Appendix 2

Treasury Management Strategy Statement

Warwickshire County Council
2025/26

1.0 Introduction

Background

1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) defines Treasury Management 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."

1.2 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the Treasury Management operation is to ensure that this cash flow is adequately planned and managed with cash being available when it is needed. Surplus monies are invested in low-risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

1.3 The second main function of the Treasury Management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.4 The contribution the Treasury Management function makes to the Council is critical, as the balance of debt and investment operations ensure cash liquidity and the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The costs of debt and the investment income arising from cash deposits have an effect on the Council's available budget. Since cash balances generally exist to serve specific purposes, it is paramount to ensure adequate security of the sums invested so that ultimately the cash is still available to be used for the reason it was originally being held for.

Treasury Management reporting

1.5 The Council is currently required to receive and approve, as a minimum, three main Treasury reports each year, which incorporate a variety of policies, estimates and actuals:

a.) **Prudential and Treasury indicators and Treasury strategy** (this report) -:

- the capital plans, (including prudential indicators);
- a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time);
- the Treasury Management strategy, (how the investments and borrowings are to be organised), including Treasury indicators; and
- an investment strategy, (the parameters on how investments are to be managed).

b.) **A mid-year Treasury Management report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.

c.) **An annual Treasury report** – This is a backward-looking review document and provides details of a selection of actual prudential and Treasury indicators and actual Treasury operations compared to the estimates within the strategy.

d.) **Scrutiny -** The above reports are scrutinised by the Resources and Fire and Rescue Overview and Scrutiny Committee.

e.) **Quarterly reports** –These are reported to the Resources and Fire and Rescue Overview and Scrutiny Committee.

Capital Strategy and Investment Strategy

1.6 The Treasury Management Strategy Statement (TMSS) interacts with both the Capital Strategy and the Investment Strategy.

a.) **Capital Strategy -** The CIPFA 2021 Prudential and Treasury Management Codes require all local authorities to prepare a Capital Strategy report which will provide the following:

- a high-level long-term overview of how capital expenditure, capital financing and Treasury Management activity contribute to the provision of services;
- an overview of how the associated risk is managed; and
- the implications for future financial sustainability.

The aim of the strategy is to ensure that all the Council's elected members fully understand the overall long-term policy objectives and resulting Capital Strategy requirements, governance procedures and risk appetite.

b.) **Investment Strategy -** The Council is required to set out separately an Investment Strategy (IS) in relation to non-Treasury investments. Non-Treasury investments must consider security, liquidity, and yield, however the relative priority of these three factors does not have to follow Treasury Management principles as non-Treasury investments are, by their nature, not intended to deliver Treasury Management objectives. The Council's Investment Strategy is a separate document; however, it does interrelate with the Treasury Management Strategy and Capital Strategy.

1.7 The table below summarises these different strategies.

Capital Strategy	**Treasury Management Strategy – including Treasury Investment Strategy**	**Investment Strategy**
Traditional capital expenditure to directly meet service objectives.	Management of cash and debt to service the delivery of day-to-day operations and the long-term financing of investments.	Non-Treasury investments with the primary objective of meeting service objectives.

Treasury Management Strategy

1.8 The strategy covers two main areas:

a.) Capital considerations -
- Capital expenditure plans and the associated prudential indicators; and
- Minimum revenue provision (MRP) policy.

b.) Treasury Management considerations -
- The current Treasury position;
- Treasury indicators which limit the Treasury risk and activities of the Council;
- Prospects for interest rates;
- Borrowing Strategy;
- Policy on borrowing in advance of need;
- Debt rescheduling;
- Investment Strategy;
- Creditworthiness policy;
- The policy on use of external service providers; and
- The Councils Income Management Policy.

1.9 These elements cover the requirements of the Local Government Act 2003, Ministry of Housing, Communities and Local Government (MHCLG) Guidance, MHCLG MRP Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code.

1.10 The Treasury Management scheme of delegation, and responsibilities of the Section 151 officer are set out in Annex 6 and 7 respectively.

Training

1.11 The CIPFA Treasury Management Code requires the responsible officer to ensure that members with responsibility for Treasury Management receive adequate training in Treasury Management. This especially applies to members responsible for scrutiny.

1.12 The following is carried out to monitor and review knowledge and skills:

a.) Planned and recorded attendance at training and events.
b.) Tailored learning plans for Treasury Management officers and board/Council members.
c.) Treasury Management officers and board/Council members undertake a self-assessment against the required competencies.
d.) Regular communication with officers and board/Council members to highlight training needs on an ongoing basis.

1.13 A formal record of the training received by officers central to the treasury function will be maintained by the treasury team. Similarly, a formal record of the Treasury Management/capital finance training received by members will also be maintained by the Treasury Manager. Both records will be included in Treasury Management Outturn reports at the end of the financial year.

Treasury Management Consultants

1.14 The Council currently contracts with Link Group, Treasury Solutions as its external Treasury Management advisers.

1.15 The Council recognises that responsibility for Treasury Management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the services of external service providers. All decisions will be undertaken with regard to all available information, including, but not solely, our Treasury advisers.

1.16 The Council also recognises that there is value in employing external providers of Treasury Management services in order to acquire access to specialist skills and resources as and when required. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly contracted, agreed and documented and subjected to regular review.

1.17 In respect of non-Treasury investments, two adviser contracts are used for access to specialist skills and resources. These are detailed in the Investment Strategy and are separate to the above treasury adviser contract.

2.0 The Capital Prudential Indicators

2.1 The Council's capital expenditure plans are the key driver of Treasury Management activity. The outputs of the capital expenditure plans are reflected in the prudential indicators (Annex 1), which are designed to assist members to review and confirm capital expenditure plans.

Prudential Indicator – Capital Expenditure and Financing

2.2 This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

Table 1 – Total Capital Programme

	2024/25 Estimate £000	**2025/26 Estimate £000**	**2026/27 Estimate £000**	**2027/28 Estimate £000**	**2028/29 Estimate £000**	**2029/30 Estimate £000**
Capital Expenditure	160,000	160,000	160,000	117,504	62,432	155,800
Non-Treasury Investment WPDG*	3,463	11,952	14,929	24,274	10,648	3,824
Non-Treasury Investment WIF*	3,800	23,040	23,160	0	0	0
Total	**167,263**	**194,992**	**198,089**	**141,778**	**73,079**	**159,624**

***WPDG Warwickshire Property and Development Group**

***WIF Warwickshire Recovery and Investment Fund BIG and PIF Pillars**

2.3 The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a need to borrow to fund the shortfall.

Table 2 – Financing of Capital Expenditure

	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000	2028/29 Estimate £000	2029/30 Estimate £000
Capital receipts	884	2,467	672	206	(17,590)	17,335
Capital grants	108,794	53,587	56,184	44,709	40,270	118,465
Self-Financed Borrowing	0	0	0	0	0	0
Revenue	1,232	100	0	0	0	0
Capital Programme Funding/Income	110,909	56,154	56,856	44,915	22,680	135,800
WPDG Receipts	2,789	4,834	27,601	22,527	27,286	9,482
WIF Receipts	98	106	124	12,544	23,114	14,342
Non-Treasury Investment Funding/Income	2,887	4,940	27,725	35,071	50,400	23,824
Total Funding/Income	**113,797**	**61,094**	**84,581**	**79,986**	**73,079**	**159,624**
Total Capital Expenditure	167,263	194,992	198,089	141,778	73,079	159,624
Net financing need for the year	**53,467**	**133,897**	**113,508**	**61,793**	**0**	**0**
Minimum Revenue Provision (MRP)	(10,437)	(12,159)	(17,028)	(20,887)	(22,524)	(21,623)
Borrowing Requirement	**43,030**	**121,739**	**96,480**	**40,905**	**(22,524)**	**(21,623)**

2.4 The net financing need split between capital expenditure and non-Treasury investments is shown below, to help show the relative scale of non-Treasury investments.

Table 3 – Financing of Non-Treasury Investments

	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000	2028/29 Estimate £000	2029/30 Estimate £000
WPDG Capital Investment	3,463	11,952	14,929	24,274	10,648	3,824
Less: WDPG Related Receipts and Repayments	(2,789)	(4,834)	(27,601)	(22,527)	(27,286)	(9,482)
WIF Capital Investment	3,800	23,040	23,160	0	0	0
Less: WIF Related Receipts and Repayments	(98)	(106)	(124)	(12,544)	(23,114)	(14,342)
Non-Treasury Net financing need for the year	**4,376**	**30,051**	**10,364**	**(10,797)**	**(39,752)**	**(20,000)**
Net financing need for the year (table 2)	**53,467**	**133,897**	**113,508**	**61,793**	**0**	**0**
Percentage of total net financing need %	8%	22%	9%	* N/A	* N/A	*N/A

*** Note that receipts exceed payments from 2028/29-2029/30 so no net financing is needed for Non-Treasury investments**

2.5 Further details in respect of non-Treasury investments are set out in the separate Investment Strategy document.

Prudential Indicator – The Council's Borrowing Need (Capital Financing Requirement)

2.6 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is a measure of the indebtedness and underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

2.7 The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life, and so charges for the economic consumption of capital assets as they are used.

