Agenda Item	**8.a**
Report No	**RES/36/24**

The Highland Council

Committee: **Corporate Resources**

Date: **5 December 2024**

Report Title: **Treasury Management - Mid-Year Report 2024/25**

Report By: **Chief Officer – Corporate Finance**

1. Purpose/Executive Summary

1.1 This report is the mid-year treasury management review for the financial year 2024/25 which is prepared in compliance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management in Local Authorities (revised 2021).

1.2 The report highlights the Council's treasury management activities undertaken, provides a commentary on the year to 30 September 2024 and compares activity to the expected activities contained in the annual Treasury Management Strategy Statement and Investment Statement (TMSS) which was approved by Council on 14 March 2024.

1.3 This Treasury Management Mid-Year Review 2024/25 is submitted to the Committee for consideration.

1.4 The Prudential Code also requires the Council to report the actual prudential indicators after the financial year end, and through this report a mid-year forecast position is shown as at 30 September 2024 in **Appendix 1.**

2. Recommendations

2.1 Members are asked to:

i. Consider and **note** the Treasury Management Mid-Year Review 2024/25.

3. Implications

3.1 **Resource:** Loan charges are forecast to be in line with the budget provision. However, this figure depends on the level of capital expenditure undertaken during the rest of the financial year and market interest rates for short- term borrowing and deposits which will continue to be monitored. While Bank base rates have reduced over the year to date, there is not always a direct relationship between base rates and the PWLB or market rates available to the Council. The Council's forecasts for the year had also assumed an expected reduction in interest rates so some aspect of a 'saving' from interest rate reductions are already captured within the loan charge budget estimate. Due to high levels of economic uncertainty, there is a risk that any approach the Council takes to its borrowing may not accurately anticipate future market movements. This is mitigated through regular review of assumptions, and regular engagement with the Council's Treasury advisors and review of economic forecasts.

3.2 **Legal:** There are no Legal implications arising as a direct result of this report.

3.3 **Risk:** See section 3.1.

3.4 **Health and Safety (risks arising from changes to plant, equipment, process, or people):** There are no Health & Safety implications arising as a direct result of this report.

3.5 **Gaelic:** There are no Gaelic implications arising as a direct result of this report.

4. Impacts

4.1 In Highland, all policies, strategies or service changes are subject to an integrated screening for impact for Equalities, Poverty and Human Rights, Children's Rights and Wellbeing, Climate Change, Islands and Mainland Rural Communities, and Data Protection. Where identified as required, a full impact assessment will be undertaken.

4.2 Considering impacts is a core part of the decision-making process and needs to inform the decision-making process. When taking any decision, Members must give due regard to the findings of any assessment.

4.3 This is a monitoring and update report and therefore an impact assessment is not required.

5. Background

5.1 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*".

5.2 This report has been written in accordance with the requirements of the CIPFA Code of Practice on Treasury Management (revised 2021). The primary requirements of the code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the way the Council will seek to achieve those policies and objectives.
- Receipt by the Council of an Annual Strategy Report for the year ahead, a mid–year report and an Annual Review Report for the previous year.
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Council of the role of scrutiny of treasury management policies to a specific named body, which in this Council is the Corporate Resources Committee.

5.3 This Treasury Management Mid-Year Review 2024/25 covers the following:

- An economic update for the first six months of 2024/25, provided by the Council's Treasury Advisers, Link Treasury Services (Link)
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy
- A review of the Council's capital expenditure (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 any debt rescheduling undertaken during 2024/25
- A review of compliance with Treasury and Prudential Limits for 2024/25

6. Economic update (provided by Link)

6.1 The Council has appointed Link as treasury adviser to the Council and part of their service is to assist the Council to formulate a view on interest rates. **Appendix 2** provides an economic update from Link.

