

## AUDIT COMMITTEE - 26 JULY 2024

### TREASURY MANAGEMENT REPORT Q1 2024/25

#### 1. PURPOSE

- 1.1. New Forest District Council has adopted the key recommendations of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code), last updated in 2021 which requires the Council to approve, as a minimum, treasury management semi-annual and annual outturn reports.

#### 2. SUMMARY

- 2.1. This quarterly report provides an update on treasury management activity including the requirement in the 2021 Code of quarterly reporting of the treasury management prudential indicators. The non-treasury prudential indicators are incorporated in the Council's normal quarterly Financial Monitoring report.
- 2.2. The Council's treasury management strategy was approved at a meeting of Full Council in February 2024. The Council has borrowed and invested sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Council's treasury management strategy.
- 2.3. Treasury management in the context of this report is defined as:

“The management of the organisation's 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.”
- 2.4. Hampshire County Council's Investments & Borrowing Team has been contracted to manage the Council's treasury management balances since March 2014 but overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

#### 3. EXTERNAL CONTEXT

- 3.1. The following sections outline the key economic themes in the UK against which investment and borrowing decisions have been made so far in 2024/25.

##### **Economic background**

- 3.2. UK headline consumer price inflation (CPI) continued to decline over the quarter, falling from an annual rate of 3.2% in March to 2.0% in May, in line with the Bank of England's (BoE) target. The core measure of inflation, however, only declined from 4.2% to 3.5% over the same period,

which, together with stubbornly services price inflation at 5.7% in May, helped contribute to the BoE maintaining Bank Rate at 5.25% during the period, a level unchanged since August 2023.

- 3.3. Data released during the period showed that the UK economy had emerged from the technical recession at the end of 2023 to expand by 0.7% (upwardly revised from the initial estimate of 0.6%) in the first quarter of the calendar year. Monthly GDP data showed zero growth in April 2024 following an expansion of 0.4% in the previous month.
- 3.4. Arlingclose, the authority's treasury adviser, maintained its central view that 5.25% is the peak in Bank Rate and that interest rates will most likely be cut later in in second half of 2024. The risks over the medium term are deemed to be to the upside as while inflation has fallen to target, it is expected to pick up again later in the year and as services price inflation and wage growth are still on the firmer side, the MPC could well delay before delivering the first rate cut.

### **Financial markets**

- 3.5. Sentiment in financial markets showed signs of improvement over the quarter, but bond yields remained volatile. Early in the period bond yields climbed steadily, but mixed signals from economic data and investors' constant reassessment of when rate cuts might come caused a couple of fairly pronounced but short lived dips in yield. Towards the end of the quarter yields rose once again and were generally higher than at the start of the period.

### **Credit review**

- 3.6. Arlingclose maintained its advised recommended maximum unsecured duration limit on all banks on its counterparty list at 100 days.
- 3.7. Credit default swap (CDS) prices are used as an indicator of credit risk, where higher premiums indicate higher perceived risks. CDS prices started and ended the quarter at broadly similar levels in the UK as they did for the European, Singaporean and Australian lenders on Arlingclose's counterparty list, while Canadian banks generally trended modestly downwards.
- 3.8. Financial market volatility is expected to remain a feature, at least in the near term and, CDS 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.

## **4. LOCAL CONTEXT**

- 4.1. On 31 March 2024, the Council had net borrowing of £92.7m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying resources available for investment. Table 1 lays out the various CFR elements and how they are financed, comparing the position at 31 March 2024 to the forecast position expected at 31 March 2025.

Table 1: Balance Sheet Summary

	31/03/24 Balance £m	31/03/25 Forecast £m
General Fund CFR	26.4	28.8
Housing Revenue Account (HRA) CFR	19.8	29.6
HRA Settlement	114.0	109.9
<b>Total CFR</b>	<b>160.2</b>	<b>168.3</b>
Financed By:		
External Borrowing	124.0	132.9
Internal Borrowing	36.2	35.4
<b>Total Borrowing</b>	<b>160.2</b>	<b>168.3</b>

- 4.2. The treasury management position at 30 June 2024 and the change over the quarter is shown in Table 2.

