Audit and Governance Committee
Monday, 9 December 2024
Treasury Management Mid-Year Update

For Decision

Portfolio Holder: Cllr Simon Clifford, Finance & Capital Strategy

Local Councillor(s): All

Executive Director: A Dunn, Executive Director, Corporate Development

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Report Status: Public

Brief Summary

This report summarises the treasury management performance and position information for Dorset Council for the six months to 30 September 2024.

Treasury management at the Council is conducted within the framework of CIPFA's Treasury Management Code of Practice. In adopting the code, recommended best practice is for members to approve an annual treasury management strategy report, and to then receive a mid-year update on progress against the strategy (this report) and a year-end review of actual performance against the strategy.

The Council's total external borrowing at 30 September 2024 was £225m, compared to £221m at 31 March 2024, and is forecast to increase to £320m by 31 March 2026, compared to the budget of £313m. The total interest paid servicing external debt for the year is forecast to be £10.5m compared to a budget of £10.3m.

At 30 September 2024 the Council held cash and cash equivalents of £32m and treasury investments of £49m – in total £81m compared to £74m at 31 March

2024. The total interest and investment income for the year is forecast to be £4.9m compared to a budget of £4.0m.

Recommendation:

That the Committee note and comment upon the report, and to offer any suggestions for improvements in treasury management arrangements for the future.

Reason for Recommendation:

To better inform members of treasury management activity, in accordance with the corporate requirement to ensure money and resources are used wisely.

1. Introduction

1.1 The Council's treasury management strategy for 2024/25 was approved by a meeting of Dorset Council on 13 February 2024.

1.2 The Council has borrowed and invested substantial 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.

1.3 Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

1.4 The Council employs professionally qualified and experienced staff with responsibility for making borrowing and investment decisions. Officers are supported by external advisers who are specialists in their fields. The Council currently employs Arlingclose Limited as treasury management advisers.

1.5 This approach ensures that the Council has access to a wide pool of relevant market intelligence, knowledge and skills that would be very difficult and costly to replicate internally. However, whilst advisers provide support to the internal treasury function, final decisions on treasury matters always remain with the Council.

2. External Context

2.1 Treasury management decisions made by the Council must take into consideration external factors, particularly the wider economic backdrop and the outlook for financial markets and interest rates, and the wider regulatory framework.

2.2 UK headline consumer price inflation remained around the Bank of England target later in the period, falling from an annual rate of 3.2% in March to 2.0% in May and then rebounding marginally to June to 2.2% in July and August, as was expected, due to base effects from energy prices. With headline inflation lower, the Bank of England cut Bank Rate from 5.25% to 5.00% at the meeting of its Monetary Policy Committee (MPC) in August 2024.

2.3 Bank Rate was reduced by a further 0.25% to 4.75% at the November meeting of the MPC but with more cautious messaging on the speed of further reductions largely due to the potentially inflationary impact of the government's Autumn Budget 2024. Arlingclose are currently forecasting a further 0.25% cut in February 2025.

2.4 A detailed commentary on the external context provided by Arlingclose is included in Appendix 1 together with their most recent economic and interest rate forecast in Appendix 2.

3. Local Context

3.1 The Council's balance sheet is summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31-Mar 2024 Actual £m	30-Sep 2024 Actual £m	31-Mar 2025 Budget £m	31-Mar 2025 Forecast £m
Capital Financing Requirement (CFR)	**388**	**420**	**483**	**450**
Less: PFI and other debt liabilities	19	20	20	20
Loans CFR (underlying borrowing requirement)	**369**	**400**	**463**	**430**
Less: External borrowing	225	221	313	325
Internal Borrowing	144	179	150	105
Cash and Investments	74	81	90	60

3.2 All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The Council's cumulative outstanding amount of debt finance is measured by the Capital Financing Requirement (CFR).

3.3 Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as Minimum Revenue Provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. The CFR increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt.