Table 4 – Capital Financing Requirement

	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000	2028/29 Estimate £000	2029/30 Estimate £000
CFR – Capital Programme	299,083	390,771	476,887	528,589	545,817	544,194
CFR - WPDG	6,029	13,147	476	2,223	(14,415)	(20,073)
CFR - WIF	3,637	26,570	49,606	37,062	13,948	(394)
Total CFR	308,749	430,488	526,968	567,873	545,350	523,727
Movement in CFR - Capital Prog	49,156	103,846	103,144	72,589	39,752	20,000
Movement in CFR - WPDG	674	7,118	(12,671)	1,747	(16,638)	(5,658)
Movement in CFR - WIF	3,637	22,934	23,036	(12,544)	(23,114)	(14,342)
Movement in CFR - Total	53,467	133,897	113,508	61,793	0	0
Movement in CFR represented by						
Net financing need for the year	53,467	133,897	113,508	61,793	0	0
Less MRP and other financing	(10,437)	(12,159)	(17,028)	(20,887)	(22,524)	(21,623)
Movement in CFR net of MRP	**43,030**	**121,739**	**96,480**	**40,905**	**(22,524)**	**(21,623)**

Prudential Indicator – Liability Benchmark

2.8 A third prudential indicator, which was introduced in 2024/25 is the Liability Benchmark. The Council is required to estimate and measure the Liability Benchmark for the forthcoming financial year and the following two financial years, as a minimum.

2.9 There are five components to the Liability Benchmark :

a.) Existing & New Loans, Total Debt Outstanding: The Council's existing loans that remain outstanding in future years, along with planned new borrowing.

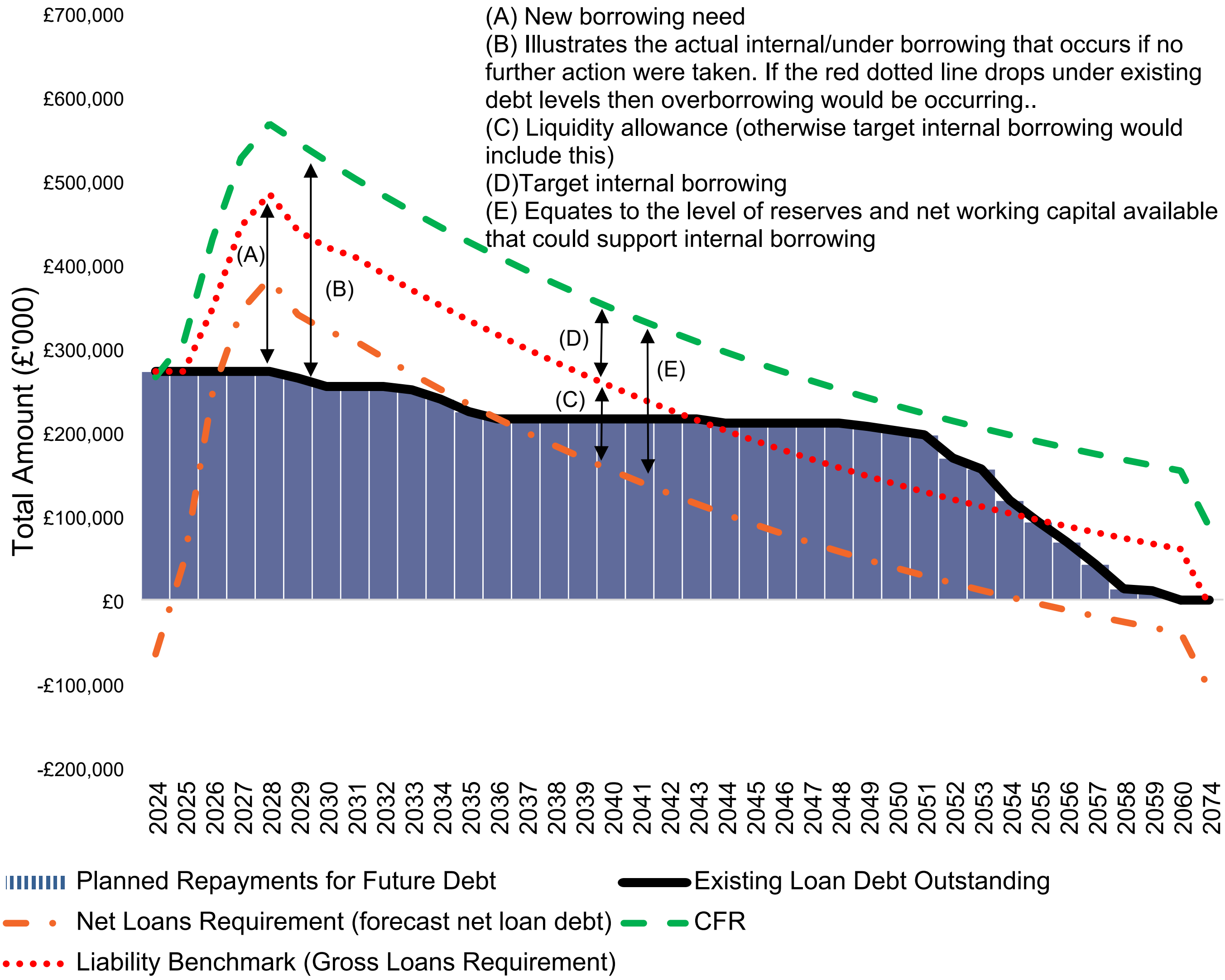
b.) CFR: this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned MRP.

c.) Net loans requirement: this shows the Council's gross loan debt less Treasury Management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned MRP and any other major cash flows forecast.

d.) Forecast Investments/Liquidity Allowance: the Council forecasts maintaining treasury investments of £100m each year from 2025/26 onwards, after starting with £227m in 2024/25. the liquidity allowance is an additional amount of funds set aside to ensure the council has enough cash available to manage day-to-day operations and unexpected expenses.

e.) Liability Benchmark: This represents the gross loans requirement, which matches the debt outstanding figures each year, indicating that the Council plans to meet its liability benchmark.

2.10 **Chart 1: Liability Benchmark prior to management actions**



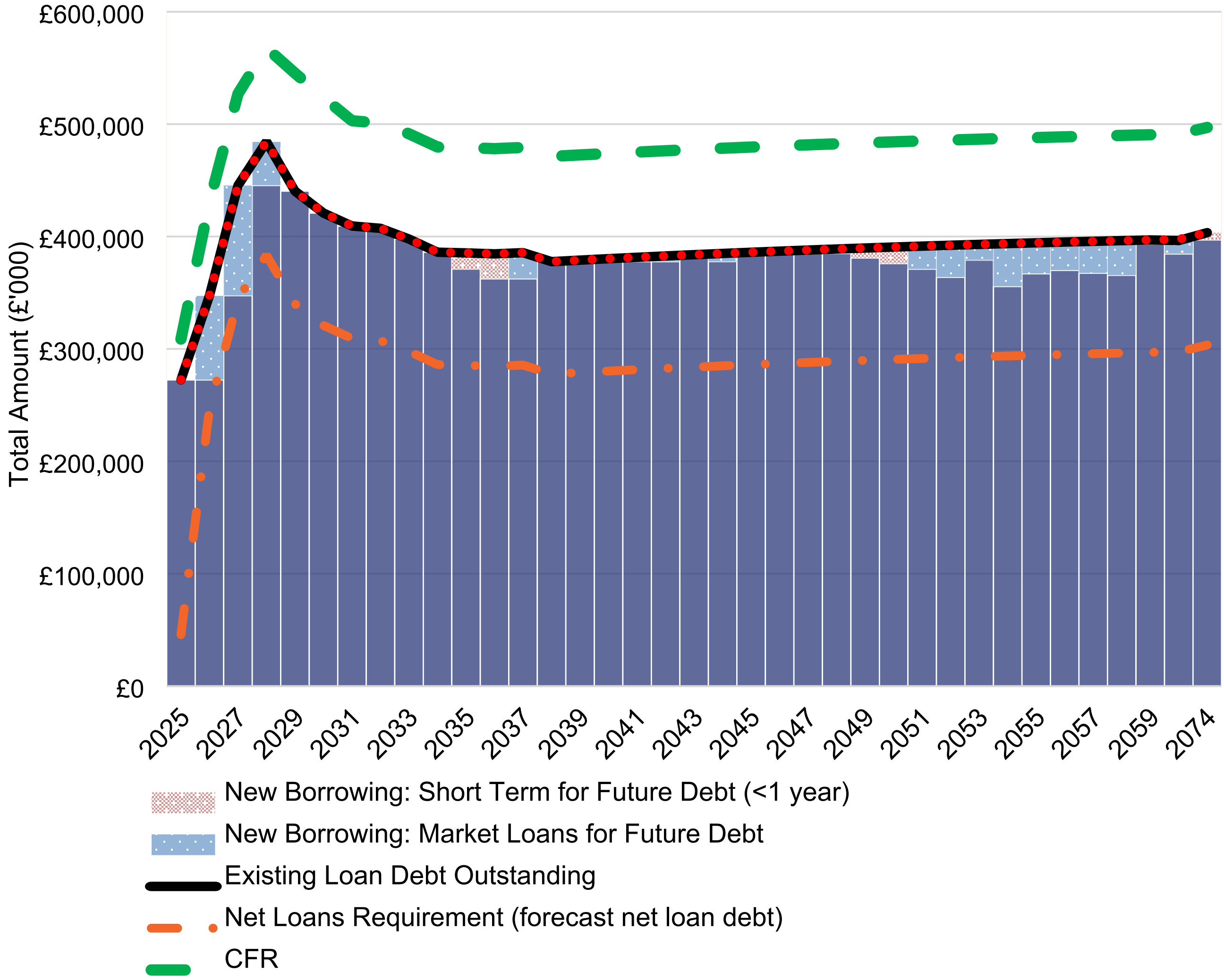
2.11 The benchmark liability graph is generally used by local authorities to illustrate the current Medium-Term Financial Strategy (MTFS) position and the position before management actions are implemented, projecting forward without making assumptions about the level of future borrowing or capital financing need beyond the medium term. Consequently, it is not expected that the projected path for CFR and external borrowing will accurately materialise, but the graph is intended to show the outlook/target need to borrow, having regard to being efficient. Chart 1 above shows the liability benchmark in this more standardised way.

