AUDIT COMMITTEE 25 OCTOBER 2024

TREASURY MANAGEMENT REPORT Q2 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 remained around the Bank of England (BoE) target during the second quarter of the financial year, with

July and August 2024 returning annual rates of 2.2% as was expected, due to base effects from energy prices. Core and services price inflation remained higher at 3.6% and 5.6% respectively in August 2024.

3.3. The UK economy continued to expand over the period, albeit slowing from the 0.7% gain in the first calendar quarter to 0.5% (downwardly revised from 0.6%) in the second. Of the monthly figures, the economy was estimated to have registered no growth in July 2024. With headline inflation lower, the BoE cut the Bank Rate from 5.25% to 5.00% at the August 2024 Monetary Policy Committee (MPC) meeting.

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

Credit review

3.5. Arlingclose maintained its advised recommended maximum unsecured duration limit on all banks on its counterparty list at 100 days.

3.6. Credit default swap (CDS) prices are used as an indicator of credit risk, where higher premiums indicate higher perceived risks. CDS prices were generally lower at the end of the period compared to the beginning for the vast majority of the names on UK and non-UK lists. Price volatility over the period was also generally more muted compared to previous periods.

3.7. 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
Total CFR	**160.2**	**168.3**
Financed By:		
External Borrowing*	124.0	132.9
Internal Borrowing	36.2	35.4
Total Borrowing	**160.2**	**168.3**

* shows only loans to which the Council is committed and excludes optional refinancing

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

Table 2: Treasury Management Summary

	30/06/24 Balance £m	Movement £m	30/09/24 Balance £m	30/09/24 Rate %
Long-term borrowing	(119.9)	0.0	(119.9)	3.5
Short-term borrowing	(4.1)	0.0	(4.1)	2.8
Total borrowing	**(124.0)**	**0.0**	**(124.0)**	**3.5**
Long-term investments	9.1	0.0	9.1	5.5
Short-term investments	9.5	4.0	13.5	5.0
Cash and cash equivalents	21.3	(4.1)	17.2	5.0
Total investments	**39.9**	**(0.1)**	**39.8**	**5.1**
Net borrowing	**(84.1)**	**(0.1)**	**(84.2)**	

4.3. The second quarter of the financial year shows very little movement in the treasury management balances in comparison to the end of the first quarter. This reflects no change to the borrowing position combined with a reduction of £100,000 in the investments position.

4.4. During the quarter no further borrowing was secured, and the repayment of the short-term borrowing shown is due in March 2025. The marginal reduction in investment balances 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, netted off by capital expenditure. 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. After substantial rises in interest rates since 2021 many central banks have now begun to reduce rates, albeit slowly. Gilt yields were volatile over the first half of the financial year, reducing slightly between April and September 2024. Much of the downward pressure from lower inflation figures was counteracted by upward pressure from positive economic data. Data from the US continues to impact global bond markets including UK gilt yields.

5.3. During the first half of the financial year, gilts were fairly volatile which impacted the borrowing rates provided by the PWLB. The lowest available 10-year maturity loan at certainty rate was 4.52% and the highest was 5.18%. Rates for 20-year maturity loans ranged from 5.01% to 5.57% during the half year, and 50-year maturity loans from 4.88% 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, primarily due to a dearth of LA-LA lending/borrowing activity during the month, as expected shorter-term rates reverted to a more normal range and were generally around 5.00% - 5.25%.

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 (Housing Revenue Account) 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, providing a window of opportunity for HRA-related borrowing and to replace the Council's loans relating to the HRA maturing during this time frame. 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 continues to be considered by the Section 151 Officer.

5.8. At 30 September 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 September 2024 are summarised in Table 3.

Table 3: Borrowing Position

	30/06/24 Balance £m	Movement £m	30/09/24 Balance £m	30/09/24 Rate %	30/09/24 WAM* years
Public Works Loan Board	(124.0)	0.0	(124.0)	3.5	16.7
Total borrowing	**(124.0)**	**0.0**	**(124.0)**	**3.5**	**16.7**

* Weighted average maturity

6. TREASURY INVESTMENT ACTIVITY

6.1. The CIPFA Treasury Management Code defines treasury management investments as investments that arise from the Authority'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 financial year to date the Council's investment balances have ranged between £29.7m and £63.9m due to timing differences between income and expenditure. The investment position is shown in Table 4.