Table 2: Treasury Management Summary

	31/03/24 Balance £m	Movement £m	30/06/24 Balance £m	30/06/24 Rate %
Long-term borrowing	(119.9)	0.0	(119.9)	3.50
Short-term borrowing	(4.1)	0.0	(4.1)	2.82
<b>Total borrowing</b>	<b>(124.0)</b>	<b>0.0</b>	<b>(124.0)</b>	<b>3.48</b>
Long-term investments	9.1	0.0	9.1	5.44
Short-term investments	10.0	(0.5)	9.5	5.17
Cash and cash equivalents	12.2	9.1	21.3	5.15
<b>Total investments</b>	<b>31.3</b>	<b>8.6</b>	<b>39.9</b>	<b>5.22</b>
<b>Net borrowing</b>	<b>(92.7)</b>	<b>8.6</b>	<b>(84.1)</b>	

Note: the figures in Table 2 at 31/03/24 are from the balance sheet in the Council's statement of accounts adjusted to exclude operational cash, market value adjustments and accrued interest.

- 4.3. The decrease in net borrowing of £8.6m shown in Table 2 reflects the normal pattern of the Council's cash balances, with higher balances at the start of the financial year due to the uneven pattern of grant receipts. Further details are provided in the Borrowing Strategy and Activity and Treasury Investments Activity sections of this report.

## 5. BORROWING STRATEGY AND ACTIVITY

- 5.1. As outlined in the Treasury Management Strategy, the Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing lower interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is 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. At the present time short term interest rates are higher than long term interest rates.

- 5.2. Policy interest rates have risen substantially since 2021 although they have largely plateaued over the last year. Over the last quarter gilt yields have risen slightly overall, having had a number of peaks and troughs. There has been downward pressure from lower inflation figures, but also upward pressure from unexpectedly positive economic data.
- 5.3. The Public Works Loan Board (PWLB) certainty rate for 10-year maturity loans was 4.80% at the beginning of the quarter and 4.96% percent at the end. The lowest available 10-year maturity rate during the quarter was 4.80% and the highest was 5.18%. Rates for 20-year maturity loans ranged from 5.24% to 5.57% during the quarter, and 50-year maturity loans from 5.06% to 5.40%.
- 5.4. Whilst the cost of short-term borrowing from other local authorities (LA) spiked to around 7% in late March 2024, shorter-term rates reverted to a more normal range and were generally around 5.25% through the quarter.
- 5.5. CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement and so may lead to new borrowing, unless directly and primarily related to the functions of the Authority. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield unless these loans are for refinancing purposes. The Council has no plans to borrow to invest primarily for financial return, so is able to retain full access to the PWLB.
- 5.6. The PWLB HRA rate which is 0.4% below the certainty rate 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. The Council borrowed at the HRA rate in March 2024 as reported in the Treasury Management Outturn report. Borrowing is potentially required in relation to the HRA during 2024/25 and if the PWLB is identified as the most cost effective solution for the Council, the intention is to use the PWLB HRA rate.
- 5.7. The Council is a net borrower and as stated in the Treasury Management Strategy 2024/25, the Council expects a positive liability benchmark across the forecast period, which generally means an authority is required to take external borrowing to fund the gap between its resources and the CFR. Although the Council currently has taken external borrowing, this is not predicted to be sufficient to meet the CFR between 2024 and 2034 and therefore, as a result, further borrowing will be considered by the Section 151 Officer over the coming months and years, if required.
- 5.8. At 30 June 2024 the Council held £124.0m of loans. The vast majority of the outstanding loans are in relation to the resettlement of the HRA in 2012/13. Outstanding loans on 30 June 2024 are summarised in Table 3.

