Medway COUNCIL
Serving You

Audit Committee

26 September 2024

Treasury Management Report 2024/25: Quarter 1

Report from: Phil Watts, Chief Operating Officer

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1. Recommendation

1.1. The Committee is asked to note the treasury management report.

2. Budget and Policy Framework

2.1. The Council's Treasury Management Strategy and Policy are approved by Full Council following consideration by Cabinet and Audit Committee. The Audit Committee is responsible for approving the quarterly treasury reports.

3. Background

3.1. The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management 2021 recommends that members be updated on treasury management activities at least quarterly. This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

3.2. During 2024/25 the minimum reporting requirements were that the full Council should receive the following reports:

- An annual treasury strategy in advance of the year (Council 29 February 2024).
- A mid-year treasury review report

3.3. Audit Committee will also receive reports for quarter 1 (this report) and quarter 3.

4. Interest Rate Forecasts

4.1. The Council has appointed Link Asset Services as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. The Public Works Loans Board (PWLB) rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1st November 2012. For Housing Revenue Account (HRA) authorities, the lower HRA PWLB rate has also been available since 15 June 2023 (standard rate minus 60 bps) but is available for HRA borrowing only.

4.2. The latest forecast, updated on 28th May, sets out a view that both short and long-dated interest rates will start to fall once it is evident that the Bank of England has been successful in squeezing excess inflation out of the economy, despite a backdrop of a stubbornly robust economy and a tight labour market.

4.3. Moreover, whatever the shape of domestic data, recent gilt market movements have been heavily influenced by the sentiment pertaining to US monetary policy. Again, inflation and labour data has proven sticky and the market's expectation for rate cuts has gradually reduced throughout the course of the year, so that possibly rates may not be cut more than once, or possibly twice, before the end of 2024. In any event, even if the Bank of England starts to cut rates first, it may mean that the medium and longer parts of the curve take longer to fully reflect any such action until the US yield curve shifts lower too. Given the potential inflationary upside risk to US treasuries if Trump wins the presidential election in November (increased tariffs on imports from China for example), therein lies a further risk to yields remaining elevated for longer.

4.4. Closer to home, the General Election is not expected to have a significant impact on UK monetary policy. There is minimal leeway for further tax cuts or added spending without negatively impacting market sentiment.

4.5. Link's central case is still for a rate cut before the end of September, but we are not committed to whether it will be in August or September. Thereafter, the path and speed of rate cuts is similar to that which we previously forecast, with Bank Rate eventually falling to a low of 3% by the second half (H2) of 2026.

4.6. However, given the increased uncertainty surrounding Link's central gilt market forecasts, and the significant issuance that will be on-going from several of the major central banks, it has marginally increased its PWLB forecasts by c20 to 30 basis points across the whole curve since the previous quarter.

4.7. In summary, regarding PWLB rates, movement in the short-end of the curve is expected to reflect Link's Bank Rate expectations to a large degree, whilst medium to longer-dated PWLB rates will remain influenced not only by the outlook for inflation, domestically and globally, but also by the market's appetite for significant gilt issuance (£200bn+ for each of the next few years). As noted at the Link March Strategic Issues webinars, there is upside risk to that part of our forecast despite the Debt Management Office skewing its issuance to the shorter part of the curve.

4.8. Link's current Bank and PWLB rate forecasts are set out below. PWLB forecasts are based on the Certainty Rate.

Link Group Interest Rate View	28.05.24											
	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	5.25	5.00	4.50	4.00	3.50	3.25	3.25	3.25	3.25	3.00	3.00	3.00
3 month ave earnings	5.30	5.00	4.50	4.00	3.50	3.30	3.30	3.30	3.30	3.00	3.00	3.00
6 month ave earnings	5.30	4.90	4.40	3.90	3.50	3.30	3.30	3.30	3.30	3.10	3.10	3.20
12 month ave earnings	5.10	4.80	4.30	3.80	3.50	3.40	3.40	3.40	3.40	3.20	3.30	3.40
5 yr PWLB	4.90	4.70	4.50	4.30	4.10	4.00	3.90	3.90	3.90	3.90	3.90	3.80
10 yr PWLB	5.00	4.80	4.60	4.40	4.30	4.10	4.10	4.10	4.00	4.00	4.00	3.90
25 yr PWLB	5.30	5.20	5.00	4.80	4.70	4.50	4.50	4.40	4.40	4.40	4.30	4.30
50 yr PWLB	5.10	5.00	4.80	4.60	4.50	4.30	4.30	4.20	4.20	4.20	4.10	4.10

- Money market yield forecasts are based on expected average earnings by local authorities for 3 to 12 months.
- The Link forecast for average earnings are averages i.e., rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short-term cash at any one point in time.