2.12 In reality, the continuation of the capital program with new spending coming into the programme over time will affect these projections, as will proactive management actions to maintain appropriate debt levels, and the picture taking this into account is shown in table 6 and graph 2 below, which illustrate the Council's planned borrowing and debt management strategy, showing alignment of debt levels with the liability benchmark.

Table 6 Liability Benchmark

	2024/25 Estimate £000	**2025/26 Estimate £000**	**2026/27 Estimate £000**	**2027/28 Estimate £000**	**2028/29 Estimate £000**	**2029/30 Estimate £000**
Current PWLB Loans	272,400	272,400	330,373	430,021	471,572	431,458
Planned Repayments for Existing Debt	0	0	0	0	(8,000)	(10,000)
Planned Repayments for Future Debt	0	0	0	0	(36,000)	(9,517)
New Borrowing	0	75,000	98,000	39,000	0	0
Existing Loan Debt Outstanding	**272,400**	**347,400**	**445,400**	**484,400**	**440,400**	**420,883**
CFR	308,749	430,488	526,968	567,873	545,350	523,727
(Over)/ Under borrowed based on CFR and Debt	**36,349**	**83,088**	**81,568**	**83,473**	**104,950**	**102,844**
Net Loans Requirement (forecast net loan debt)	45,774	246,689	344,633	383,381	340,118	320,883
Liquidity allowance above net debt (liquidity buffer)	226,626	100,711	100,767	101,019	100,000	100,000
Liability Benchmark (Gross Loans Requirement)	**272,400**	**347,400**	**445,400**	**484,400**	**440,118**	**420,883**
(Over)/Under Liability Benchmark	**0**	**0**	**0**	**0**	**0**	**0**

Chart 2 Liability Benchmark - ***The chart and table include management actions required to maintain the benchmark, such as taking out and repaying new borrowing as appropriate.***



Core Funds and Expected Investment Balances

2.10 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

2.11 This table highlights a trend of decreasing financial reserves and investments over the period, with significant reductions in expected treasury investments being a key factor. The DSG High Needs Deficit, driven by high needs pressures, has required the use of a DSG override. This allows the Council to carry forward the deficit without affecting the general fund. However, the override does not ease the cash flow impact, as the deficit continues to deplete our cash reserves.

Table 7 – Expected Investments

	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000	2028/29 Estimate £000	2029/30 Estimate £000
Fund balances / reserves	218,689	203,274	200,106	200,106	199,461	199,461
DSG Override	(87,570)	(147,570)	(147,570)	(147,570)	(147,570)	(147,570)
Capital receipts	0	0	0	0	17,525	13,190
Other	4,211	4,211	4,211	4,211	4,211	4,211
Total core funds	**135,330**	**59,915**	**56,747**	**56,747**	**73,692**	**69,357**
Working capital	129,946	129,946	129,946	129,946	129,946	129,946
(Under)/over borrowing	(36,349)	(83,088)	(81,568)	(83,473)	(68,950)	(57,327)
Expected Treasury Investments	**228,926**	**106,773**	**105,125**	**103,219**	**134,688**	**141,975**

* Working capital balances shown are estimated, this will fluctuate during the year

2.12 As we plan to hold less cash, the Council will reduce the minimum level of total Treasury investments from £100m to £80m. This change necessitates more efficient cash flow management and forecasting. To achieve this, we will introduce new internal controls to ensure accurate and timely cash flow projections, enabling us to maintain the necessary liquidity.

2.13 The DSG override figure remains static from 2026/27 onwards based on the assumption that the government will implement a national solution to manage DSG deficits by the end of 2025/26. If this solution is not in place, we will need to fund the overspends from other sources, which could increase the pressure on our fund balances or under-borrowing position. If the national solution is delayed or inadequate, we may face additional financial pressure post 2026/27.

2.14 Currently, we perform regular cash flow forecasts, maintain liquidity buffers, and conduct daily bank reconciliations to ensure the accuracy of our cash records. We also use scenario planning to assess the impact of different cash flow scenarios and plan accordingly.

2.15 To further enhance our cash flow management, we will seek implement the following additional controls:

a.) Implement a requirement for advance notice of any significant payments, with the specific threshold to be agreed upon, excluding Exchequer control transactions, to ensure that sufficient liquidity is maintained.

b.) Increase Cash Flow Monitoring: We will increase the frequency of cash flow monitoring and reporting to quickly identify and address any potential issues. This will be somewhat constrained because the capital programme forecasts are only updated quarterly. As a result, while we can update other aspects of the forecast more frequently, the capital programme portion will remain quarterly.

c.) Conduct a review of our current cash flow monitoring model to identify opportunities for improvement. This review will aim to enhance the accuracy and efficiency of our cash flow projections

2.16 These additional measures will help us achieve more efficient cash flow management and maintain the necessary liquidity.

Minimum Revenue Provision (MRP) Policy Statement

2.17 Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. It would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred and so such expenditure is spread over several years so as to try to match the years over which such assets benefit the local community through their useful life. The manner of spreading these costs is through an annual Minimum Revenue Provision (MRP).

2.18 The MRP should be designed to make prudent provision to redeem debt liabilities over a period which is reasonably commensurate with the associated capital expenditure benefits.

2.19 Having regard to these requirements, the MRP provision will be calculated as set out below.

MRP for Capital Programme Expenditure.

2.20 The MRP provision will be calculated on the average remaining useful life of the Council's asset portfolio. We will calculate and apply the remaining useful life over two categories of asset:

- Land, buildings and infrastructure; and
- Vehicles, plant and equipment and intangible assets.

2.21 The proportion of debt outstanding in each category of asset will be determined by the value of assets included in the balance sheet at the end of each financial year.

2.22 The 2020 review shows that the remaining useful life of our assets is now 25 years. By using an average life of 25 years for our assets equates to an annual provision of 4% straight line MRP.

2.23 For vehicles, plant and equipment, the remaining useful life is assumed to be 6 years e.g. 5 years average remaining useful life will result in 20% straight line MRP.

MRP for the Warwickshire Property Development Group (WPDG)

2.24 Unlike mainstream capital spending where provision for purchase of replacement assets has to be made in order to have funding available for replacement assets, expenditure (investment) in the WPDG will at a later date be repaid in full.

2.25 It is possible to assume that these repayments of principal amount to the necessary revenue provision. However, there is a risk that repayment of principal is not made, or not made in full. In order to mitigate this risk, the MRP policy for the WPDG will be to make a provision as follows:

- No MRP will be charged to the revenue account on any equity land or asset transfers into Wholly Owned subsidiaries.
- No MRP will be charged on working capital loans. Any anticipated impairments will be treated following the relevant accounting standards (namely IFRS9 - Financial Instruments), and not charged through the capital financing regime.
- MRP on development loans made to Warwickshire Property Development Ltd (a subsidiary of WPDG) will be charged over 25 years of equivalent to 4% per year on any amount reasonably expected to default, rather than the full value of the loan.
- MRP on loans to Warwickshire Property Management Ltd (a subsidiary of WPDG for purchase of assets from Warwickshire Property Development Ltd) will be charged to the revenue account over 25 years (4% per year) on any amount expected to default, rather than the full value of the loan.
- Any capital receipts then received as repayment of the loan principal from Warwickshire Property Management Ltd and Warwickshire Property Development Ltd will be used to offset "traditional" borrowing requirements for financing the wider capital programme.

MRP for the Warwickshire Investment Fund (WIF)

2.26 Unlike mainstream capital spending where provision for purchase of replacement assets has to be made in order to have funding available for replacement assets, expenditure (investment) in the WIF will at a later date be repaid in full.

2.27 It is possible to assume that these repayments of principal amount to the necessary revenue provision. However, there is a risk that repayment of principal is not made, or not made in full. In order to mitigate this risk, the MRP policy for the WIF will be to make a provision as follows:

> "*MRP on WIF loans that are capital in nature will be charged over 25 years or equivalent to 4% per year on any amount reasonably expected to default, rather than the full value of the loan*"

2.28 Any capital receipts then received as repayment of the loan principal from WIF will be used to offset "traditional" borrowing requirements for financing the wider capital programme.

MRP For International Financial Reporting Standard 16 (IFRS16) - Leases

2.29 On 1 April 2024, the Council adopted a new accounting standard for leases (IFRS16). This means that for all leases where we are the lessee, our right-to-use the asset will be recognised, and we will account for the leased asset on our Balance Sheet as though we had purchased the asset.

2.30 The inclusion of more leases on the Balance Sheet will increase the Capital Financing Requirement. However, to avoid double counting the cost of leased assets, a technical adjustment will be made to ensure a "net nil" effect on the revenue budget, as lease rental payments are already made from revenue budgets.

2.31 For assets under lease contracts existing from 2025/26 onwards, the annual MRP charge will match the portion of the rent/charge that reduces the lease liability. Therefore, there will be no impact on available capital resources or the capital financing requirement from this new accounting requirement.

MRP Calculation

2.32 The calculation of MRP will be based on the [Total Capital Financing Requirement x 4%]. This is deemed to be a prudent overall level of provision based upon the requirements set out above.

2.33 The Council has the option to link internal borrowing directly to specific investments and where this is the case a MRP would not be made. This would mean that repayments associated with the loan would not be capital and would therefore not be ringfenced to financing capital spending. Any anticipated impairments will be treated following the relevant accounting standards (namely IFRS9 - Financial Instruments), and not charged through the capital financing regime. However, the default position is that specific funding sources are not directly linked to specific investments therefore an express decision to link specific funding to a specific investment would need to be made for this to happen.

