Mid Devon
DISTRICT COUNCIL

Report for:	**Cabinet**
Date of Meeting:	12 November 2024
Subject:	**Treasury Management Strategy Mid-Year Review Report 2024/25**
Cabinet Member:	Cllr James Buczkowski, Cabinet Member for Governance, Finance & Risk
Responsible Officer:	Andrew Jarrett, Deputy Chief Executive (S151)
Exempt:	N/A
Wards Affected:	All
Enclosures:	Appendix A – Economic Commentary from our Treasury Advisors (Link Group)

Section 1 – Summary and Recommendation(s)

To inform the Cabinet of the treasury performance during the first six months of 2024/25, to agree the ongoing deposit strategy for the remainder of 2024/25 and a review of compliance with Treasury and Prudential Limits for 2024/25.

Recommendation(s):

1. The Cabinet are asked to recommend to Council approval of:

- **a) A continuation of the current policy outlined at paragraphs 4.0 – 4.5 be agreed; and**
- **b) The changes to the Capital Financing Requirement, Operational Boundaries and Authorised Limits for the current financial year at paragraphs 5.4 – 5.5.**

Section 2 – Report

1.0 Introduction

1.1 CIPFA's Code of Practice for Treasury Management recommends the annual setting of a Treasury Management Strategy and best practice dictates a half yearly update on treasury performance. This report updates Members on the treasury performance over the first six months of 2024/25, but also seeks approval for the ongoing deposit strategy.

2.0 Treasury Performance 01/04/2024 to 30/09/2024

2.1 The table below shows the Council's overall treasury management position for the first six months of 2024/25.

Treasury Position	Average Interest	Total Interest as at 30/09/2024	Forecast Year-End Position
Temporary Investments and Deposits	5.34%	£530k	£966k
CCLA Dividends	4.69%	£117k	£240k
Loans to Redlands Primary Care*	3.72%	£39k	£78k
Total		**£686k**	**£1,284k**
Split Between:			
General Fund		£473k	£864k
Housing Revenue Account		£213k	£420k

**The Council made two loans in 2021 totalling £2.175m towards the construction of a new GP surgery in Crediton.*

2.2 The General Fund 2024/25 budget for all investment activity is £1,021k and for the Housing Revenue Account is £574k.

3.0 Economic Update

3.1 The Council's treasury advisor, Link Group, provided the following forecasts on 28 May 2024 (PWLB rates are certainty rates, gilt yields plus 80bps):

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

3.2 Bank Rate peaked at 5.25% in August 2023, before the Bank of England initiated its loosening cycle in August 2024 by cutting rates to 5.00%. At the Monetary Policy Committee meeting in September, the Bank opted to hold rates at 5.00%, however markets are forecasting a further cut to 4.75% in November 2024.

3.3 Please refer to Appendix 1 for the economic commentary provided by the Council's treasury advisors (Link Group).

4.0 Investment Portfolio

4.1 In accordance with the Code, 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 (SLY Principle).

4.2 The Council's investment portfolio as at 30 September 2024 was made up of short term investments/deposits to the value of £19.63m, comprising of £18.00m in fixed term investments and £1.63m in NatWest call accounts. In addition to this, the Council also holds £5.00m in the CCLA commercial property fund.

4.3 Short term investments/deposits held as at 30 September 2024 are as follows:

Institution	Principal (£)	Rate	Start Date	Maturity Date
Uttlesford District Council	5,000,000	5.35%	07/05/2024	07/11/2024
Eastleigh Borough Council	4,000,000	5.35%	28/05/2024	23/01/2025
NBK International PLC	2,000,000	5.05%	08/08/2024	08/11/2024
London Borough of Waltham Forest	3,000,000	4.85%	03/09/2024	03/06/2025
DMO	4,000,000	4.94%	27/09/2024	07/10/2024

4.4 The Council received an average return of 5.34% on investments during the first six months of 2024/25, up from 4.90% at the same point in the previous year. Interest rates on offer had started to reduce before the start of 2024/25, as markets began to price in potential cuts to Bank Rate. Therefore, returns during the first half of this year were strengthened slightly by maturing investments made in late 2023/24 and early 2024/25, with typical interest rates having dipped below 5% by September 2024. Performance is expected to reduce slightly in the second half of 2024/25 as interest rates continue to decrease.

