.83%	0.83%	0.66%	0.53%	0.52%



10 Liquidity Benchmark

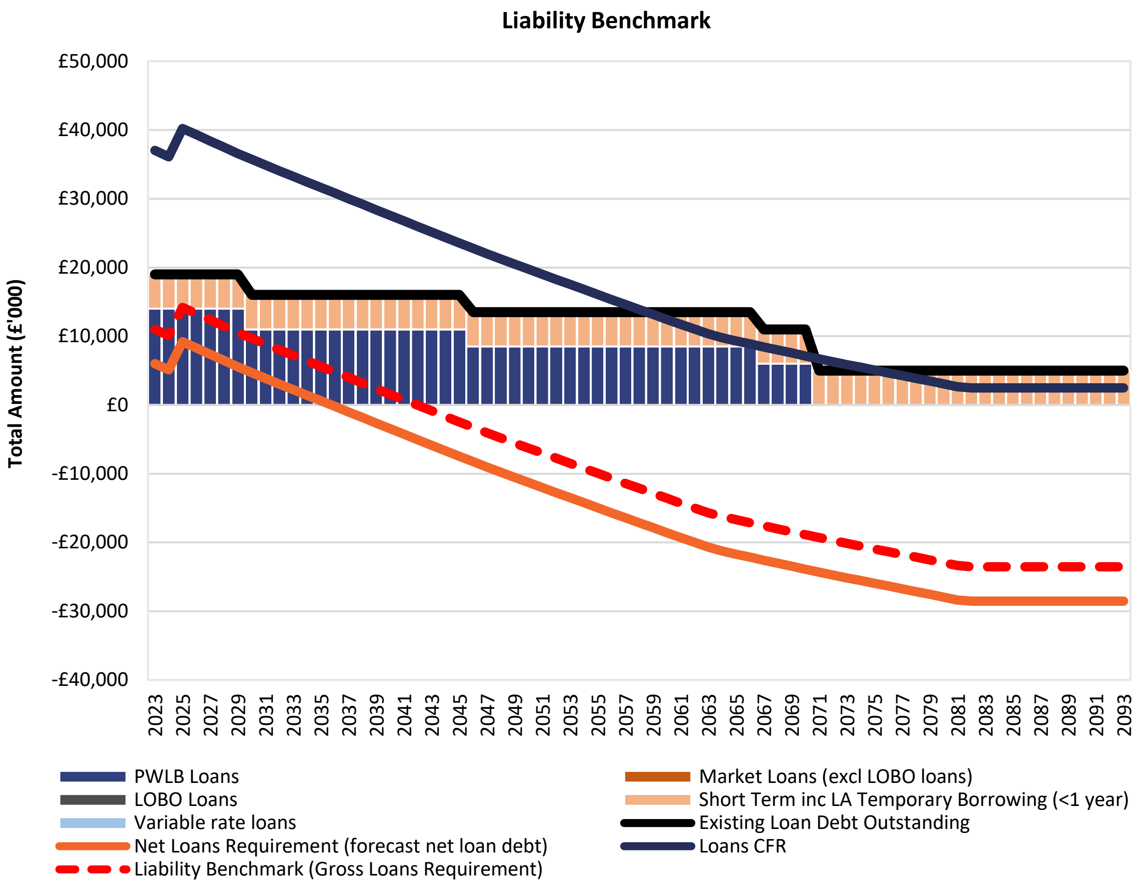
10.1 To Compare the Council's actual borrowing against an alternative strategy, a Liability Benchmark has been calculated showing the lowest risk level of borrowing. This prudential indicator is made up of four components:

- Existing loan debt outstanding: the Authority's existing loans that are still outstanding in future years.

- Loans CFR: this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned MRP.

- Net loans requirement: this will show the Authority's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned MRP and any other major cash flows forecast.

- Liability benchmark (or gross loans requirement): this equals net loans requirement plus short-term liquidity allowance



Liability Benchmark
Total Amount (£'000)
£50,000
£40,000
£30,000
£20,000
£10,000
£0
-£10,000
-£20,000
-£30,000
-£40,000
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2083
2085
2087
2089
2091
2093
PWLB Loans
Market Loans (excl LOBO loans)
LOBO Loans
Short Term inc LA Temporary Borrowing (<1 year)
Variable rate loans
Existing Loan Debt Outstanding
Net Loans Requirement (forecast net loan debt)
Loans CFR
Liability Benchmark (Gross Loans Requirement)

APPENDIX B: Approved countries for investments as at 30 September 2024

Based on lowest available rating

AAA

- Australia
- Denmark
- Germany
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- Qatar (upgraded from AA- 20/3/24)

AA-

- Belgium
- France
- **U.K.**