Table 3: Borrowing Position

	31/03/24 Balance £m	Movement £m	30/06/24 Balance £m	30/06/24 Rate %	30/06/24 WAM* years
Public Works Loan Board	(124.0)	0.0	(124.0)	3.48	17.0
<b>Total borrowing</b>	<b>(124.0)</b>	<b>0.0</b>	<b>(124.0)</b>	<b>3.48</b>	<b>17.0</b>

\* Weighted average maturity

Note: the figures in Table 3 at 31/03/24 are from the balance sheet in the Council's statement of accounts adjusted to exclude accrued interest.

## 6. TREASURY INVESTMENT ACTIVITY

6.1. The CIPFA Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (revised in 2021) defines treasury management investments as investments that arise from the organisation's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

6.2. The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year to date the Council's investment balances have ranged between £29.7m and £54.7m due to timing differences between income and expenditure. The investment position is shown in Table 4.

Table 4: Treasury investment position

	31/03/2024 Balance £m	Movement £m	30/06/2024 Balance £m	30/06/24 Rate %	30/06/24 WAM* years
<b>Investments</b>					
<b>Short term Investments</b>					
Banks and Building Societies:					
- Unsecured	2.0	1.6	3.6	4.85	0.00
- Secured	0.0	0.0	0.0	0.00	0.00
Money Market Funds	8.2	9.5	17.7	5.21	0.00
Government:					
- Local Authorities	6.0	(2.0)	4.0	5.61	0.12
- Supranational banks	2.0	(0.5)	1.5	5.06	0.47
- High quality	0.0	2.0	2.0	5.03	0.45
- UK Treasury Bills	2.0	(2.0)	0.0	0.00	0.00
Cash Plus Funds	2.0	0.0	2.0	4.54	0.01
	<b>22.2</b>	<b>8.6</b>	<b>30.8</b>	<b>5.16</b>	<b>0.07</b>
<b>Long term investments</b>					
Pooled Property Funds**	7.6	0.0	7.6	4.94	N/A
Pooled Equity Funds**	1.5	0.0	1.5	7.97	N/A
	<b>9.1</b>	<b>0.0</b>	<b>9.1</b>	<b>5.44</b>	<b>N/A</b>
<b>TOTAL INVESTMENTS</b>	<b>31.3</b>	<b>8.6</b>	<b>39.9</b>	<b>5.22</b>	<b>0.05</b>

\* Weighted average maturity, excluding pooled funds

\*\* The rates provided for pooled fund investments are reflective of annualised income returns pooled over the year to 30 June 2024 based on the market value of investments at the start of the year.

Note: the figures in Table 4 at 31/03/24 are from the balance sheet in the Council's accounts but adjusted to exclude operational cash, market value adjustments and accrued interest.

- 6.3. 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 income.
- 6.4. The security of investments has been maintained by following the counterparty policy and investment limits within the TMSS, taking advice from Arlingclose on changes in counterparty credit worthiness, and making use of secured investment products that provide collateral. The Council should invest in liquid investments to ensure money is available when required to meet its financial obligations, spreading these investments across a number of counterparties to mitigate operational risk.
- 6.5. As demonstrated by the liability benchmark shown later in this report, the Council expects to be a long-term borrower and new treasury investments are therefore primarily made to manage day-to-day cash flows using short-term low risk instruments. The Council has invested in pooled funds as part of its Treasury Management strategy. This is not a policy to primarily generate yield but a part of the implementation of the wider Treasury Management strategy to invest the Council's surplus cash and reserves ensuring it is investing its funds prudently, having regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. By investing a diversified portfolio in respect of yield this meets the Council's aim of protecting reserves from high inflation. The Section 151 Officer will review the current pooled fund investment prior to making any external borrowing decisions.
- 6.6. Bank Rate remained at 5.25% through the quarter with short term interest rates largely around this level. Money market rates ranged between 5.19% and 5.23% at the end of June 2024.
- 6.7. The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5. These metrics monitor the internal investments of the portfolio, which is the total portfolio less both the pooled funds and the cash plus fund.