3.0 BORROWING

3.1 The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The Treasury Management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Capital Strategy. This involves both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant Treasury / prudential indicators, the current and projected debt positions, and the Annual Investment Strategy

3.2 In 2023/24, the Council was marginally over borrowed by £6.7m (meaning external borrowing was greater than the total capital financing requirement). However, for 2024/25, we forecast an under-borrowed position of £36m, which is expected to increase to approximately £80m from 2025/26 onwards. This change is due to reducing cash balances. The capital programme and use of internal borrowing will mean the Council expects to maintain an under borrowed position, which is a more efficient use of our balance sheet resources.

3.3 Our total debt outstanding is planned to increase in 2025/26. The net loans requirement will align with our capital financing needs. The need for further borrowing will be kept under review to ensure alignment with our financial strategy and capital requirements. This borrowing strategy is sensitive to the progress of the capital programme, and adjustments will be made as necessary to respond to any changes in capital expenditure plans.

Current Portfolio Position

The overall Treasury Management portfolio as at 31st March 2024, 30th September 2024 and 31 December 2024 are shown below for both borrowing and investment

Table 8 – Current Portfolio Position

	Actual 31 Mar 24 £000	Actual 31 Mar 24 %	Actual 30 Sep 24 £000	Actual 30 Sep 24 %	Actual 31 Dec 24 £000	Actual 31 Dec 24 %
Treasury Investments						
Banks	16,371	5.34%	11,803	3.79%	11,428	4.04%
Building Societies	-	0.00%	-	0.00%	-	0.00%
Local authorities	180,350	58.80%	160,350	51.48%	130,000	45.99%
Housing Associations	40,000		40,000	12.84%	40,000	14.15%
Total managed in house	**196,721**	**64.14%**	**212,153**	**68.11%**	**181,428**	**64.18%**
Bond funds	30,221	9.85%	30,393	9.76%	30,141	10.66%
Property funds	9,634	3.14%	9,600	3.08%	9,736	3.44%
Cash fund managers	70,138	22.87%	59,359	19.06%	61,389	21.72%
Total managed externally	**109,993**	**35.86%**	**99,352**	**31.89%**	**101,266**	**35.82%**
Total Treasury Investments	**306,714**	**100.00%**	**311,505**	**100.00%**	**282,694**	**100.00%**
Treasury External Borrowing						
PWLB	272,400	100.00%	272,400	100.00%	272,400	100.00%
Total external borrowing	**272,400**		**272,400**		**272,400**	
Net Treasury Investments (Borrowing)	**34,314**		**39,134**		**10,294**	

3.4 Annex 2 sets out the current maturity profile of the borrowing portfolio. Currently there is a significant concentration of debt maturities across the period 2050-2060.

3.5 The Council’s forward projections for borrowing are summarised below. The table shows the actual and planned external debt, against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

3.6 The projections indicate that the Council will maintain an under-borrowed position from 2024/25 onwards. This strategy ensures that external borrowing remains below the Capital Financing Requirement, aligning with our strategy to optimise the use of internal resources and minimise interest costs. The under-borrowed position provides flexibility to adjust borrowing levels in response to changes in the capital programme and financial conditions, ensuring that we can meet our capital financing needs efficiently.

Table 9 – External Debt Forecast

	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000	2028/29 Estimate £000	2029/30 Estimate £000
External Debt						
Current Debt	272,400	272,400	347,400	445,400	484,400	440,400
Planned Repayments for Existing Debt	0	0	0	0	(8,000)	(10,000)
Planned Repayments for Future Debt	0	0	0	0	(36,000)	(9,517)
New Debt	0	75,000	98,000	39,000	0	0
Actual gross debt at 31 March	**272,400**	**347,400**	**445,400**	**484,400**	**440,400**	**420,883**
The Capital Financing Requirement	308,749	430,488	526,968	567,873	545,350	523,727
Under / (over) borrowing	**36,349**	**83,088**	**81,568**	**83,473**	**104,950**	**102,844**

Internal Debt

3.7 The Council will seek to hold efficient levels of cash and will therefore run-down external investment balances and use cash to finance a share of the Capital Financing Requirement. This is referred to as internal borrowing. The level of internal borrowing will be kept under review to ensure that the level of liquid Treasury investments (a liquidity buffer) does not fall below £75m, and total Treasury Investments does not fall below £100m.

3.8 Further details on the reduction in the minimum level of Treasury investments and the associated cash flow management can be found in the paragraph 2.10 onwards - Core Funds and Expected Investment Balances section.

Table 10 – Internal Debt Forecast

	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000	2028/29 Estimate £000	2029/30 Estimate £000
External Debt	272,400	347,400	445,400	484,400	440,400	420,883
Internal Debt (internal borrowing)	36,349	83,088	81,568	83,473	104,950	102,844
Internal borrowing as % of CFR	**11.8%**	**19.3%**	**15.5%**	**14.7%**	**19.2%**	**19.6%**

3.9 Where it is deemed appropriate to add to the level of current external loan finance, any risks associated with such borrowing will be subject to prior appraisal (including borrow now or borrow later analysis) and subsequent reporting through the mid-year or annual reporting mechanism.

3.10 Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2025/26 and the following two financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue or speculative purposes.

3.11 The Director of Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Treasury Indicators: Limits to Borrowing Activity

3.12 **The operational boundary** – This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Table 11 – Operational Boundary

	2024/25 Actual £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000	2028/29 Estimate £000	2029/30 Estimate £000
External Debt	496,942	474,000	580,000	625,000	600,000	577,000
Total	**496,942**	**474,000**	**580,000**	**625,000**	**600,000**	**577,000**

The Authorised Limit for External Debt

3.13 This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

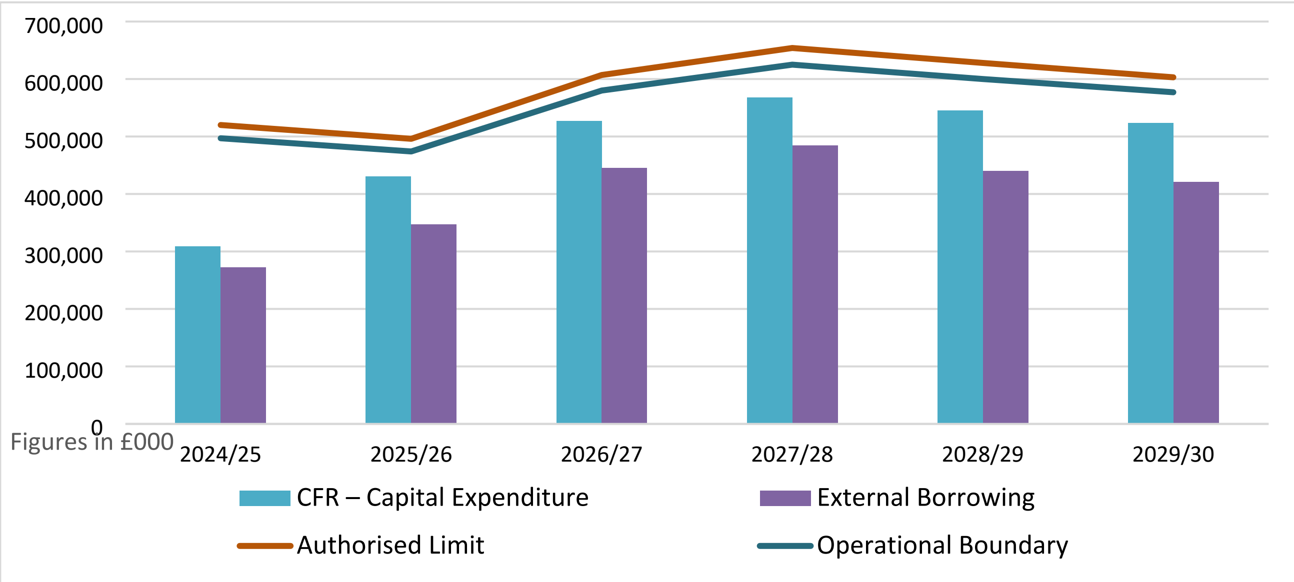
3.14 This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all Councils' plans, or those of a specific Council, although this power has not yet been exercised.

3.15 The Council is asked to approve the following authorised limit.

Table 12 – Authorised Limit

	2024/25 Actual £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000	2028/29 Estimate £000	2029/30 Estimate £000
External Debt	520,000	496,000	607,000	654,000	628,000	603,000
Total	**520,000**	**496,000**	**607,000**	**654,000**	**628,000**	**603,000**

Chart 2 - Capital Financing Requirement, Debt and Prudential Limits



Prospects for Interest Rates

3.16 The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 11 November 2024. These are forecasts for Bank Rate, average earnings and PWLB certainty rates, gilt yields plus 80 bps.

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

3.17 Additional notes by Link on this forecast table:

- 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.
- Following the 30 October Budget, our central case is that the policy announcements will impact inflation, at least in the near-term. The Office for Budgetary Responsibility and the Bank of England concur with that view. The latter have the CPI measure of inflation hitting 2.5% y/y by the end of 2024 and

staying sticky until at least 2026. The Bank forecasts CPI to be 2.7% y/y (Q4 2025) and 2.2% (Q4 2026) before dropping back in 2027 to 1.8% y/y.