3.4 The CFR is forecast to rise by about £60m over the year to roughly £450m, less than budgeted due to slippage in delivering the capital programme. External borrowing is forecast to increase by about £100m over the year, higher than the increase in CFR as the Council is expected to have less reserves available to support 'internal borrowing' than it did at the beginning of the year.

3.5 CIPFA's 2021 Prudential Code makes 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

3.6 The treasury management position at 30 September 2024 and the forecast position for 31 March 2025 are shown in Table 2 below.

Table 2: Treasury Management Summary

	31.03.24 Actual £m	30.09.24 Actual £m	31.03.25 Forecast £m
Long-term borrowing	175.0	175.0	265.0
Short-term borrowing	49.5	46.3	60.0
Total Borrowing	**224.5**	**221.3**	**325.0**
Long-term investments	19.0	19.0	19.0
Short-term investments	32.5	30.3	11.0
Cash and cash equivalents	22.4	32.0	30.0
Total Cash and Investments	**73.9**	**81.3**	**60.0**
Net Borrowing	**150.6**	**140.0**	**265.0**

4. Borrowing

4.1 The chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should long-term plans change being a secondary objective.

4.2 Outstanding loans at 30 September 2024 are summarised in Table 3 below.

Table 3: Borrowing Summary

	31.03.24 Balance £m	Net Movement £m	30.09.24 Balance £m	30.09.24 Average Rate %	30.09.24 Average Maturity (years)
Public Works Loan Board	91.0	-1.3	89.7	4.3	17.4
Banks (fixed-term)	25.6	0.0	25.6	4.7	53.1
Banks (LOBO*)	11.0	0.0	11.0	4.6	52.6
Local authorities (long-term)	15.0	0.0	15.0	4.4	35.7
Local authorities (short-term)	37.0	-2.0	35.0	4.7	0.9
Other lenders (fixed-term)	45.0	0.0	45.0	3.9	42.5
Total Borrowing	**224.6**	**-3.3**	**221.3**	**4.4**	**27.0**

4.3 *Lender's Option Borrower's Option (LOBO) loans are loans where the lender has the option to propose an increase in the interest rate at set dates, following which the borrower has the option to either accept the new rate or to repay the loan at no additional cost. The Council has one LOBO loan outstanding.

5. Treasury Investments

5.1 CIPFA define 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.

5.2 The Council holds significant levels of invested funds, representing income received in advance of expenditure plus balances and reserves held. Cash, cash equivalents and treasury investments held on 30 September 2024 are summarised in Table 4 below.

Table 4: Cash and Investments Summary

	31.03.24 Balance £m	Net Movement £m	30.09.24 Balance £m
Cash and Cash Equivalents	**22.4**	**9.6**	**32.0**
Investments:			
Short-dated bond funds	2.8	0.0	2.9
Strategic bond funds	9.9	0.1	10.0
Equity income funds	16.6	0.8	17.4
Property funds	19.0	0.0	19.0
Multi asset income funds	3.1	-3.1	0.0
Total Investments	**51.5**	**-2.2**	**49.3**
Total Cash and Investments	**73.9**	**7.4**	**81.3**

5.3 Both the CIPFA Code and government guidance require local authorities to invest funds prudently, and to have regard to the security and liquidity of 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.

5.4 As demonstrated 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.

5.5 The Council also holds investments in bond, equity, multi-asset and property funds. Such investments are held for the longer term with the acceptance that capital values will fluctuate over the short term but with the expectation that over a three to five-year period total returns will exceed cash interest rates.

6. Treasury Performance

6.1 The Council measures the financial performance of its treasury management in terms of its impact on the revenue budget as shown in Table 5 below.

Table 5: Treasury Performance

	Budget £m	Forecast £m	Variance £m	
Interest Payable	10.3	10.5	-0.2	A
Interest and Investment Income	-4.0	-4.9	0.9	F
Net Payable / (Receivable)	**6.3**	**5.6**	**0.7**	**F**

7. Compliance

7.1 All treasury management activities undertaken during the year to date complied with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

7.2 The Council is legally obliged to set an affordable borrowing limit (the 'authorised limit') for external debt each year and a lower 'operational boundary' is also set as a warning level should debt approach the authorised limit. Compliance with the both the authorised limit and operational boundary for external debt is shown in Table 6 below.