Table 5: Investment benchmarking (excluding pooled funds)

	Credit rating	Bail-in exposure	Weighted average maturity (days)	Rate of return
31.03.2024	AA-	51%	55	5.26%
30.06.2024	AA-	74%	27	5.19%
Similar LAs	A+	62%	52	5.06%
All LAs	A+	62%	10	5.07%

- 6.8. Table 5 shows that the Council's investments benchmarking metrics have remained favourable over Quarter 1 of 2024/25. The average credit rating has remained stable at AA- which is above the average of Arlingclose's other local authority clients. Since 31 March 2024 investment balances have increased by 27%, all of which has been invested in money market funds. These are liquid investments and so this action has resulted in the weighted average maturity metric reducing from 55 to 27 days. Money market funds are AAA-rated investments and deemed by Arlingclose to be 'bail-in light' being that they are exposed to bank bail-in. This has resulted in the Council's bail-in exposure increasing however money market funds are highly diversified therefore effectively reducing the Council's exposure to that particular risk.
- 6.9. The average rate of return on the internal investments portfolio was 5.19% at 30 June 2024; this has reduced slightly in comparison to 31 March 2024 which reflects the market expectation that the Bank Base Rate will be cut during the second half of 2024. However, 5.19% represents a good return on investment and by comparison, the Council's average rate of return is comfortably above the averages experienced by Arlingclose's other local authority clients.

#### **Externally managed pooled funds**

- 6.10. £9.1m of the Council's investments are invested in externally managed strategic pooled property and equity funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability.
- 6.11. UK equities enjoyed a positive quarter; the FTSE All Share index was buoyed in April 2024 by data showing the economy had emerged from the short, shallow recession in 2023. Sterling's weakness against the dollar in April 2024 also provided a boost to UK stocks with overseas earnings. The energy, materials and mining sectors gained as the outlook for global manufacturing improved. Healthcare and financial stocks were also supported by good earnings data. The rally faded somewhat with the unexpected announcement in May 2024 of a general election in early July 2024.
- 6.12. Dwindling prospects of policy rate cuts weighed on consumer discretionary stocks as well as on the UK real estate sector. Improvement in commercial property capital values was dampened by property's sensitivity to higher interest rates.
- 6.13. Because these 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 medium- to long-term 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 should exceed cash interest rates.
- 6.14. In April 2023 the Department for Levelling Up, Housing and Communities 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 31

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 will discuss with Arlingclose the implications for the investment strategy and what action may need to be taken.

## 7. NON-TREASURY INVESTMENTS

- 7.1. The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and/or for commercial purposes (made primarily for financial return).
- 7.2. Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) also broadens the definition of investments to include all such assets held partially or wholly for financial return.
- 7.3. This could include loans made to local businesses or the direct purchase of land or property and such loans and investments will be subject to the Council's normal approval process for revenue and capital expenditure and need not comply with the treasury management strategy.
- 7.4. The Council's existing non-treasury investments are listed in Table 6.

Table 6: Non-treasury investments

	31/03/24 Asset value £m	31/03/2024 Annual rate of return
Hythe Marina	2.798	5.90
Saxon Inn Calmore	0.179	7.04
Meeting House Lane	0.188	-
New Milton Health Centre	2.489	5.51
Ampress Car Park	2.141	4.52
The Parade Salisbury Road Totton	1.511	6.34
1-3 Queensway New Milton	1.62	-
Unit 1 Nova Business Park	0.548	6.38
Drive -Thru Salisbury Road, Totton	1.372	4.83
Units 1-3 27 Salisbury Road, Totton	1.90	8.02
85 Station Road, New Milton	5.00	5.00
1b Junction Road, Totton,	0.128	-
Unit 800 Ampress Park, Lymington	1.903	4.97
Platinum Jubilee Business Park	8.55	1.48
<b>Total investment properties</b>	<b>30.325</b>	<b>4.34</b>
Lymington Town Hall	3.321	2.91
Hardley Industrial Estate	5.088	4.42
<b>Total income earning properties</b>	<b>8.409</b>	<b>3.83</b>
<b>Grand total</b>	<b>38.734</b>	<b>4.01</b>



## 8. COMPLIANCE REPORT

- 8.1. The Section 151 Officer reports that all treasury management activities undertaken during the quarter complied fully with the principles in the Treasury Management Code and the Council's approved Treasury Management Strategy.
- 8.2. Compliance with the authorised limit and operational boundary for external debt, is demonstrated in Table 7.