- The anticipated major investment in the public sector, according to the Bank, is expected to lift UK real GDP to 1.7% in 2025 before growth moderates in 2026 and 2027. This will require the Government's policies to lead to a material uptick in growth primarily focus on the logistics of fast-tracking planning permissions, identifying sufficient skilled labour to undertake a resurgence in building, and an increase in the employee participation rate within the economy.
- There are inherent risks to all the above. The worst-case scenario would see systemic blockages of planning permissions and the inability to identify and resource the additional workforce required to deliver large-scale IT, housing and infrastructure projects. This would lead to upside risks to inflation, an increased risk of further Government borrowing, possible changes to tax, and a tepid GDP performance.
- We forecast the next reduction in Bank Rate to be made in February and for a pattern to evolve whereby rate cuts are made quarterly and in keeping with the release of the Bank's Quarterly Monetary Policy Reports (February, May, August and November).
- Any movement below a 4% Bank Rate will, nonetheless, be very much dependent on inflation data in the second half of 2025. The fact that the November MPC rate cut decision saw a split vote of 8-1 confirms that there are already some concerns around inflation's stickiness, and with recent public sector wage increases beginning to funnel their way into headline average earnings data, the market will be looking very closely at those releases.
- Regarding our PWLB forecast, the short to medium part of the curve is forecast to remain elevated over the course of the next year, and the degree to which rates moderate will be tied to the arguments for further Bank Rate loosening or otherwise. The longer part of the curve will also be impacted by inflation factors, but there is also the additional concern that with other major developed economies such as the US and France looking to run large budget deficits there could be a glut of government debt issuance that investors will only agree to digest if the interest rates paid provide sufficient reward for that scenario.
- Our revised PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1 November 2012.

Link Group - Gilt yields and PWLB rate forecast

3.18 The overall longer-run trend is for gilt yields and PWLB rates to fall back over the timeline of our forecasts, but the risks to our forecasts are to the upsides. Our target borrowing rates are set **two years forward** (as we expect rates to fall back) and the current PWLB (certainty) borrowing rates are set out below: -

PWLB debt	Current borrowing rate as at 11.11.24 p.m.	Target borrowing rate now (end of Q3 2026)	Target borrowing rate previous (end of Q3 2026)
5 years	5.02%	4.30%	3.90%
10 years	5.23%	4.50%	4.10%
25 years	5.66%	4.90%	4.40%
50 years	5.42%	4.70%	4.20%

3.19 Our long-term (beyond 10 years) forecast for Bank Rate has been increased to 3.25% (from 3%). As all PWLB certainty rates are currently significantly above this level, borrowing strategies will need to be reviewed in that context. Overall, better value can be obtained at the shorter end of the curve and short-dated fixed LA to LA monies should also be considered. Temporary borrowing rates will, generally, fall in line with Bank Rate cuts.

3.20 Our suggested budgeted earnings rates for investments up to about three months' duration in each financial year are set out below.

Average earnings in each year	Nov 2024	Nov 2023
2024/25 (residual)	4.60%	4.25%
2025/26	4.10%	3.35%
2026/27	3.70%	3.10%
2027/28	3.50%	3.25%
2028/29	3.50%	3.25%
Years 6 to 10	3.50%	3.25%
Years 10+	3.50%	3.50%

3.21 We will continue to monitor economic and market developments as they unfold. Typically, we formally review our forecasts following the quarterly release of the Bank of England's Monetary Policy Report but will consider our position on an ad hoc basis as required.

Our interest rate forecast for Bank Rate is in steps of 25 bps, whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps. Naturally, we continue to monitor events and will update our forecasts as and when appropriate.

Borrowing Strategy

3.22 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need, (the Capital Financing Requirement), has not been fully funded with external loan debt as cash supporting the Authority's reserves, balances and cash flow has been used as a temporary measure. This strategy is more efficient as internal borrowing is cheaper than external borrowing and medium and longer dated borrowing rates are expected to fall from their current levels, albeit only once prevailing inflation concerns are addressed.

3.23 Against this background and the risks within the economic forecast (Annex 8), caution will be adopted with the 2025/26 treasury operations. We will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

3.24 The following assumptions will be adopted in the borrowing strategy:

- The cheapest borrowing will be internal borrowing by running down cash balances to a minimum level and foregoing interest earned.
- Internal borrowing will be weighed against potential long-term costs that will be incurred if market loans at long term rates are higher in future years.
- Given the current interest rate environment, with the Bank Rate expected to fall to a low of 3.5% and potential further cuts, we will be flexible to adapt to these changes. The focus will be on short-term borrowing options to take advantage where appropriate of lower rates while maintaining the ability to switch to longer-term options if rates rise unexpectedly.
- Short or long-term fixed rate market loans at rates below PWLB rates will be considered where available, to ensure the best rates and to maintain an appropriate balance between PWLB and market debt in the debt portfolio.
- PWLB borrowing for periods under ten years will be considered where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowing which will spread debt maturities away from a current concentration in longer dated debt.
- To ensure that the Council considers all options to secure long-term certainty, the Council may also look to make use of forward starting loans as this will allow us to lock into a known financing rate out of a future date. These loans tend to be offered by financial institutions (primarily insurance companies and pension funds but also some banks, where the objective is to use the forward loan with a mix of internal loans/temporary borrowing to avoid a "cost of carry" or to achieve refinancing certainty over the next few years).

Policy on Borrowing in Advance of Need

3.25 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

3.26 However, the Council may borrow in advance of need for risk management or borrowing efficiency purposes. In determining whether borrowing will be undertaken in advance of need, the Council will:

- Ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to fund in advance of need;
- Ensure the ongoing revenue liabilities created, and the implications on future plans and budgets have been considered;
- Evaluate the economic and market factors that might influence the manner and timing of any decision;
- Consider the merits and demerits of alternative forms of funding;
- Consider the alternative interest rate bases available, the most appropriate time periods and repayment profiles to minimise borrowing costs and manage interest rate risk; and
- Consider the impact of temporarily increasing cash balances until cash is required to finance capital expenditure, and the consequent increase in exposure to counterparty and other risks. This includes evaluating the security, liquidity, and yield of potential investments for surplus cash.

Approval for new borrowing investment – Local Climate Bonds

3.27 As part of our commitment to innovative and sustainable financing, the TMSS proposes enabling the use of Local Climate Bonds (LCB), also known as Community Municipal Investments (CMIs), as a potential new borrowing instrument. These are a fundraising tool that allows local authorities to raise money from residents to support climate change projects.

3.28 LCBs will provide an additional fundraising option which would be used to raise funds specifically for environmentally sustainable projects. This would offer a mechanism through which to support our transition to become carbon net zero as an organisation by 2030, and to support Warwickshire County to become carbon net zero by 2050. The council will look to adopt the Green Financing Framework to ensure that any funds raised are used for projects that provide clear environmental benefits and support our sustainability goals.

3.29 Any funds raised through LCBs would be dedicated to financing projects that address climate change and promote environmental sustainability. These projects might include but would not be limited to -

- renewable energy installations
- energy efficiency improvements

- natural flood management; and
- other green initiatives

3.30 LCBs offer a potentially cheaper form of borrowing compared to traditional sources such as the PWLB. In addition, issuing Climate Bonds allows residents to invest directly in local green projects, fostering community engagement and ownership of the Council's sustainability initiatives.

Structure

3.31 LCBs will most likely be structured as peer-to-peer loans managed by FCA-regulated platforms. This structure would ensure that the Council does not require FCA accreditation, as the platform would handle the regulatory requirements.

Approval

3.32 At this stage, we are seeking **Council approval to enable the possibility of using of LCBs as a borrowing instrument.** There is no expenditure or planned income related to Climate Bonds included in the current TMSS, and any specific proposals to implement a LCB would be required to come to Cabinet for approval and a request for approval would include but not be limited to the amount of the bond, duration, objectives, governance, risk management, and regulatory requirements.

Next Steps

3.33 Detailed proposals for capital expenditure funded by Climate Bonds will be developed and presented in further Cabinet papers next year. These proposals will undergo the normal capital appraisal process and would require approval by Council.

3.34 The governance structure for LCB would be established as part of the next steps. This would include determining responsibilities for Anti-Money Laundering (AML) compliance, similar to the governance framework used for the Warwickshire Investment Fund (WIF). The governance framework will ensure that all regulatory and compliance requirements are met. The Council will conduct a thorough assessment of the provider market and put any proposals to a competitive test. Key points include understanding who takes on which risks, determining the risk appetite, and ensuring robust processes are in place. In addition, to ensure this doesn’t impose additional costs or inappropriate risks on the MTFS, limits will be set on the size and duration of the LCBs and the underlying investments. LCBs must be self-financing in terms of cost of capital and administration or funded from clearly identified Council budgets if required.

Debt Rescheduling

3.35 As short-term borrowing rates are cheaper than longer term rates, there may be opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of their short-term nature and the cost of debt repayments. Reasons for debt rescheduling would include:

- The generation of cash savings and/or discounted cash flow savings;
- Helping to fulfil the strategy; and

- Enhancing the balance of the portfolio, for example reducing concentration of the debt maturity profile.

3.36 The option to make repayment of some external debt to the PWLB in order to reduce the difference between its gross and net debt position will be kept under review.

New Financial Institutions as a Source of Borrowing and / or Types of Borrowing

3.37 Currently the PWLB Certainty Rate is set at gilts + 80 basis points for both Housing Revenue Account and non-Housing Revenue Account borrowing. However, consideration may still need to be given to sourcing funding from the following sources for the following reasons (for full list see Annex 3):

- Local authorities (primarily shorter dated maturities out to 3 years or so – still cheaper than the Certainty Rate).
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a "cost of carry" or to achieve refinancing certainty over the next few years).
- Municipal Bonds Agency (possibly still a viable alternative depending on market circumstances prevailing at the time).

3.38 Our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

4. ANNUAL INVESTMENT STRATEGY

Investment Policy – Management of Risk

4.1 The Ministry of Housing, Communities and Local Government (MHCLG) and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with Treasury (financial) investments,. Non-financial investments, essentially the purchase of income yielding assets, are covered in a separate report on the Capital Strategy.

4.2 The Council's investment policy has regard to the following:

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2021 ("the Code"); and
- CIPFA Treasury Management Guidance Notes 2018.