Table 6: Debt Limits

	Maximum 2024-25 £m	30.09.24 Actual £m	Operational Boundary £m	Authorised Limit £m	Complied Yes/No
Borrowing	225	221	483	503	Yes
PFI & Finance Leases	19	19	24	29	Yes
Total Capital Financing	**244**	**240**	**507**	**532**	

8. Treasury Management Prudential Indicators

8.1 The Council measures and manages its exposures to treasury management risks using the following indicators.

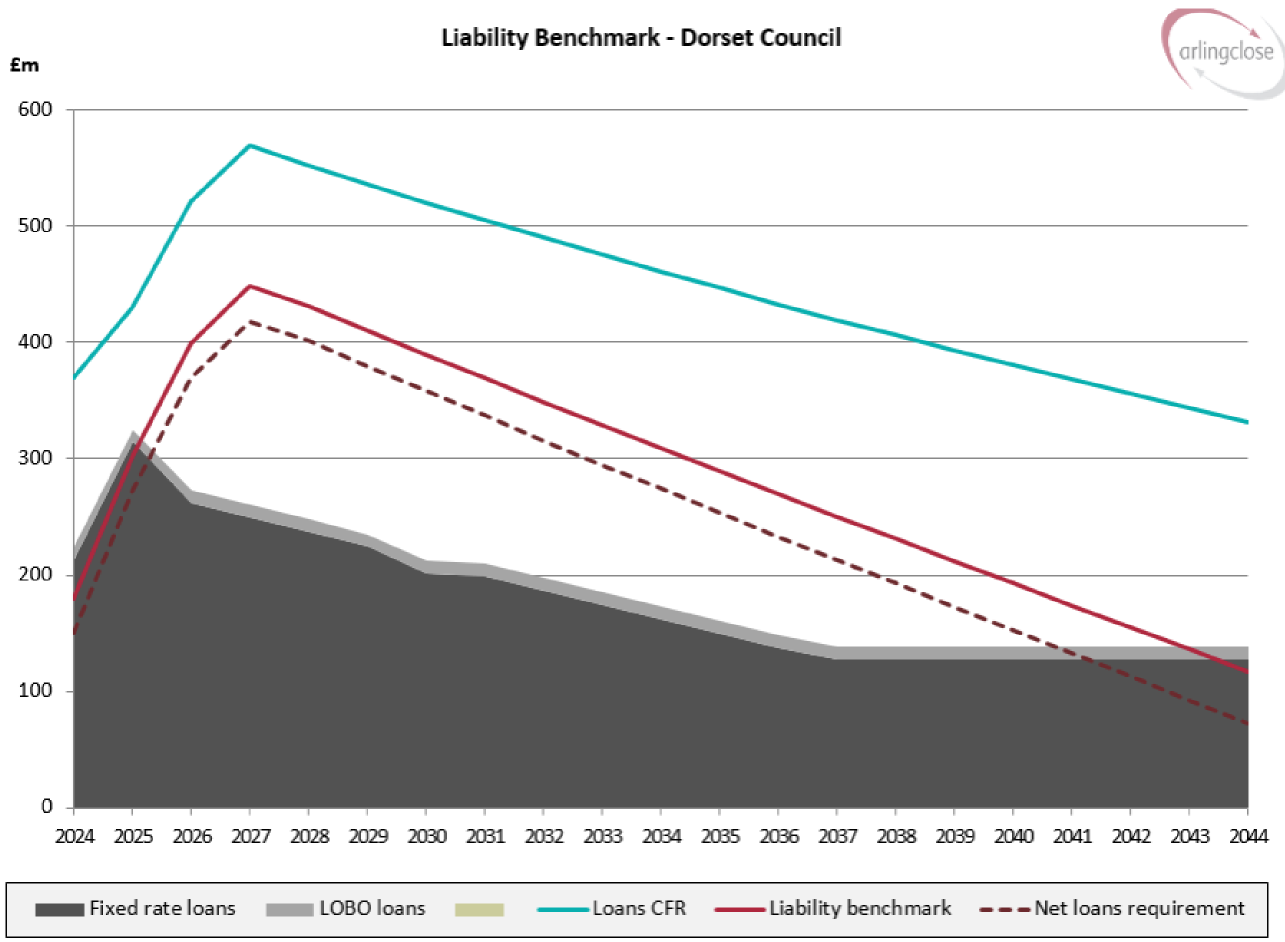
8.2 **Liability Benchmark:** This indicator compares the Council's actual existing borrowing against a 'liability benchmark' calculated to show the lowest possible level of external borrowing. The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor, 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 a minimum 'liquidity allowance' to manage day-to-day cash flows.