6.2 The Council's treasury advisor, Link, provided the following forecasts on 11 November 2024 (PWLB rates are certainty rates: gilt yields plus 80bps)

Link Group Interest Rate View	11.11.24												
	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27	Dec-27
BANK RATE	4.75	4.50	4.25	4.00	4.00	3.75	3.75	3.75	3.50	3.50	3.50	3.50	3.50
3 month ave earnings	4.70	4.50	4.30	4.00	4.00	4.00	3.80	3.80	3.80	3.50	3.50	3.50	3.50
6 month ave earnings	4.70	4.40	4.20	3.90	3.90	3.90	3.80	3.80	3.80	3.50	3.50	3.50	3.50
12 month ave earnings	4.70	4.40	4.20	3.90	3.90	3.90	3.80	3.80	3.80	3.50	3.50	3.50	3.50
5 yr PWLB	5.00	4.90	4.80	4.60	4.50	4.50	4.40	4.30	4.20	4.10	4.00	4.00	3.90
10 yr PWLB	5.30	5.10	5.00	4.80	4.80	4.70	4.50	4.50	4.40	4.30	4.20	4.20	4.10
25 yr PWLB	5.60	5.50	5.40	5.30	5.20	5.10	5.00	4.90	4.80	4.70	4.60	4.50	4.50
50 yr PWLB	5.40	5.30	5.20	5.10	5.00	4.90	4.80	4.70	4.60	4.50	4.40	4.30	4.30

6.3 Additional notes by Link on the forecast table above, are provided below:

6.4 Following the 30 October Budget, the outcome of the US Presidential election on 6 November, and the 25bps Bank Rate cut undertaken by the Monetary Policy Committee (MPC) on 7 November, we have significantly revised our central forecasts for the first time since May. In summary, our Bank Rate forecast is now 50bps – 75bps higher than was previously the case, whilst our PWLB forecasts have been materially lifted to not only reflect our increased concerns around the future path of inflation, but also the increased level of government borrowing over the term of the current Parliament.

6.5 Our PWLB rate forecasts above are based on the Certainty Rate (the standard rate minus 20 bps, calculated as gilts plus 80bps) which has been accessible to most authorities since 1 November 2012.

7. Treasury Management Strategy Statement and Annual Investment Strategy Update

7.1 The Treasury Management Strategy Statement (TMSS) for 2024/25 was approved by Council on 14 March 2024. The Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as **security** of capital, **liquidity** and then **yield.** There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position.

7.2 The investment portfolio yield for the first six months of the year was an average rate of 5.15% (2023/24 4.81%) against a benchmark (SONIA - Sterling Overnight Index Average, daily average) of 5.12%.

7.3 The daily average level of funds available for investment purposes in the first six months of 2024/25 was £83.1m (2023/24 £91.4m). These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of council tax payments, receipt of grants and progress of the Capital Programme.

7.4 In line with the investment strategy, the Council will only place deposits with counterparties with a high creditworthiness.

7.5 The Council continues to hold most of its investments in Money Market Funds (MMF) to meet cashflow requirements and minimise the requirement to borrow. Due to the Bank Rate decreases, rates on Money Market Fund investments have also decreased.

7.6 The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and 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 with security and liquidity being the key considerations.

8. New External Borrowing

8.1 The Capital Financing Requirement (CFR) represents the accumulated net capital expenditure for the General Fund and Housing Revenue account which the Council requires to fund by way of long-term debt until the capital projects, comprising the CFR, are fully written off by way of annual loan charges to revenue accounts.

8.2 The balance of external and internal borrowing is generally driven by market conditions, and the need to take a balanced view of savings available from short term and internal borrowing, versus the mitigation of re-financing risk which can be achieved from longer-term borrowing, but at a potentially higher cost.