4.3 The Council's investment priorities will be security first, portfolio liquidity second and then yield (return). The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and within the Council's risk appetite. In the current economic climate, it is considered appropriate to maintain a degree of liquidity to cover cash flow needs but to also consider spreading investments for periods up to 18 months with high credit rated financial institutions, whilst investment rates remain elevated, as well as wider range fund options

4.4 The above guidance from the MHCLG and CIPFA places a high priority on the management of risk. This Council has adopted a prudent approach to managing risk and defines its risk appetite by the following means:

- Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
- **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisers to maintain a monitor on market pricing such as **"credit default swaps"** and overlay that information on top of the credit ratings.
- **Other information sources** used will include the financial press, share price and other such information pertaining to the financial sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
- This Council has defined the list of **types of investment instruments** that the Treasury Management team are authorised to use. There are two lists in annex 4 under the categories of 'specified' and 'non-specified' investments.

4.5 **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year or have less than a year left to run to maturity if originally, they were classified as being non-specified investments solely due to the maturity period exceeding one year.

4.6 **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

- **Non-specified and loan investment limits.** The Council has determined that it will set a limit to the maximum exposure of the total Treasury Management investment portfolio to non-specified Treasury Management investments of £100m.This reduction from the previous limit of £150m ensures prudent risk management and aligns with the Council's overall strategy.
- **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in Annex 4.
- **Sector Limits.** The Council has determined that it will limit the maximum exposure within different sectors of investments. These are set out in Annex 4
- **Transaction limits** are set for each type of investment in Annex 4.
- Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 4.10).
- This Council has engaged **external consultants**, (see paragraph 1.14), to provide expert advice on how to optimise an appropriate balance of security,

liquidity and yield, given the risk appetite of this Council in the context of the expected level of cash balances and need for liquidity throughout the year.

4.7 As a result of the change in accounting standards for 2023/24 under IFRS 9, the Council will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, MHCLG, concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31.3.23. The Government has extended the Override for an additional two-year period until 31 March 2025.) An assessment of our IFRS 9-affected investments is currently in progress to determine their future status before the commencement of the 2025/26 financial year.

4.8 The Council will also pursue **value for money** in Treasury Management and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year.

4.9 The above risk management policy criteria are **unchanged** from last year **except for the reduction of the non-specified investment limit from £150m to £100m to enhance prudent risk management.**

Creditworthiness Policy

4.10 The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that it:

- Maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- Has sufficient liquidity in its investments. For this purpose, it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

4.11 The Director of Finance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

4.12 Credit rating information is supplied by the Link Group, our Treasury advisers, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of the longer-term bias outside the central rating view) are provided to officers almost immediately after they occur, and this information is considered before dealing. For instance, a negative rating Watch applying to counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

4.13 The criteria for providing a pool of high-quality investment counterparties, (both specified and non-specified investments) is:

a.) **Banks of good credit quality –** the Council will only use banks which are:
- UK banks; or
- non-UK and domiciled in a country which has a minimum sovereign Long-Term rating of A-and have, as a minimum, the following Fitch Ratings:
- Short Term – F1
- Long Term – A-

b.) **Council's own Bank** – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time invested.

c.) **Building Societies** - The Council will use all societies which meet the ratings for banks outlined above;

d.) **Money Market Funds (MMFs)**:
- CNAV (constant net asset value) – AAA rated
- LVNAV (low volatility net asset value)– AAA rated
- VNAV (variable net asset value) – AAA rated

e.) **Property Funds** - CCLA

f.) **Social Bond Funds** - Threadneedle

g.) **Ultra-Short Dated Bond Funds** – at least AA rated

h.) **Local Authorities and Parish Council Loans** - both spot and forward dates

i.) **Housing Association Loans** - both spot and forward dates

4.14 **Use of additional information other than credit ratings** – Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria rely primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, rating Watches/Outlooks) will be applied to compare the relative security of differing investment opportunities.

4.15 **Time and monetary limits applying to investments** – The time and monetary limits for institutions on the Council's counterparty list are detailed in Annex 4.

4.16 **Creditworthiness** – Significant levels of downgrades to Short and Long-Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. Nonetheless, when setting minimum sovereign debt ratings, this Council will not set a minimum rating for the UK

4.17 **Credit Default Swaps (CDS) prices** –Although bank CDS prices, (these are market indicators of credit risk), spiked upwards in the autumn of 2022, they have returned to more average levels since then. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link monitor CDS prices as part of their creditworthiness service to local authorities and the Authority has access to this information.

Other Limits

4.18 Due care will be taken to consider the exposure of the Council's total investment portfolio to non-specified investments, countries, groups and sectors:

a.) **Country limit** – The Council has determined that it will only use approved counterparties from the UK and from countries with a **minimum sovereign credit rating of *A-*** from Fitch Ratings. The list of countries that qualify using this credit criteria as at the date of this report are shown in Annex 5. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

b.) **In-house funds** – Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e., rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed:

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Investment Performance / Risk Benchmarking

4.19 **Benchmarks** are guides to risk, they may be breached depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is so that officers can monitor the current and trend position and amend the operational strategy to manage risk as conditions change. As per last year, current advice suggests using the investment benchmark – 'returns above the 7-day SONIA compounded rate'.

4.20 Using the 7-day SONIA compounded rate as the benchmark is beneficial because it provides a stable and consistent measure. Specifically, as the Council is expected to maintain an under-borrowed position from 2025/26 onwards, making it crucial to have a reliable benchmark for managing cash flow and liquidity. Additionally, the Council's strategy to optimise the use of internal resources and minimise interest costs further supports the use of the 7-day SONIA compounded rate.

Non-Treasury Investment Strategy

4.21 A separate document entitled "Investment Strategy" covers the Council's position in respect of non-Treasury Management investments held for service reasons or commercial reasons.

End of Year Investment Report

4.22 At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

External Fund Managers

4.23 The County Council uses a number of external managers to spread risk and obtain maximum market exposure. Current external fund managers actively used during the last year are listed below. This list is not exhaustive and new fund managers may be engaged if necessary. Officers will periodically review the position, performance, and costs of external fund managers, and may meet with client relationship managers or fund managers as appropriate.

- Deutsche Bank
- Insight
- Aberdeen
- Aviva
- Federated Hermes
- CCLA
- Threadneedle

4.24 The council currently holds investments with two variable net asset value funds, CCLA and Threadneedle. Both funds have experienced volatility driven by Covid followed by a period of stabilisation.

Environmental, Social, and Governance Policy

4.25 As a responsible investor, the Council is committed to considering environmental, social, and governance (ESG) issues, and has a particular interest in taking action against climate change and pursuing activities that have a positive social impact.

4.26 However, the Treasury Management function is controlled by statute and by professional guidelines and the first priorities of Treasury must remain security, liquidity, and yield. With those priorities kept in place, the following activity will be undertaken in respect of climate change and responsible investing. Steps will be taken to:

- Ensure an understanding of the degree to which investments may contribute towards climate change, including measuring carbon footprints..
- Where appropriate, move cash balances to funds that have are ESG driven targets, or "green funds", to ensure our investment is contributing towards tackling ESG issues.
- Identify and understand the extent to which investments which are exposed to risks driven by climate change, for example investments in assets at risk of

weather change (e.g. property or infrastructure at risk of flooding), assets at risk of becoming stranded (e.g. fossil fuel investments), or assets at risk from geopolitical risks driven by climate change (e.g. water access, the capacity for food production, or economic conflict).

- Keep abreast of new investment opportunities that have regard to ethical investing and climate change as this is a quickly developing arena.
- Understand the ESG policies of funds, other local authorities, when considering new investment opportunities.

Pension Fund Cash

4.27 This Council will comply with the requirements of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, implemented 1 January 2010. With effect 1 April 2010, the Council does not pool pension fund cash with its own cash balances for investment purposes. Any investments made by the pension fund directly with this local Council after 1 April 2010 must comply with the requirements of SI 2009 No 393. The council has a separate statement for Pension Fund investment purposes.

ANNEXES

1. Prudential and Treasury Indicators
2. Treasury Management - Portfolio
3. Approved Sources of Long and Short Term borrowing
4. Treasury Management - Practice
5. Approved Countries for Investments
6. Treasury Management - Scheme of Delegation
7. Treasury Management - Role of the Section 151 Officer
8. Economic background

Annex 1

Prudential and Treasury Indicators

The Council's capital expenditure plans are the key driver of Treasury Management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

The following indicators are set out in the main body of the report:

Prudential Indicator	Reference
Capital Expenditure	Table 1
Gross Debt	Table 9
Capital Financing Requirement	Table 4
Liability Benchmark	Table 6
Over/Under Borrowing	Table 7
Borrowing - Operational Boundary	Table 11
Borrowing - Authorised Borrowing Limit	Table 12

In addition, the prudential indicators below will be applied.

Table A Treasury Management Prudential Indicators -

Financial Year	2025/26	2026/27	2027/28	2028/29	2029/30
Upper limit for fixed interest rate exposure Net principal re fixed rate borrowing / fixed term investments	100%	100%	100%	100%	100%
Upper limit for variable rate exposure Net principal re fixed rate borrowing / fixed term investments	25%	25%	25%	25%	25%
Upper limit for total principal sums invested for over 365 days – per maturity date	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
	100,000	100,000	100,000	100,000	100,000

The indicator is important for monitoring and controlling the Council's exposure to financial risks from investment decisions. It sets an upper limits, ensuring that investments remain within manageable and sustainable limits. This year, the upper limit for total principal sums invested has been reduced from £150m to £100m due to the Council's strategy of moving to an under borrowed position This TMSS optimises the use of internal resources, consequently, with less available cash due to increased efficiency, the Council will not be in a position to tie up income for extended periods, necessitating the reduction in the investment limit.