4.5 The Council currently has £5m deposited with the CCLA (Churches, Charities and Local Authorities) Local Authorities' Property Fund, which pays dividends quarterly. For the first two quarters of 2024/25, dividends of £117k (4.69%) were received, up slightly from £116k (4.63%) for the same period in 2023/24. There has been a small decrease in fund value of £16k during the first half of 2024/25, with the Council's share in the fund now valued at £4.442m.

5.0 Borrowing Requirements and Prudential Indicators

5.1 The Council has no short-term borrowing but has existing PWLB loans of £30.393m as at 30 September 2024, in addition to £3.610m in finance leases.

5.2 The Council's revised capital financing requirement (CFR) for 2024/25 is £63.359m. 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. Table 5.6 shows the Council has forecast borrowings at 31 March 2025 of £39.497m, and so will have utilised £23.862m of cash flow funds in lieu of borrowing to finance the CFR of £63.359m shown in table 5.5.

5.3 There has so far been no new borrowing in 2024/25, however it is possible that new borrowing of up to £6.000m will be required before the end of the financial year to help fund the capital programme. This is a reduction in the level of new borrowing forecast at the start of the year, which originally stood at £7.800m, and is mainly due to slippage in the Capital Programme.

5.4 The Treasury Management Strategy Statement (TMSS) for 2024/25 was approved by Council on 21 February 2024. The underlying TMSS approved previously requires revision in light of a revised deliverable Capital Programme for 2024/25. The proposed changes are set out below:

Prudential Indicator 2024/25	**Original £000**	**Q1 Updated Forecast £000**	**Revised Prudential Indicator £000**
Authorised Limit	75,000	76,000	73,000
Operational Boundary	66,000	67,000	64,000
Capital Financing Requirement	65,606	66,660	63,359

5.5 The table below shows a breakdown of the revised CFR.

Prudential Indicator – Capital Financing Requirement	**2024/25 Original Estimate £000**	**Q1 Updated Forecast £000**	**2024/25 Revised Estimate £000**
CFR – Non Housing	18,657	18,949	15,876
CFR – Housing	46,949	47,711	47,483
Total CFR	**65,606**	**66,660**	**63,359**
Net movement in CFR*	**15,721**	**4,426**	**1,125**

**In-year movement calculated against 2023/24 CFR (estimated at £49,885k when the original 2024/25 estimate was calculated, now known to be £62,234k – 2023/24 Treasury Outturn).*

5.6 The table below shows the expected debt position at 31 March 2025, which determines the Operational Boundary and Authorised Limit shown in 5.4 above.

Prudential Indicator – External Debt	**2024/25 Original Estimate £000**	**2024/25 Revised Estimate £000**
Borrowing	37,198	35,398
Other Long Term Liabilities*	3,981	4,099
Total Debt (Year End Position)	**41,179**	**39,497**

** Includes finance leases*

6.0 Annual Investment Strategy

6.1 Any fixed term investments in the market place (except Debt Management Office [DMO]) are restricted to a maximum term of two years (previously one year). The Council's substantial commitments (particularly the monthly precepts to Devon County Council, the Police and Fire Authority) constrain the term of investments. The Cabinet of 7 February 2019 resolved to diversify the investment portfolio to include non-UK banks with a minimum Sovereign Fitch rating of AAA (highest possible rating).

6.2 The Council will continue to have regard to the Ministry of Housing, Communties and Local Government's Guidance on Local Government Investments ("the Guidance") issued in April 2018 (3rd Edition) and CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectorial Guidance Notes ("the CIPFA Treasury Management Code").

7.0 Lending Criteria and Counterparty Limits

7.1 The current policy allows the lending of funds to be deposited with major UK banks and building societies with an investment period no longer than two years and where the counterparty is required to meet the following ratings requirements: Banks (Fitch F1, F1+) and for building societies based upon a minimum Fitch rating of F1 and an asset base level of at least £1bn. The maximum lending limit to any group counterparty is £5m. The policy includes investments with CCLA property fund and money market funds with a limit of £2m on this option. Note that delegation was provided to the S151 officer and Finance Portfolio Holder in 2011/12 to make reactive decisions when market conditions changed due to volatility in rating changes when our own bankers, NatWest, were downgraded, along with other part nationalised banks. We do not invest any term deposits with the Royal Bank of Scotland Group and only have our call accounts with them.

7.2 Officers would recommend a continuation of the existing policy for investments with banks and building societies, property funds and money market funds.

