Item 10

SURREY
COUNTY COUNCIL

Audit & Governance Committee
20 November 2024

Treasury Management Mid-Year Report 2024/25

Purpose of the report:
This report summarises the Council's treasury management activity during the first half of 2024/25, as required to ensure compliance with CIPFA's Code of Practice for Treasury Management.

10

Recommendations:

The Audit & Governance Committee is asked to note the content of the Treasury Management Mid-Year Report for 2024/25.

Introduction:

1. The Council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in Public Services: Code of Practice (the CIPFA Code) which requires the Council to produce treasury management mid-year and annual reports.
2. The Council's Treasury Management Strategy Statement for 2024/25 was approved at the Audit and Governance Committee meeting on 17 January 2024. The investing and borrowing of cash potentially expose the Council to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's Treasury Management Strategy.
3. This report includes the requirement in the 2021 Code, mandatory from 1 April 2023, of quarterly reporting of the treasury management prudential indicators, which are also included in quarterly budget monitoring reports to Cabinet.

External Context

4. The Bank of England's Monetary Policy Committee (MPC) cut Bank Rate from 5.25% to 5.00% at the August meeting. The decision was finely balanced, voted by a 5-4 majority with four members preferring to hold at 5.25%. At the September MPC meeting, committee members voted 8-1

for no change at 5.00%, with the lone dissenter preferring Bank Rate to be cut again to 4.75%.

5. Following the September MPC meeting, Arlingclose, the Council's treasury adviser, maintained its central view that Bank Rate would steadily fall from the 5.25% peak, with the first cut in August being followed by a series of further cuts, with November 2024 the likely next one, taking Bank Rate down to around 3% by the end of 2025.

6. UK headline consumer price inflation remained around the Bank of England (BoE) target later in the period, falling from an annual rate of 3.2% in March to 2.0% in May and then rebounding marginally to June to 2.2% in July and August, as was expected, due to base effects from energy prices.

7. The UK economy continued to expand over the period, albeit slowing from the 0.7% gain in the first calendar quarter to 0.5% (downwardly revised from 0.6%) in the second. Of the monthly figures, the economy was estimated to have registered no growth in July.

8. Annex 1 contains commentary from Arlingclose, our Treasury Management advisors, on the external context for Treasury Management activity and Annex 2 provides interest rate market projections.

10

Mid-Year Treasury Management Report 2024/25

9. The Treasury Management Strategy for 2024/25, approved by Audit and Governance Committee in January 2024, continued the policy of internal borrowing. This maintains borrowing below its underlying level by utilising available cash balances on a temporary basis (i.e. working capital and useable reserves) which are not required in the short to medium term. This approach reduces market and credit risk for the investment portfolio and reduces borrowing costs.

10. The Council held a net borrowing position of £701m on 31 March 2024 arising from its revenue and capital income and expenditure, as shown in Table 1. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). Useable reserves and working capital are the underlying resources available for use in the short term to reduce the gross borrowing requirement.

Table 1: Balance Sheet Summary

	31/03/24 Actual £m	**31/03/25 Forecast £m**
General fund CFR	1,503	1,700
Less: Other long-term liabilities	(82)	(77)
Borrowing CFR	**1,421**	**1,623**
Less: Balance sheet resources	(720)	(693)
Net Borrowing	**701**	**930**

11. The treasury management position as at 30 September 2024 and the change over the six months is summarised in Table 2.

Table 2: Treasury Management Strategy

	31/03/24 Balance £m	Movement £m	30/09/24 Balance £m
Long-term borrowing	461	(3)	458
Short-term borrowing	246	156	402
Surrey Police	35	16	51
Total Borrowing	**742**	**169**	**911**
Money Market Funds	(41)	26	(15)
Net Borrowing	**701**	**195**	**896**

*The Council manages cash on behalf of Surrey Police and Crime Commissioner, the balance of which was £51m as at 30 September 2024. The Council accounts for this as short-term borrowing.

Borrowing Strategy

12. The Council's main objective when borrowing has been to strike a balance between securing low interest rates and achieving cost certainty over a period for which funds are required. This position provides short term savings with the flexibility to secure longer dated loans as and when the level of funds available for internal borrowing reduces, or financial forecasts indicate that external borrowing rates may increase. 10

13. The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. The Council actively manages the borrowing position, especially in time of interest rate fluctuations, to ensure we are managing risks.