Table B Maturity structure of new fixed rate borrowing during year

	Upper limit	Lower limit
under 12 months	20%	0%
12 months and within 24 months	40%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Table C Maturity structure of new external borrowing during year

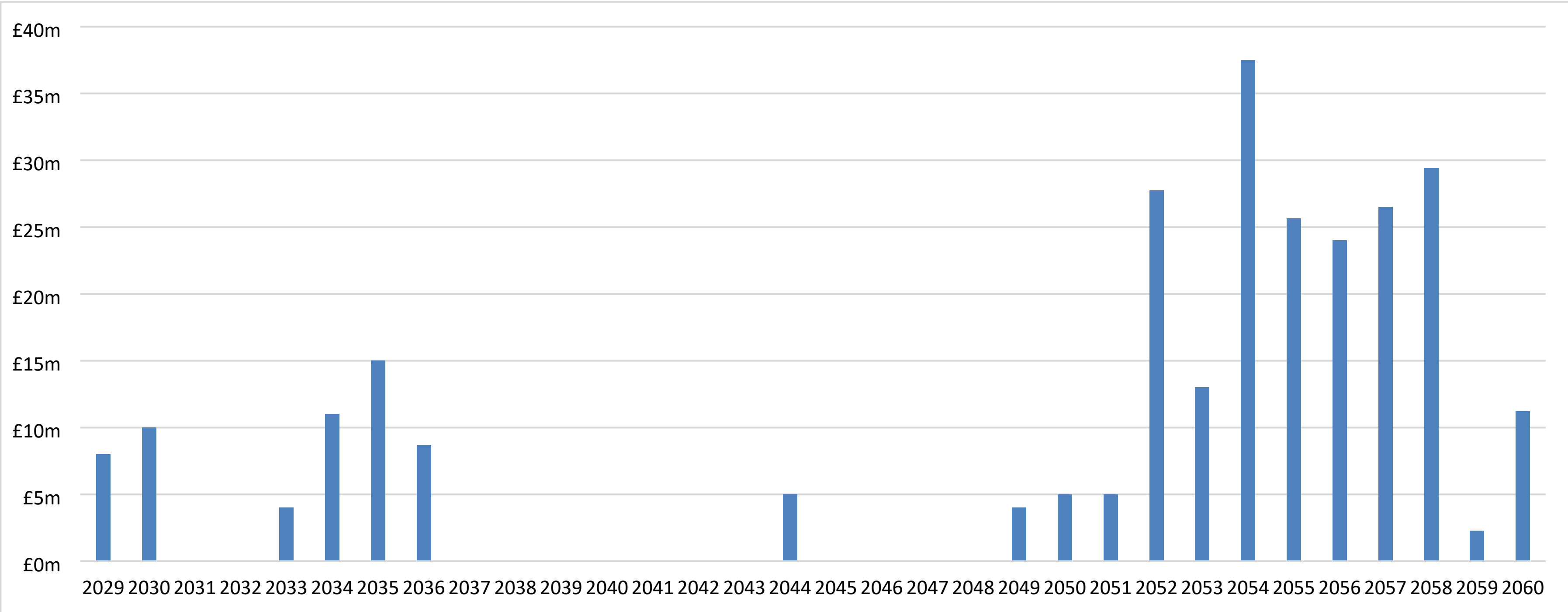
	Upper limit	Lower limit
under 12 months	35%	0%
12 months and within 24 months	45%	0%
24 months and within 5 years	65%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Tables B and C specify the upper and lower limits for different time periods for new fixed rate borrowing and new external borrowing, respectively. These limits ensure a balanced distribution of debt maturities, reducing refinancing risk and aligning with the Council's strategic financial planning.

Annex 2

Treasury Management Portfolio

1. **Debt Schedule: PWLB Loan Maturity Profile** – this shows the current maturity profile of the Council's borrowing portfolio, highlighting the significant concentration of debt maturities across the period 2050-2060. This information helps in understanding the timing and scale of future debt repayments and the need for debt management.



2. **Balance Sheet Forecast –** This table provides a detailed projection of the Council's financial position over the coming years. It includes estimates of assets and liabilities, helping to illustrate the expected changes in the Council's financial health and the impact of planned capital expenditures and borrowing on its overall financial stability. This forecast is important for financial planning and ensuring the Council can meet its future financial obligations.

2024/25 (£'000)		2025/26 (£'000)	2026/27 (£'000)	2027/28 (£'000)	2028/29 (£'000)	2029/30 (£'000)
308,749	CFR Relating to General Fund	430,488	526,968	567,873	545,350	523,727
308,749	Total CFR	430,488	526,968	567,873	545,350	523,727
	Finance Lease Liabilities	-	-	-	-	-
308,749	Underlying Borrowing Requirement	430,488	526,968	567,873	545,350	523,727
272,400	External Borrowing c/fwd	272,400	347,400	445,400	484,400	476,400
-	Loan Maturities	-	-	-	(8,000)	(10,000)
-	New Loans	75,000	98,000	39,000	-	-
272,400	External Borrowing	347,400	445,400	484,400	476,400	466,400
36,349	Under / (Over) Borrowing	83,088	81,568	83,473	68,950	57,327
12%	*Borrowing as a % of Requirement*	*19%*	*15%*	*15%*	*13%*	*11%*
26,000	General Fund Balance	26,000	26,000	26,000	26,000	26,000
1,380	Collection Fund Adjustment Account	1,380	1,380	1,380	1,380	1,380
(87,570)	DSG Override	(147,570)	(147,570)	(147,570)	(147,570)	(147,570)
191,309	Earmarked reserves	175,894	172,726	172,726	172,081	172,081
0	Capital Receipts Reserve	0	0	0	17,590	13,255
2,885	Provisions	2,885	2,885	2,885	2,885	2,885
1,326	Capital Grants Unapplied	1,326	1,326	1,326	1,326	1,326
(36,349)	Over / (Under) Borrowing	(83,088)	(81,568)	(83,473)	(68,950)	(57,327)
129,946	Working Capital	129,946	129,946	129,946	129,946	129,946
228,926	Expected Treasury Investments	106,773	105,125	103,219	134,688	141,975

Annex 3

Approved Sources of Long and Short-Term Borrowing – There has only been one change since 2024/25, this is to include Local Climate Bonds, further details on this can be found section 3.

On Balance Sheet	Fixed	Variable
PWLB	●	●
UK Municipal Bond Agency	●	●
Local Authorities	●	●
Banks	●	●
Pension Funds	●	●
Insurance Companies	●	●
UK Infrastructure Bank	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Market (LOBOs)	●	●
Stock Issues	●	●
Local Temporary	●	●
Local Bonds	●	
Local Authority Bills	●	●
Overdraft		●
Negotiable Bonds	●	●
Local Climate Change Bonds (New for 2025/26)	●	
Internal (capital receipts & revenue balances)	●	●
Commercial Paper	●	
Medium Term Notes	●	
Finance Leases	●	●

Annex 4

Treasury Management – Practice

4.1 ***Counterparty Limits***

	Fitch Long term Rating	Money Limit	Transaction limit	Time Limit
Banks	*A*-	£20m	£20m	1yr
Building Societies	*A*-	£20m	£20m	18 months
Local authorities	N/A	£10m	£10m	2yr
Housing Associations	N/A	£10m	£10m	3yr
DMADF	UK sovereign	unlimited	unlimited	6 months
Other Institutions limit	N/A	£10m	£10m	1yr
	Fund rating	**Money Limit**	**Transaction Limit**	**Notice Period**
Money Market Funds (CNAV, LVNAV, VNAV)	AAA	£150m	£150m	liquid
Ultra-Short Dated Bond Funds	AA	£60m	£60m	liquid
Property Fund	N/A	£15m	£15m	90 day
Social Bond Funds	N/A	£40m	£40m	90 day

Table 4.1 outlines the investment limits for various institutions and funds, these limits are designed to manage risk by setting maximum exposure levels and ensuring investments are made with high-quality counterparties.

The only change for 2025/26 is the consolidation of individual limits for Money Market Funds (CNAV, LVNAV, and VNAV) into a single limit of £150m. These funds are all AAA-rated, ensuring high credit quality and security. This change allows for greater flexibility in fund allocation, enabling the Council to mix funds and potentially achieve slightly higher yields.

4.2 Sector Limits

Sector Type	Limit Applied
Money Market Funds (overnight funds) and Instant Access funds	£150m aggregate
Money Market Funds (overnight funds) and Instant Access funds	Maximum holding in any one fund should not represent more than 5% of that funds total asset value
Short Term Investments 7-95 day (deposits, call and notice accounts, property and social bond funds)	£200m aggregate
Medium Term Investments 95-365 day (lending, deposit, call and notice accounts)	£200m aggregate
Lending to Local Authorities	Maximum £200m total
Lending to Local Authorities	Forward deals (deals agreed in advance of the loan issue date) allowed up to a total of 2 years to include both notice and loan term
Deposits with Housing Associations	Maximum £100m total
Deposits with Housing Associations	Forward deals (deals agreed in advance of the loan issue date) allowed up to a total of 3 years to include both notice and loan term
Deposits with Building Societies	Maximum £100m total
Deposits with Building Societies	Forward deals (deals agreed in advance of the loan issue date) allowed up to a total of 18 months to include both notice and loan term

Table 4.2 outlines the investment limits for various sectors, specifying the aggregate limits and conditions for each type of investment. These limits are designed to manage risk by setting maximum exposure levels and ensuring investments are diversified and made with high-quality counterparties.

The only changes made for 2025/26 are the reduction of Local Authority lending by £50m to £200m, which aligns with running down cash balances and indicates that we won't be fixing in so much of our investments. Additionally, the money market funds limit has been reduced by £150m to £150m aggregate to reflect the current strategy. There are no other changes.