5. Annual Investment Strategy

5.1. The Treasury Management Strategy Statement (TMSS) for 2024/25, which includes the Annual Investment Strategy, was approved by the Council on 29 February 2024. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

5.2. The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity, aligned with the Council's risk appetite. In the current economic climate, over and above keeping investments short-term to cover cash flow needs, there is a benefit to seeking out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

5.3. As shown by the charts below and the interest rate forecasts in section 2, investment rates have remained elevated during the first quarter of 2024/25 but are expected to fall back through the second half of 2024 as inflation reduces and the Monetary Policy Committee (MPC) starts to loosen monetary policy.

5.4. Creditworthiness - there have been few changes to credit ratings over the quarter under review. However, officers continue to closely monitor these, and other measures of creditworthiness to ensure that only appropriate counterparties are considered for investment purposes.

5.5. Investment counterparty criteria - the current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

5.6. CDS prices - for UK banks, these have remained low, and prices are not misaligned with other creditworthiness indicators, such as credit ratings. Nevertheless, it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances.

5.7. Investment balances - the average level of funds available for investment purposes during the quarter was £22.653million. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme. The Council holds £22.203million core cash balances for investment purposes (i.e., funds available for more than one year).

6. Approved limits

6.1. Officers can confirm that the approved limits within the Annual Investment Strategy were breached during the quarter ended 30th June 2024. Short term borrowing was temporarily more than the approved limit of £150million by £1.256million between 24/05/24 and 29/05/24. This approved limit is set within the Council's own treasury strategy, as one of a series of prudential indictors of risk. Whilst the breach was modest and quickly rectified, and therefore not a matter for immediate concern, it is however an indication that the council may need to look at to take some more borrowing for longer than twelve months when the opportunity arises, a direction that the Chief Operating Officer has instructed officers to undertake.

7. Borrowing

7.1. Total borrowing increased by £21.444million during the quarter. However maturing loans were replaced by new loans with longer durations where available. The maturing loans had interest rates of between 1.7% and 5.25%. The new loans received in Q1 have interest rates of 4.45% to 5.4% arranged between April 2024 and June 2024.

7.2. The Council's Capital Financing Requirement (CFR) for the year is shown below and represents a key prudential indicator.

CFR: General Fund	2023/24 Actual* £000	2024/25 Per Strategy £000	2024/25 R1 Forecast £000
Opening balance	415,630	483,434	453,632
Add unfinanced capital expenditure	26,964	66,924	59,078
Add Long Term Debtors (Capital Loans)	29,115	0	21,588
Less MRP	(5,782)	(5,409)	(6,343)
Less KCC Debt Repayment	(1,156)	(1,156)	(1,110)
Less repayment of Capital Loans	(11,140)	(52,411)	(24,575)
Closing balance	453,632	491,382	502,270

CFR: HRA	2023/24 Actual* £000	2024/25 Per Strategy £000	2024/25 R1 Forecast £000
Opening balance	42,829	44,377	45,844
Add unfinanced capital expenditure	3,423	5,016	16,060

CFR: HRA	2023/24 Actual* £000	2024/25 Per Strategy £000	2024/25 R1 Forecast £000
Less VRP	(408)	(390)	(481)
Closing balance	45,844	49,003	61,423

*CFR is provisional as work is continuing on the audit of the Statement of Accounts for 2023/24.

7.3. Borrowing is forecast to remain below the CFR and both the operational and authorised limits set in the treasury Strategy.