Table 7: Debt limits

	Q1 2024/25 Maximum £m	30/06/24 Actual £m	2024/25 Operational Boundary £m	2024/25 Authorised Limit £m	Complied
Total debt	(124.0)	(124.0)	(211.5)	(230.5)	✓

- 8.3. 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.

## 9. TREASURY MANAGEMENT INDICATORS

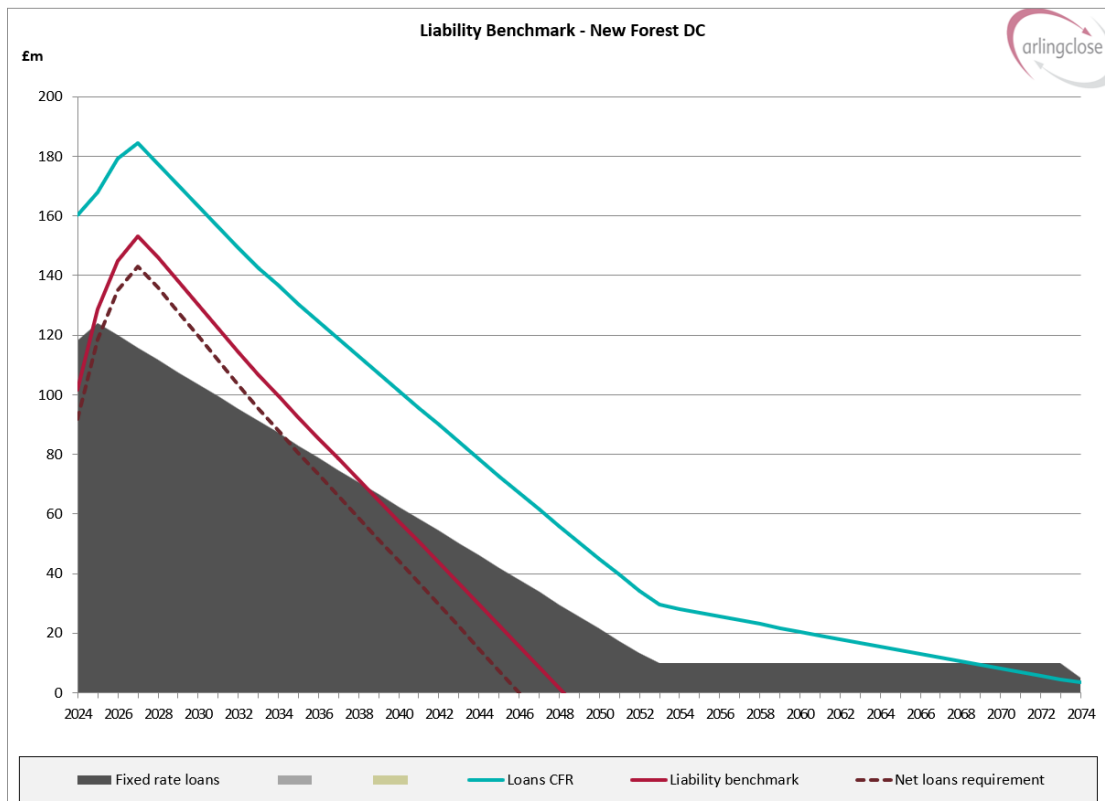
- 9.1. As required by the 2021 CIPFA Treasury Management Code, the Council monitors and measures the following treasury management prudential indicators.

### Liability benchmark

- 9.2. This 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 required to manage day-to-day cash flow.