4.3 Specified Investments

Investment Type	Credit Criteria (Fitch Ratings)	Limits (per institution)	Use
DMO Deposit Facility	--	No Limit	In-house
Term deposits: Local Authorities	--	£10m	In-house
Term deposits: Housing Associations	--	£10m	In-house
Nationalised Banks	Short-term F1, Support 1	£20m	In-house and External Manager
Term deposits: UK Banks	Short-term F1, Long-term A, Viability a, Support 3	£20m	In-house and External Manager
Term deposits: Bank Council uses for current account	--	£25m	In-house and External Manager
Term deposits: UK Building Societies	Top five largest societies as reported annually. (To be continually monitored)	£20m	In-house and External Manager
Term deposits: Overseas Banks	Short-term F1+, Long-term AA- Viability aa, Support 1	£20m	In-house and External Manager
Certificates of deposits issued by UK banks and building societies	Short-term F1, Long-term A, Viability a, Support 3	£20m	External Manager
Money Market Funds	AAA	£60m	In-house and External Manager
Ultra Short Dated Bond Funds	AA	£40m	In-house and External Manager
UK Government Gilts, Treasury Bills	--	No Limit	External Manager
Gilt Funds and Bond Funds	Long-term A	No Limit	External Manager

(All such investments will be sterling denominated, with **maturities up to a maximum of 1 year**, meeting the minimum ‘high’ rating criteria where applicable)

4.4 Non-Specified Investments

Investment Type	Credit Criteria (Fitch Ratings)	Limits (per institution)	Use
Term deposits: UK banks and building societies with maturities in excess of one year with a maximum of three years allowed for in-house deposits	Short-term F1, Long-term A, Viability a, Support 3	£20m	In-house and External Manager
Fixed Term Deposit with Variable Rates and Variable Maturities	Short-term F1, Long-term A, Viability a+, Support 3	£20m	In-house and External Manager
Certificates of Deposits issued by UK banks and building societies	Short-term F1, Long-term A, Viability a, Support 3	£20m	External Manager
UK Government Gilts with maturities in excess of 1 year	--	£20m	External Manager
Local Government Association Municipal Bond Agency	--	£20m	--
CCLA Property Fund	--	£20m	--
Threadneedle Social Bond Fund	--	£40m	--
Local Authority wholly owned trading company	--	£5m	In-house

Annex 5

APPROVED COUNTRIES FOR INVESTMENTS

This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Hong Kong, Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link credit worthiness service.

Based on lowest available rating (as at 25.11.24)

AAA

- Australia
- Denmark
- Germany
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- Qatar

AA-

- Belgium
- France
- **U.K.**

Annex 6

Treasury Management - Scheme of Delegation

(i) Council

- approval of annual strategy.
- budget consideration and approval.
- approval of the division of responsibilities.

(ii) Cabinet

- scrutinise the proposed annual strategy.
- approval of/amendments to the organisation's adopted clauses, Treasury Management policy statement and Treasury Management practices.
- Receiving and reviewing half year and annual monitoring reports and acting on recommendations.

(iii) Resources and Fire & Rescue Overview and Scrutiny Committee

- Overview and scrutiny of Treasury Management policy, practice, and activity as required.
- Receiving quarterly monitoring reports for overview and scrutiny.

Annex 7

Treasury Management – Role of the Section 151 Officer

The S151 (responsible) officer

- recommending clauses, Treasury Management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular Treasury Management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the Treasury Management function;
- ensuring the adequacy of Treasury Management resources and skills, and the effective division of responsibilities within the Treasury Management function;
- approve the early payment of pension fund contributions
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and Treasury Management, with a long term timeframe. ensuring that the Capital Strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money.
- recommending the MRP policy.
- creation of Treasury Management Practices be carried out and managed, to include the following (TM Code p54): -
    - Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;
    - Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;
    - Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;
    - Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;
    - Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.

Annex 8

ECONOMIC BACKGROUND-

Provided by Link Treasury Advisors

The third quarter of 2024 (July to September) saw:

- Gross Domestic Product (GDP) growth stagnating in July following downwardly revised Q2 figures (0.5% quarter/quarter (q/q))
- A further easing in wage growth as the headline 3 month year on year (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 Consumer Price Inflation (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% month/month (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 Office National Statistics (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.
- 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.
- 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%.

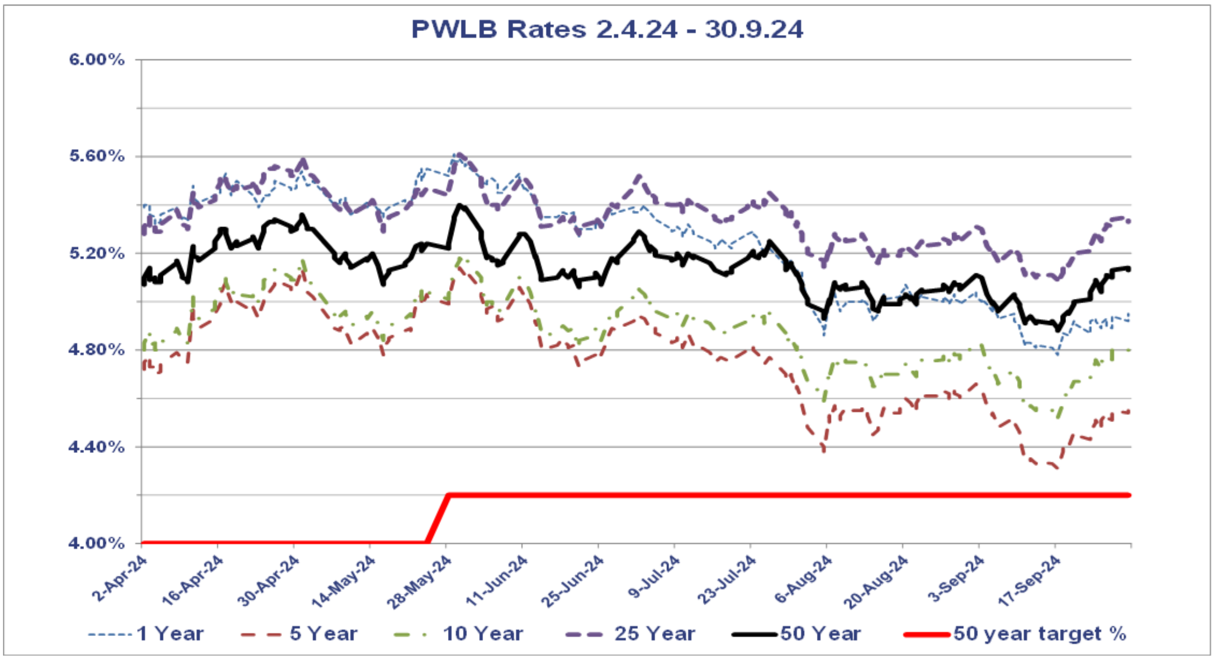
- The FTSE 100 reached a peak of 8,380 in the third quarter of 2024, but its performance is firmly in the shade of the US S&P500, which has breached the 5,700 threshold on several occasions recently. Its progress, however, may pause for the time being whilst investors wait to see who is elected the next 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.

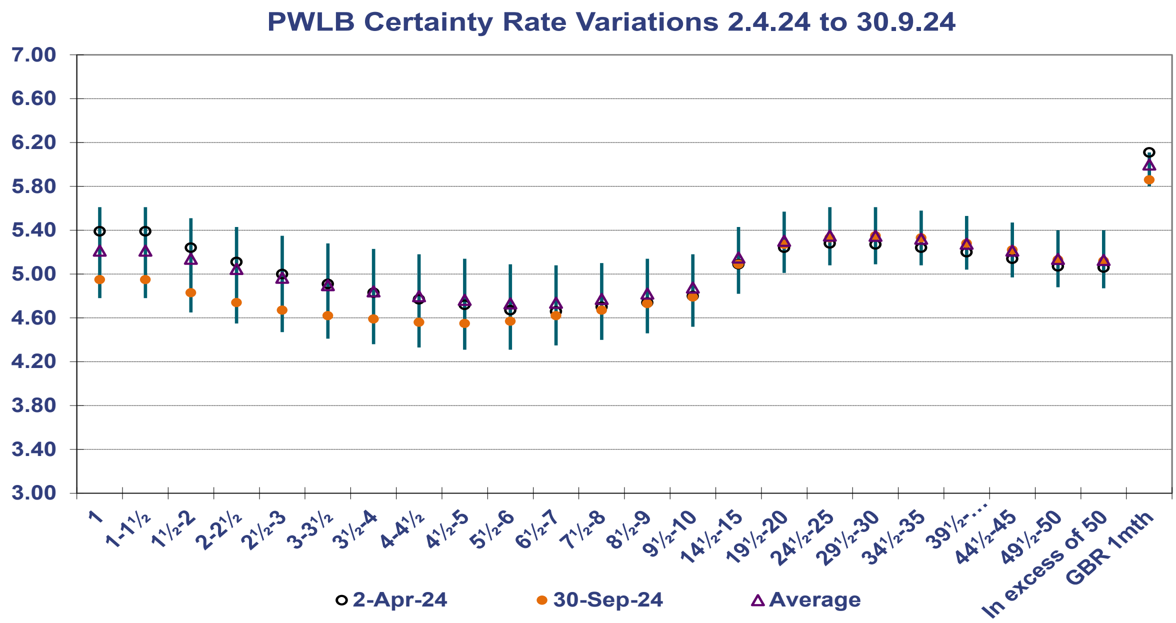
MPC meetings: 9 May, 20 June, 1 August, 19 September 2024

- 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.

In the chart below, despite a considerable gilt market rally in mid-September, rates started and finished the six-month period under review in broadly the same position.

PWLB RATES 02.04.24 - 30.09.24





HIGH/LOW/AVERAGE PWLB RATES FOR 02.04.24 – 30.09.24

	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%