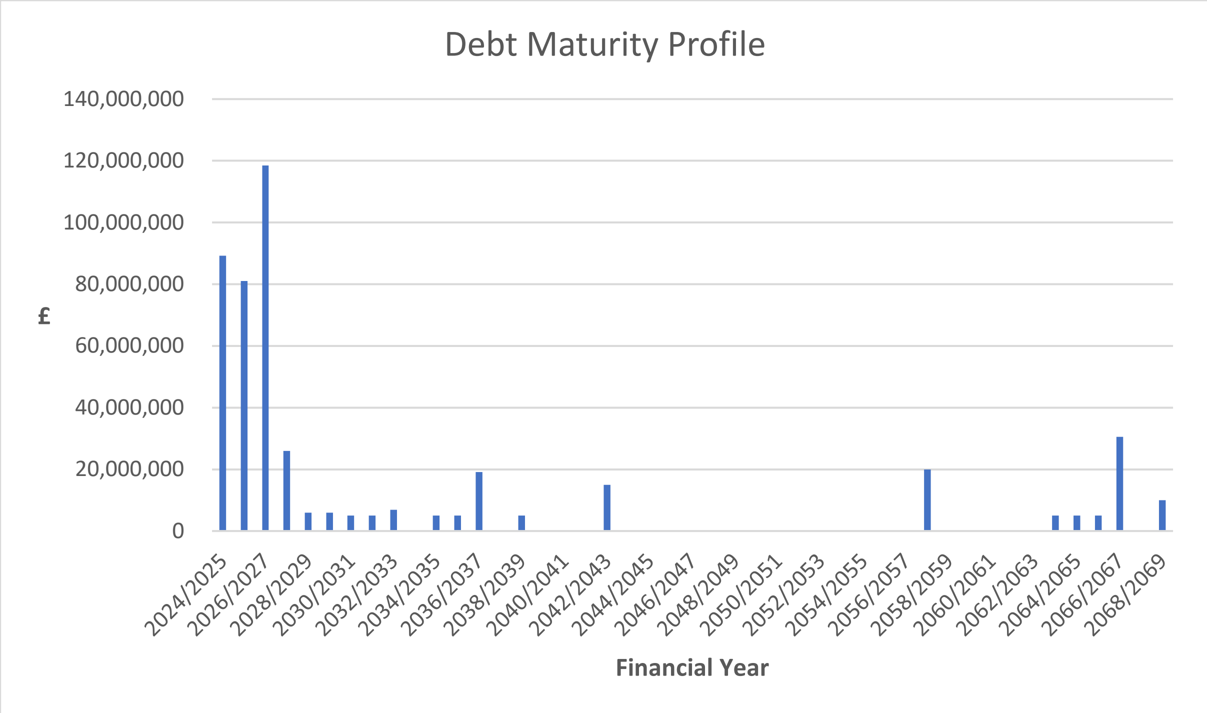
8. Treasury Position as at 30 June 2024

8.1. The Council's treasury management debt and investment position is organised by the treasury management officers to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the end of June 2024, the Council's treasury position was as follows:

Borrowing and investment levels:

	31/03/24 £000	Rate	30/06/24 £000	Rate
Long Term Borrowing – LOBO	81,800	4.13%	60,500	4.07%
Long Term Borrowing – PWLB	216,024	4.05%	251,025	4.19%
Long Term Borrowing – Other Local Authority	52,500	4.78%	42,500	5.01%
Long Term Borrowing – Growing Places/Salix/LEP	450	0.00%	350	0.00%
KCC Debt (includes approx. £1m short term)	28,901	4.41%	27,745	4.41%
Short Term Borrowing	114,100	3.81%	133,100	4.22%
Total Debt (Principal)	493,775		515,220	
Capital Financing Requirement (CFR)	499,475		563,693	
(Under)/Over Borrowing	*(5,700)*		*(48,472)*	
Less investments (exc. Property Funds & Loans to Subsidiaries)	22,999	5.17%	30,776	5.18%
Less Loan to Kyndi Ltd	890	5.00%	853	5.00%
Less Loans to MDC Ltd	87,540	7.79%	92,942	7.80%
Less Property Fund Investments *	20,105	-15.36%	18,446	0.57%
Net borrowing	362,241		372,203	

* The return on the property fund investments includes the change in capital value.



8.2. The table above shows the debt maturity profile as at 30 June 2024. Where contractual arrangements have been entered into for the renewal of loans or their direct replacement with new loans liability is shown at the expiry of the new or replacement loan.

8.3. The Ministry of Housing, Communities and Local Government (MHCLG) guidance since 2011 has been to show the maturity date for Lenders Options, Borrowers Options (LOBOs) as the next call date. Whilst, there was one early repayment made during quarter 1 (see paragraph 9.2), it is felt that the likelihood of further early repayments is receding due to the expected future reductions in interest rates and therefore the table does not follow this guidance and LOBOs have therefore been shown as maturing at their full term.

8.4. Upper limits for the proportion of debt maturing within various bands of years were set at the start of the year as shown below. There has been no breach of these limits.