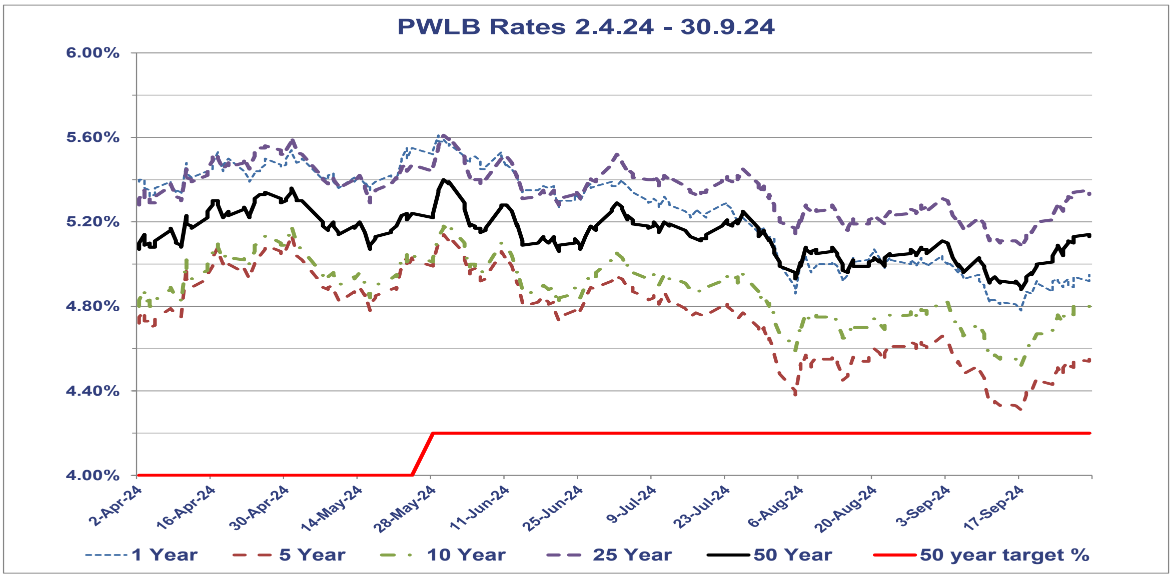
8.3 The table below shows the estimated CFR at 31/03/25 and how it is expected to be funded by short-term borrowing and historic long-term borrowing. The reduction in difference between CFR and borrowing compared to the TMSS is a result of cashflow requirements in 24/25.

8.3.1

	£m
Estimated Capital Financing Requirement (CFR) at 31/03/25 See appendix 1 – indicator 2	1,482.4
Less PPP/NPD	-182.0
Estimated CFR 31/03/25	**1,300.4**
Opening Long Term Debt 01/04/24	1,009.0
Long term maturities	-67.0
New PWLB loans	160.0
Estimated Long Term Debt 31/03/25	**1,102.0**
Opening short-term borrowing 01/04/24	133.0
Raised and repaid to 30 Sept 2024	-4.0
Add estimated net borrowing for new capital expenditure and replace maturities in 2024/25 (November to March)	46.8
Estimated Short Term Debt at 31/03/25	**175.8**
Estimated total long term and short-term debt 31/03/25	**1,277.8**
Difference between CFR and borrowing = Funding from internal balances and cash flow	22.6

8.4 The graph and table below show the movement in PWLB rates from 1 April until 30 September incorporating the certainty rate (0.20% discount on rates for local authorities who have applied for rate and in June 2023 discount of an additional 0.40% for HRA was re-introduced). 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.

8.4.1 Link forecast rates to fall back over the next two to three years as inflation dampens.



8.5 The 50-year PWLB rate for new long-term borrowing started 2024/25 at 5.07% and was 5.13% at the end of September 2024. Rates were volatile during this period.

	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%

8.6 There was no PWLB borrowing to the end of September 2024 with borrowing requirements being funded using short-term borrowing.

8.7 Two PWLB Loans were taken during October 2024 (£10m for 1.5y at 4.86% and £20m for 5y at 4.83%). It is anticipated that over the remainder of the financial year there will be borrowing to fund the Capital Programme but whether this is funded by long-term or short-term borrowing will depend on market rates and available funding. Decisions will be made using rates and other available market information to achieve optimum value and risk exposure in the long-term. Markets remain volatile and although short-term borrowing opportunities continue to be available to the Council, there are fewer Offers which means rates payable are unlikely to reduce in the short to medium term. The strategy remains flexible, and consideration will be given to the appropriate mix of long and short-term borrowing based on prevailing market conditions.

8.8 In consultation with Link, the market situation is constantly monitored and borrowing strategies reviewed on a regular basis.

9. Debt Rescheduling

9.1 No debt rescheduling was undertaken during the first six months of 2024/25 as there were no cost-effective opportunities and officers continue to monitor and investigate potential debt rescheduling opportunities.

10. Compliance with Treasury and Prudential Limits

10.1 It is a statutory duty for the Council to determine and keep under review the "Affordable Capital Expenditure Limits". The Council's approved Treasury and Prudential Indicators (affordability limits) are outlined in the approved Treasury Management Strategy Statement (TMSS) agreed on 14 March 2024.