7.3 In addition to these fixed term deposits, the Council also uses an instant access liquidity account with NatWest (the Council's banker) to sweep any small surplus funds which cannot be placed by our brokers. Again, this account will be subject to the same £5m maximum deposit level, plus the balance of any grant fund.

7.4 The Council will also continue to lend to:

- Local Authorities, Police, Fire & Rescue, Parish Councils and other Public Bodies
- UK Government (including gilts, Treasury Bills and the DMADF)
- Other Bodies.

7.5 The investments that can be made to the organisations stated in paragraph 7.4 will not be constrained to a maximum deposit of £5m due to their lower level of risk. However, other bodies have a monetary limit of £3m.

8.0 Conclusion

8.1 The first half-year performance has seen a marginal improvement on 2023/24 in most areas, however the overall treasury management position has been hit by the loss of interest from 3 Rivers Developments Ltd following the soft closure of the company at the end of 2023/24. A slight decrease in performance is expected through the second half of the year as interest rates on temporary investments and deposits continue to decline. The Council's investment in the CCLA property fund has remained relatively stable and returns should be unaffected by reducing interest rates.

8.2 This report was prepared using advice and narrative provided prior to the Autumn Budget on 30 October 2024. Whilst the Budget doesn't appear to have a direct impact on the contents of this report, economic conditions will be monitored as financial markets react to the new policies.

Financial Implications: Good financial management and administration underpins the entire strategy. The Council's Treasury Management Strategy should attempt to maximise investment return commensurate with minimum risk to the principal sums invested**.**

Legal Implications: The Council is under a statutory duty to "have regard" to the 2011 CIPFA Treasury Management Code of Practice. The Council's own Financial Regulations include requirements as to the reporting of treasury management information.

Risk Assessment: The Council considers deposit security as the paramount function in any treasury dealings or activities. It should be noted that any investment decisions will always be subject to a degree of risk. However, in complying with an agreed Treasury Management Strategy, these risks would be kept to an acceptable level.

Impact on Climate Change: There are no Climate Change implications relating to the content of this report.

Equality Impact Assessment: It is considered that the impact of this report on equality related issues will be nil.

Relationship to Corporate Plan: Maximising investment return whilst minimising risk of credit default enables the Council to finance the delivery of its Corporate Plan objectives.

Section 3 – Statutory Officer sign-off/mandatory checks

Statutory Officer: Andrew Jarrett
Agreed by or on behalf of the Section 151
Date: 01/11/2024

Statutory Officer: Maria De Leiburne
Agreed on behalf of the Monitoring Officer
Date: 01/11/2024

Chief Officer: Stephen Walford
Agreed by or on behalf of the Chief Executive/Corporate Director
Date: 01/11/2024

Performance and risk: Dr Stephen Carr
Agreed on behalf of the Corporate Performance & Improvement Manager
Date: 01/11/2024

Cabinet member notified: Yes

Section 4 - Contact Details and Background Papers

Contact: Kieran Knowles, Operations Manager for Financial Services
Email: kknowles@middevon.gov.uk
Telephone: 01884 24(4624)

Background papers: Treasury Management Strategy Statement 2024/25 (Council 21/02/2024)

Appendix 1

1.0 Economic Commentary from our Treasury Advisors (Link Group)

1.1 The second quarter of 2024/25 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.

1.2 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.

1.3 The 1.0% m/m jump 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.

1.4 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.

1.5 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%.

1.6 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.

1.7 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.

1.8 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.

1.9 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.

1.10 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.

1.11 Looking at gilt movements in the first half of 2024/25, and you will note 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%.

1.12 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.

1.13 MPC meetings: 9 May, 20 June, 1 August, 19 September 2024

- On 9 May, the Bank of England's Monetary Policy Committee (MPC) voted 7-2 to keep Bank Rate at 5.25%. This outcome was repeated on 20th June.
- However, by the time of the August meeting, there was a 5-4 vote in place for rates to be cut by 25bps to 5%. However, subsequent speeches from MPC members have supported Governor Bailey's tone with its emphasis on "gradual" reductions over time.
- Markets thought there may be an outside chance of a further Bank Rate reduction in September, following the 50bps cut by the FOMC, but this came to nothing.
- Nonetheless, November still looks most likely to be the next month to see a rate cut to 4.75% but, thereafter, inflation and employment data releases, as well as geo-political events, are likely to be the determinant for what happens in the remainder of 2024/25 and into 2025/26.