Table 4: Treasury investment position

Investments	30/06/24 Balance £m	Movement £m	30/09/24 Balance £m	30/09/24 Rate %	30/09/24 WAM* years
Short term Investments					
Banks and Building Societies:					
- Unsecured	3.6	0.4	4.0	5.0	0.0
Money Market Funds	17.7	(4.0)	13.7	5.0	0.0
Government:					
- Local Authorities	4.0	(2.5)	1.5	5.7	0.0
- Supranational banks	1.5	0.0	1.5	5.1	0.2
- High quality	2.0	0.0	2.0	5.0	0.2
- UK Treasury Bills	0.0	6.0	6.0	5.1	0.1
Cash Plus Funds	2.0	0.0	2.0	4.7	0.0
	30.8	**(0.1)**	**30.7**	**5.0**	**0.1**
Long term investments					
Pooled Property Funds**	7.6	0.0	7.6	5.0	N/A
Pooled Equity Funds**	1.5	0.0	1.5	7.7	N/A
	9.1	**0.0**	**9.1**	**5.5**	N/A
TOTAL INVESTMENTS	**39.9**	**(0.1)**	**39.8**	**5.1**	**0.1**

* Weighted average maturity, excluding pooled funds

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

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 where available and appropriate. 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. During the quarter liquidity levels were reduced as appropriate investments became available, this included the use of UK treasury bills which provide a greater source of security for the Council's cash balances.

6.6. 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. The existing portfolio of strategic pooled funds will be maintained to diversify risk into different asset classes and boost investment income as part of the implementation of the wider Treasury Management strategy 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 in 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.

6.7. Bank Rate reduced from 5.25% to 5.00% in August 2024 with short term interest rates largely being around these levels and average money market rates fell from 5.21% at the end of June 2024 to 5.00% at the end of September 2024.

6.8. 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. At the time of writing, the benchmarking for Quarter 2 was not yet available other than the data for the Council's internal investments.

Table 5: Investment benchmarking (excluding pooled funds)

	Credit rating	Bail-in exposure	Weighted average maturity (days)	Rate of return
30.06.2024				
NFDC Similar LAs All LAs	AA- A+ A+	74% 62% 62%	27 52 10	5.19% 5.06% 5.07%
30.09.2024				
NFDC	AA-	62%	20	5.05%

6.9. Table 5 shows that the Council's investments benchmarking metrics were favourable as at the end of Quarter 1 of 2024/25. As at the end of Quarter 2 the Council's metrics have remained stable although the rate of return has reduced as a result of the cut to the Base Rate in August 2024.

6.10. The average credit rating has remained consistent at AA-, and this continued into Quarter 2, which was above the average of Arlingclose's other local authority clients as at the end of Quarter 1. Although investment balances have remained steady, over the quarter the amount held as cash has reduced and has been replaced by treasury bills to improve the overall security of the portfolio, which has resulted in the bail-in exposure for the Council reducing by 12%. This means that the Council's bail-in exposure level now sits in line with the average bail-in exposure for Arlingclose clients at the end of Quarter 1.

6.11. The average rate of return on the internal investments portfolio was 5.05% at 30 September 2024; this has reduced in comparison to 30 June 2024 as a result of the Bank Base Rate being cut in August 2024. However, 5.05% represents a good return on investment and by comparison, the Council's average rate of return is only slightly below the averages experienced by Arlingclose's other local authority clients at the end of Quarter 1, and it is expected that other clients also experienced a similar drop in investment return over the period.

6.12. A comparison of the Council's Quarter 2 position to other Arlingclose clients will be reported in the Quarter 3 Treasury Management Report.

Externally managed pooled funds

6.13. £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. Over the 12 months to 30 September 2024 these funds generated an average total return of 4.3%, comprising a 5.4% income return which is used to support services in year, and 1.1% of unrealised capital loss.

6.14. By comparison, over the holding period of these investments, the pooled funds have generated a total return of 3.5% pa, comprising 4.0% pa average income return and -0.68% pa average capital return. There is currently an unrealised capital loss of £804,000 on the pooled funds, and it is hoped that the capital value of these investments will recover over the medium term. Regardless of this, a total return of 3.5% pa represents good value over a period where generally interest rates have remained low.

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

6.16. Stock markets across the UK, Europe, and US were buoyed by hopes of rate cuts over the first half of the financial year and UK equities saw growth in small and mid-sized companies. The FTSE All Share index was marginally lower at the end of the 6-month period at 4529 on 30/9/24 v 4338 on 31/3/24.

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

6.18. 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.