10.2 During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's TMSS and in compliance with the Council's Treasury Management Practices. The Prudential and Treasury Indicators are shown in **Appendix 1**, comparing the initial limits agreed for the year and updated year-end forecasts.

Designation: Chief Officer – Corporate Finance

Date: 11 November 2024

Authors: Rachel MacDonald, Principal Accountant
Mairi MacCallum, Treasury Officer

Background Papers: Treasury Live and CiA financial ledger systems

Appendices: Appendix 1 – Estimated Treasury Position & Prudential Indicators
Appendix 2 – Economics Update

Appendix 1

Estimated Treasury Position and Prudential Indicators
Figures are for financial year unless otherwise titled in italics

Prudential Indicator		2024/25 Original £m	2024/25 Revised £m
1.	**Capital expenditure**		
	Gross capital expenditure		
	General Fund including PPP	155.1	188.7
	Housing Revenue Account	51.5	62.2
	Total gross capital expenditure	**206.6**	**250.9**
	Income - General Fund	(26.0)	(82.6)
	Income - HRA	(18.1)	(22.7)
	Total income	**(44.1)**	**(105.3)**
	Net capital expenditure		
	General Fund	129.1	106.1
	HRA	33.4	39.5
	Total net capital expenditure	**162.5**	**145.6**
	Loan charge instalments		
	General Fund	(34.0)	(33.0)
	HRA	(13.1)	(8.6)
	Total instalments	**(47.1)**	**(41.6)**
	Net borrowing for new capital expenditure		
	General Fund	95.1	73.1
	HRA	20.3	28.1
	Total net borrowing for new capital expenditure	**115.4**	**101.2**
2.	**Capital Financing Requirement (CFR) at 31 March**		
	General Fund excluding PPP/NPD	937.7	881.2
	Housing Revenue Account	411.0	405.5
	Joint Boards	13.7	13.7
	PPP	191.9	182.0
	Total	**1,554.3**	**1,482.4**

Prudential Indicator		2024/25 Original £m	2023/24 Revised £m
	Treasury Position at 31 March		
	Borrowing – Long term	1,162.4	1,102.0
	Borrowing – Short term	100.0	175.8
	Other Long-Term Liabilities (PPP/NPD)	191.9	182.0
	Total Debt	**1,454.3**	**1,459.8**
	Investments	(50.0)	(50.0)
	Net Borrowing	**1,404.3**	**1,409.8**
3.	**Ratio of financing costs to net revenue stream**		
	General Fund including PPP/NPD	13.7%	13.7%
	Housing Revenue Account	40.0%	40.0%

Prudential Indicator		2024/25 Maximum £m	2023/24 Actual £m
4.	**Authorised Limit for Borrowing**	1,391.2	1,157.6 (April 2024)
5.	**Operational Boundary for Borrowing**	1,291.3	1,157.6 (April 2024)
6.	**Interest rate exposures of debt net of investments**		
	Upper Limit (Fixed)	1,554.3	1,104.1 (June 2024)
	Upper Limit (Variable)	544.0	-18.5* (Sept 2024)
7.	**Maturity structure of fixed rate borrowing (against maximum position)**		
	Under 12 months	30.0%	21.3% (Sept 2024)
	12 months to 2 years	30.0%	1.8% (Sept 2024)
	2 years to 5 years	40.0%	9.1% (June 2024)
	5 years to 10 years	50.0%	8.7% (Sept 2024)
	10 years and above	100.0%	60.8% (June 2024)
8.	**Upper limit for the maturing of investments made for periods longer than 364 days**	20.0	Nil
9.	**Short term borrowing as a % of outstanding long-term debt (maximum position)**	25.0%	12.5% (April 2024)
10.	**Variable interest debt as a % of outstanding long-term debt (maximum position)**	35.0%	3.2% (Sept 2024)

*Negative as higher level of investments than variable borrowing

Appendix 2

Economics Update (provided by Link, 3 October 2024)

3.1 Economics Update

- 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.
- 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.
- 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.
- 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.
- 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%.
- 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.

- 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.
- 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.
- 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.
- 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.
- 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%.

- 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.
- 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.