Table 7: Liability Benchmark (medium term forecast)

	31.03.24 Actual £m	**31.03.25 Forecast £m**	**31.03.26 Forecast £m**	**31.03.27 Forecast £m**
Loans CFR (underlying borrowing requirement)	**369**	**430**	**520**	**570**
Less: Balance sheet resources	220	160	155	155
Net loans/borrowing requirement	**149**	**270**	**365**	**415**
Plus: Liquidity allowance	30	30	30	30
Liability Benchmark	**179**	**300**	**395**	**445**

8.3 The long-term liability benchmark based on the most recent capital programme is shown in the chart below together with the maturity profile of the Council's forecast borrowing as at 31 March 2025.

Chart 1: Liability Benchmark (long term forecast)



8.3 **Security**: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA = 1, AA+ = 2 etc.) and taking the average, weighted by the size of each investment. The credit score of money market funds is calculated from the fund's underlying investments and unrated investments are assigned a score based on their perceived risk.

Table 8: Security

	30.09.24 Actual	**2024/25 Target**	**Complied Yes/No**
Portfolio average credit score	5.0	< 6	Yes
Equivalent average credit rating	A+		

8.4 **Liquidity**: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period without additional borrowing. In addition, the Council aims to hold a minimum of £10m readily available in same day access bank accounts and Money Market Funds.

Table 9: Liquidity

	2024/25 Min £m	30.09.24 Actual £m	2024/25 Target £m	Complied Yes/No
Total cash available within 1 day	29	32	10	Yes
Total cash available within 3 months	59	62	30	Yes

8.5 **Interest Rate Exposure**: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests were:

Table 10 Interest Rate Exposure

	30.09.24 Actual £000s	2024/25 Limit £000s	Complied Yes/No
Upper limit on one-year revenue impact of a 1% rise in interest rates	253	1,000	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	-253	1,000	Yes

8.6 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced.

8.7 **Sums invested for periods longer than a year**: 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 long-term principal sum invested at the period end were:

Table 11: Investments longer than one year

	2024/25 £m	2025/26 £m	2027/28 £m	No fixed date £m
Limit on principal invested beyond one year	20.0	20.0	20.0	100.0
Actual principal invested beyond one year	0.0	0.0	0.0	49.3
Complied (Yes/No)	Yes	Yes	Yes	Yes

8.8 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 cash and cash equivalents.

8.9 **Maturity Structure of Borrowing**: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing were:

Table 12: Maturity Structure of Borrowing

	30.09.24 Actual £m	% of Total Borrowing	Upper Limit	Lower Limit	Complied Yes/No
Under 12 months	20.0	9.0%	25%	0%	Yes
12 Months to 2 Years	25.0	11.3%	25%	0%	Yes
2 Years to 5 Years	0.0	0.0%	25%	0%	Yes
5 Years to 10 Years	10.0	4.5%	35%	0%	Yes
10 Years to 20 Years	27.9	12.6%	35%	0%	Yes
20 Years to 30 Years	41.8	18.9%	45%	0%	Yes
30 Years to 40 Years	15.0	6.8%	45%	0%	Yes
40 Years to 50 Years	45.0	20.3%	45%	0%	Yes
50 Years and above	36.6	16.5%	75%	0%	Yes
Total	**221.3**	**100.0%**			

8.10 Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

9. Financial Implications

This report summarises the performance of the Council's treasury management activity in the six months to 30 September 2024. There are no other financial implications arising from this report.