Table 8: Liability benchmark

	31/03/24 Actual £m	31/03/25 Forecast £m	31/03/26 Forecast £m	31/03/27 Forecast £m
Loans CFR	160.2	168.3	178.5	182.5
Less: Balance sheet resources	(62.1)	(45.4)	(43.2)	(40.7)
<b>Net loans requirement</b>	<b>98.1</b>	<b>122.9</b>	<b>135.3</b>	<b>141.8</b>
Plus: Liquidity allowance	10.0	10.0	10.0	10.0
<b>Liability benchmark</b>	<b>108.1</b>	<b>132.9</b>	<b>145.3</b>	<b>151.8</b>
<b>Existing borrowing</b>	<b>124.0</b>	<b>119.9</b>	<b>115.8</b>	<b>111.7</b>



9.3. Table 8 and the graph shown above illustrates that by the end of 2025/26, the Council's existing borrowing will no longer be sufficient to meet the liability benchmark and the Council will need to source external borrowing if it is to meet the full delivery of its capital programme. The Council will keep this position under review and continue to take advice from Arlingclose on the most appropriate time to borrow when it is required.

### Interest rate exposures

9.4. The following indicator shows the sensitivity of the Council's current investments and borrowing to a change in interest rates.

Table 9 – Interest Rate Risk Indicator

	30/06/24 Actual	Impact of +/- 1% interest rate change
Sums subject to variable interest rates		
Investment	£32.4m	+/- £0.3m
Borrowing	(£4.1m)	+/- £0.0m

9.5. Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments and loans that mature during the financial year are classed as variable rate.

## Maturity structure of borrowing

9.6. This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits show the maximum and minimum maturity exposure to fixed rate borrowing as agreed in the Treasury Management Strategy Statement.

Table 10: Maturity structure of borrowing

	30/06/24 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	3%	25%	0%	✓
12 months and within 24 months	3%	25%	0%	✓
24 months and within 5 years	10%	25%	0%	✓
5 years and within 10 years	17%	25%	0%	✓
10 years and above	67%	100%	0%	✓

## Long-term Treasury Management Investments

9.7. The purpose of this indicator is to control the Council'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 were:

Table 11: Long-term Treasury Management Investments

	2024/25	2025/26	2026/27	No fixed date
Actual principal invested beyond a year	£0m	£0m	£0m	£9.1m
Limit on principal invested beyond a year	£20m	£15m	£15m	£10m
Complied	✓	✓	✓	✓

9.8. Long-term investments with no fixed maturity date include strategic pooled funds but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

## 10. CRIME AND DISORDER AND ENVIRONMENTAL IMPLICATIONS

10.1. None arising directly from this report.

## 11. RECOMMENDATIONS

11.1. Members are recommended to:

11.2. Consider the performance of the treasury function detailed in this report.

<b>Further information</b>	<b>Background papers</b>
<p data-bbox="252 237 456 264">Please contact:</p> <p data-bbox="252 300 651 465">Gemma Farley Principal Accountant Investments &amp; Borrowing Hampshire County Council Gemma.Farley@hants.gov.uk</p> <p data-bbox="252 535 655 734">Alan Bethune Strategic Director of Corporate Resource, and Transformation Section 151 Officer New Forest District Council alan.bethune@nfdc.gov.uk</p>	<p data-bbox="710 237 1305 297">The Prudential Code, CIPFA Guidance Notes and ODPM Investment Guidance</p> <p data-bbox="710 333 1075 360">Local Government Act 2003</p> <p data-bbox="710 396 1337 465">SI 2003/3146 Local Authorities (Capital Finance and Accounting) (England) Regulations 2003</p> <p data-bbox="710 501 1337 600">Treasury Management Strategy Report 2024/25 Audit Committee – 26 January 2024 Council – 26 February 2024</p> <p data-bbox="710 636 1326 705">Treasury Management Outturn Report 2023/24 Audit Committee – 31 May 2024</p>