Maturity Structure of Fixed rate Borrowing during 2024/25	**Upper Limit**	**Lower Limit**
under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and above	100%	0%

8.5. Property fund investment and income are summarised below.

	CCLA	Patriza	Total
	£000	**£000**	**£000**
Opening Value 31 March	11,566	4,890	16,456
Revaluation	(59)	(7)	(66)
Closing Value 30 June	11,507	4,883	16,390
Dividend Received	151	56	207
Overall Gain/(Loss)	92	49	141

8.6. Members will be aware that the Lothbury Property Fund ceased on 31 May 2024 and redemptions against the final valuation of the fund are being made, as and when the portfolio is sold as detailed below:

	Lothbury
	£000
Value as at 31 March	3,650
Dividend/Redistribution Received	(1,593)
Awaiting Redistribution	2,056

9. Debt Rescheduling

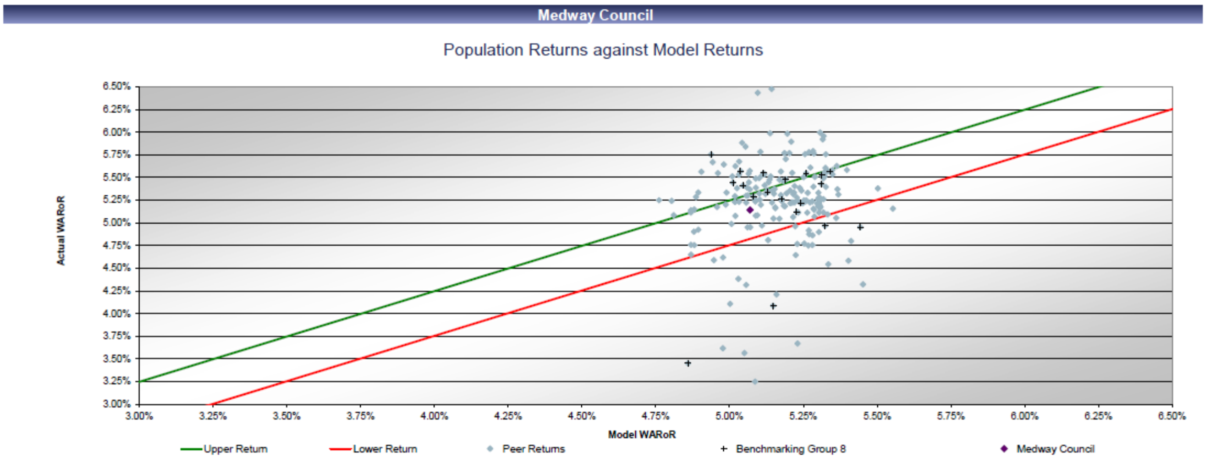
9.1. No debt restructuring was undertaken during quarter 1 as the average differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

9.2. During the first quarter the Council received notice from one LOBO lender of an increase in interest rate. The Council exercised its right to repay the £21.3m principal on 29 April 2024 at par.

10. Investments

10.1. At 30 June 2024 there were no investments with other local authorities.

10.2. The Council's performance relative to our peer group is shown by the graph below, which is a snapshot produced by Link Asset Services as at June 2024. Medway is the bold dot between the red and green lines showing our performance to be in line with our peers.



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
Medway Council	5.14%	5.07%	0.07%	4.82%	5.32%	Inline

11. Risk Management

11.1. Risk and the management thereof is a key feature throughout the strategy and in detail within the Treasury Management Practices (TMP1) within the Treasury Strategy.

12. Financial Implications

12.1. Overall, the Interest and Financing costs at round 1 were forecast to underspend the budget by £147,000.

12.2. A breakdown of the Interest and Financing budget is shown below:

Interest and Finance Budget against spend:

	Budget 2024/25 £000	Round 1 Forecast £000	(Under)/Overspend £000
Interest Earned	(5,842)	(10,331)	(4,489)
Interest Paid	17,342	21,738	4,396
KCC Principal	1,204	1,110	(94)
MRP	6,442	6,442	0
Treasury Costs	65	105	40
Total	**19,211**	**19,064**	**(147)**

12.3. The body of the report outlines the significant financial implications. Any transactions undertaken on either investments or borrowings are governed by the London Code of Conduct, the Council's treasury policy statement, and the CIPFA Code of Practice on Treasury Management in Local Authorities.

13. Legal implications

13.1. Our investments were managed in compliance with the Codes of Practices, guidance and regulations made under the Local Government Act 2003.

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Appendices

Appendix 1 Commentary by Link Asset Services on The Economy and Interest Rates
Appendix 2 Glossary of Terms

Background papers
None