10. Natural Environment, Climate & Ecology Implications

None identified.

11. Well-being and Health Implications

None identified.

12. Other Implications

None identified.

13. Risk Assessment

Having considered the risks associated with this decision, the level of risk has been identified as:
Current Risk: HIGH
Residual Risk: Medium

Treasury management is an inherently risky area of activity and a number of controls are embedded in its operation. The key treasury management risks are highlighted as part of the treasury management strategy approved by Council as part of the budget setting process. This report highlights any variances from this strategy and draws out any specific risks which have arisen.

14. Equalities Impact Assessment

There are no equalities implications arising from this report.

15. Appendices

Appendix 1: External Context (Arlingclose 3 October 2024)
Appendix 2: Economic and Interest Rate Forecast (Arlingclose 11 November 2024)

16. Background Papers

Budget Strategy MTPF Appendix 3 Capital Strategy 202425-202728.pdf
Budget Strategy MTPF Appendix 4 Treasury Mangement.pdf

Appendix 1: External Context (Arlingclose 3 October 2024)

Economic background: UK headline consumer price inflation remained around the Bank of England (BoE) target later in the period, falling from an annual rate of 3.2% in March to 2.0% in May and then rebounding marginally to June to 2.2% in July and August, 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.

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.

Labour market data was slightly better from a policymaker perspective, showing an easing in the tightness of the job market, with inactivity rates and vacancies declining. However, a degree of uncertainty remains given ongoing issues around the data collected for the labour force survey by the Office for National Statistics. Figures for the three months to July showed the unemployment rate fell to 4.1% (3mth/year) from 4.4% in the previous three-month period while the employment rate rose to 74.8% from 74.3%.

Over the same period average regular earnings (excluding bonuses) was 5.1%, down from 5.4% in the earlier period, and total earnings (including bonuses) was 4.0% (this figure was impacted by one-off payments made to NHS staff and civil servants in June and July 2023). Adjusting for inflation, real regular pay rose by 2.2% in May to July and total pay by 1.1%.

With headline inflation lower, the BoE cut Bank Rate from 5.25% to 5.00% at the August Monetary Policy Committee (MPC) meeting. The decision was finely balanced, voted by a 5-4 majority with four members preferring to hold at 5.25%. At the September MPC meeting, committee members voted 8-1 for no change at 5.00%, with the lone dissenter preferring Bank Rate to be cut again to 4.75%. The meeting minutes and vote suggested a reasonably hawkish tilt to rates, with sticky inflation remaining a concern among policymakers.

The latest BoE Monetary Policy Report, published in August, showed policymakers expected GDP growth to continue expanding during 2024 before falling back and moderating from 2025 to 2027. Unemployment was forecast to stay around 4.5% while inflation was shown picking up in the latter part of 2024 as the previous years' energy price declines fell out of the figures before slipping below the 2% target in 2025 and remaining there until early 2027.

The US Federal Reserve (the Fed) also cut interest rates during the period, reducing the Federal Funds Rate by 0.50% to a range of 4.75%-5.00% at its policy meeting in September. The forecasts released at the same time by the central bank suggested a further 1.00% of easing is expected by the end of the calendar year, followed by the same amount in 2025 and then a final 0.50% of cuts during 2026.

Having first reduced interest rates in June, the European Central Bank (ECB) held steady in July before cutting again in September, reducing its main refinancing rate to 3.65% and its deposit rate to 3.50%. Unlike the Fed, the ECB has not outlined a likely future path of rates, but inflation projections remain in line with the central bank's previous forecasts where it will remain above its 2% target until 2026 on an annual basis.