6.19. 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
Total investment properties	**30.325**	**4.34**
Lymington Town Hall	3.321	2.91
Hardley Industrial Estate	5.088	4.42
Total income earning properties	**8.409**	**3.83**
Grand total	**38.734**	**4.01**

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

	Q2 2024/25 Maximum £m	30/09/24 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 PRUDENTIAL INDICATORS

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

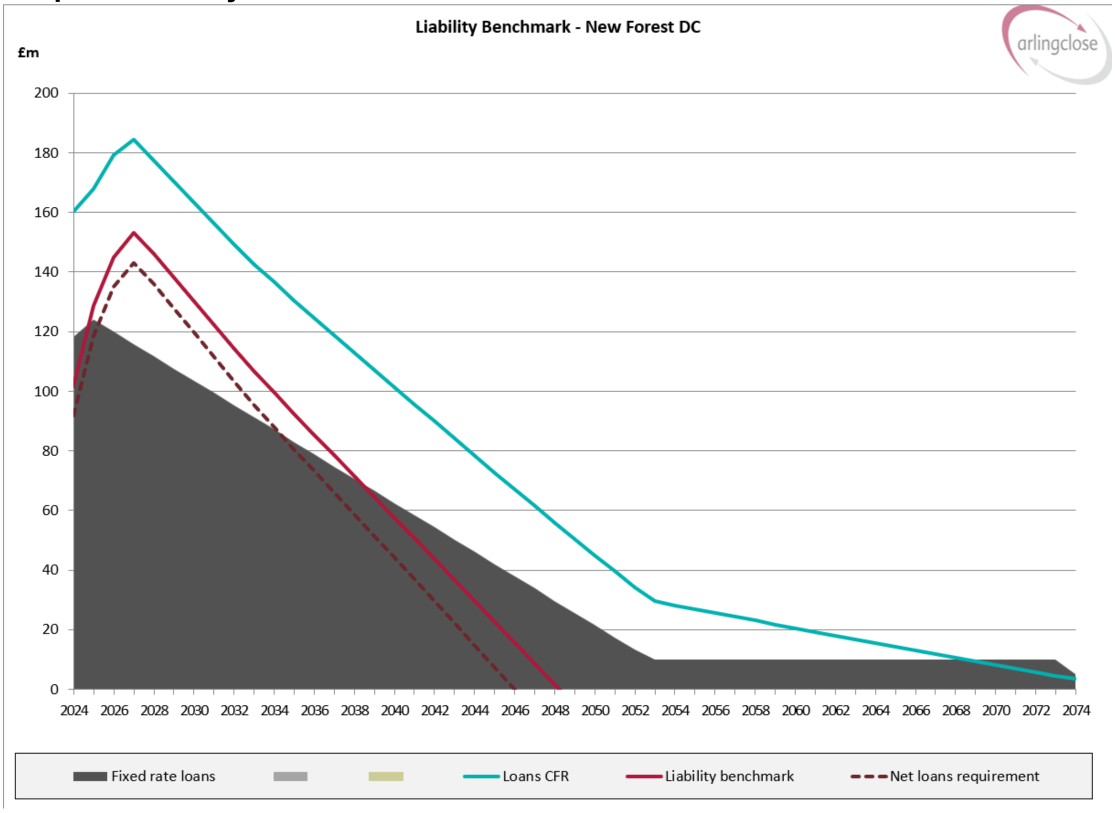
Liability benchmark

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)
Net loans requirement	**98.1**	**122.9**	**135.3**	**141.8**
Plus: Liquidity allowance	10.0	10.0	10.0	10.0
Liability benchmark	**108.1**	**132.9**	**145.3**	**151.8**
Existing borrowing	**124.0**	**119.9**	**115.8**	**111.7**

Graph 1: Liability benchmark



9.3. Table 8 and the Graph 1 illustrate that by the end of 2024/25, 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

	30/09/24 Actual	Impact of +/- 1% interest rate change
Sums subject to variable interest rates		
Investment	£39.8m	+/- £0.4m
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

	30/09/24 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.

Further information	Background papers
Please contact: Gemma Farley Principal Accountant Investments & Borrowing Hampshire County Council Gemma.Farley@hants.gov.uk Alan Bethune Strategic Director of Corporate Resource, and Transformation Section 151 Officer New Forest District Council alan.bethune@nfdc.gov.uk	The Prudential Code, CIPFA Guidance Notes and ODPM Investment Guidance Local Government Act 2003 SI 2003/3146 Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 Treasury Management Strategy Report 2024/25 Audit Committee – 26 January 2024 Council – 26 February 2024 Treasury Management Q1 Report 2024/25 Audit Committee – 26 July 2024