Financial markets: Sentiment in financial markets continued to mostly improve over the period, but the ongoing trend of bond yield volatility remained. The general upward trend in yields in the early part of the period was reversed in the later part, and yields ended the half-year not too far from where they started. However, the volatility in response to economic, financial and geopolitical issues meant it was a bumpy ride for bond investors during that time.

Over the period, the 10-year UK benchmark gilt yield started at 3.94% and ended at 4.00% but hit a high of 4.41% in May and a low of 3.76% in mid-September. While the 20-year gilt started at 4.40% and ended at 4.51% but hit a high of 4.82% in May and a low of 4.27% in mid-September. The Sterling Overnight Rate (SONIA) averaged 5.12% over the period to 30th September.

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

Having had its outlook increased by Fitch and ratings by S&P earlier in the period, Moody's upgraded Transport for London's rating to A2 from A3 in July.

Moody's also placed National Bank of Canada on Rating Watch for a possible upgrade, revising the outlook on Standard Chartered to Positive, the outlook to Negative on Toronto Dominion Bank, and downgrading the rating on Close Brothers to A1 from Aa3. S&P upgraded the rating on National Bank of Canada to A+ from A, and together with Fitch, the two rating agencies assigned Lancashire County Council with a rating of AA- and A+ respectively.

Credit default swap 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.

Financial market volatility is expected to remain a feature, at least in the near term and, credit default swap levels will be monitored for signs of ongoing credit stress. As ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remain under constant review.

Appendix 2: Economic and Interest Rate Forecast (Arlingclose 11 November 2024)

As expected, the Monetary Policy Committee (MPC) cut Bank Rate to 4.75% in November in an 8-1 vote. However, the outlook for monetary policy has changed following the new government's fiscal plans, as delivered in the recent Budget.

The Budget measures will boost demand in a constrained supply environment, while pushing up direct costs for employers. The short to medium-term inflationary effects of the Budget require a change to our Interest Rate Forecast.

UK GDP recovered well in H1 2024 from technical recession, but underlying growth appears relatively subdued. The Budget will significantly boost government spending over the short-term, with few offsetting measures to subdue household demand, so GDP growth is likely to rise relatively steeply.

Private sector wage growth and services inflation remain elevated. The increase in employers' NICs, minimum and public sector wage levels could have wide ranging impacts on private sector employment demand and costs, but the near-term impact will likely be inflationary as these additional costs get passed to consumers.

CPI inflation rates will rise a little by year-end due to higher energy prices and less favourable base effects. The Bank of England (BoE) estimates the Budget impact will see the CPI rate at 2.7% by year end 2025 and remain over target in 2026, as opposed to the prior projection of inflation easing back to and then below target.

The MPC re-emphasised that monetary policy will be eased gradually, and we now believe the Budget measures have both reduced the pace of Bank Rate cuts and raised the low point for this loosening cycle (although downside risks develop later).

The Office for Budget Responsibility's (OBR) projections for increased borrowing, higher inflation and a shallower path for Bank Rate raised gilt yields. The material change in expectations means that yields will be generally higher in the post-Budget world.

US government bond yields have risen following Donald Trump's and Republican victories in the US elections. Trump ran on a platform of policies that appear inflationary, calling into question the extent of policy loosening required from the Federal Reserve (which was already uncertain given continued solid US growth data). Higher US yields could also support higher UK yields.

In line with our forecast, Bank Rate was cut to 4.75% in November.

The MPC will continue to reduce Bank Rate, but more slowly and by less. We see another rate cut in February 2025, followed by a cut alongside every

Monetary Policy Report publication, to a low of 3.75%.

Long-term gilt yields have risen to reflect both UK and US economic, monetary and fiscal policy expectations, and increases in bond supply. Volatility will remain elevated as the market digests incoming data for clues around the impact of policy changes.

This uncertainty may also necessitate more frequent changes to our forecast than has been the case recently.