14. At 30 September 2024 the Council held £911m of loans (an increase of £169m since 31 March 2024). Outstanding loans on 30 September 2024 are summarised in Table 3 below:

Table 3: Borrowing Position

	31/03/24 Balance £m	Net change £m	30/09/24 Balance £m	30/09/24 Weighted average rate %	30/09/23 Weighted average maturity (years)
Public Works Loan Board	451	(3)	448	3.65	27 years
Banks (fixed-term)	10	-	10	5.00	30 years
Local Authorities (short-term)	246	156	402	5.13	< 1 year
Surrey Police & Crime Commissioner	35	16	51	5.10	0 days
Total Borrowing	**742**	**169**	**911**		

15. CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the Council.

16. The increase in short-term borrowing of £169m is as a result of the Councils significant capital investment in line with the approved capital programme. Borrowing balances are expected to continue to increase in the second half of the year to support expected cash outflows. The Council will look to convert some of the short-term balances into longer term borrowing if interest rates reduce as forecast.

17. No new long-term borrowing was undertaken in the first half of 2024/25; internal borrowing was maximised, and short-term borrowing was utilised to manage cash flow. Monthly discussions are undertaken with Arlingclose, immediately after the Bank of England's Monetary Policy Committee meetings, to review interest rate forecasts, assess the cost of carry and review the need to undertake further borrowing in advance for future years' planned expenditure

18. After substantial rises in interest rates since 2021 many central banks have now begun to reduce rates, albeit slowly. Gilt yields were volatile over the 6-month period and have reduced slightly between April and September 2024. Much of the downward pressure from lower inflation figures was counteracted by upward pressure from positive economic data. Data from the US continues to impact global bond markets 10 including UK gilt yields.

19. The PWLB certainty rate for 10-year maturity loans was 4.80% at the beginning of the half year and 4.79% at the end. The lowest available 10-year maturity rate was 4.52% and the highest was 5.18%. Rates for 20-year maturity loans ranged from 5.01% to 5.57% during the half year, and 50-year maturity loans from 4.88% to 5.40%.

20. Whilst the cost of short-term borrowing from other local authorities spiked to around 7% in late March 2024, primarily due to high demand in Local Authority inter lending/borrowing activity during the month, as expected shorter-term rates reverted to a more normal range and were generally around 5.00% - 5.25%.

Treasury Investment Activity

21. The CIPFA Treasury Management Code defines treasury management investments as those investments which arise from the Council's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

22. The Council holds invested funds, representing income received in advance for expenditure plus balances and reserves held. During the first half of 2024/25 the Council's average daily level of investments was £67m compared to £68m for the first 6 months of 2023/24.

23. The Council can place cash on deposit on the money market through brokers, directly with counterparties, through the use of call accounts, money market funds or direct deal facilities, or with the Debt Management Office (DMO). No new fixed term deposits have been agreed during the first half of 2024/25. All investments have been made through overnight money market funds.

24. The weighted average return on all investments the council received in the quarter to 30 September 2024 is 5.14%. This compares to the average Bank of England (BoE) base rate of 5.17% for the same period.

Table 4: Investment Benchmarking BoE

	BoE base rate (average)	Weighted return on Investments
2024/25 Quarter 2	5.08%	5.10%
2024/25 Quarter 1	5.25%	5.23%
2023/24 Total	5.00%	4.99%
2022/23 Total	2.30%	1.83%

25. The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in table 5 below.

Table 5: Investment Benchmarking – Security

	Average Credit Score	Average Credit Rating	Bail-in Exposure
2024/25 Quarter 2	4.87	A+	100%

10

26. Both the CIPFA Code and the government's Investment Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money, in line with these codes of practice, is to strike and appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. In furtherance of these objectives, the Council's strategy of maximising internal borrowing has reduced the cash available for investment and reduced the scope of creating longer-term investment deposits.

Non-Treasury Investments

27. The definition of investments in the Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) or for commercial purposes (made primarily for financial return).

28. The Council holds the following non-treasury investments:
    - £98m of directly owned investment property
    - £234m of loans to Halsey Garton Property Ltd
    - £7m of loans to Halsey Garton Residential Ltd
    - £27m of equity investments in Halsey Garton Property Ltd
    - £4m of equity investments in Halsey Garton Residential Ltd
    - £2m of loans to other subsidiaries

29. It is projected that these non-treasury investments will generate £6.5m net investment income for the Council in 2024/25 after taking into account direct costs, notional interest and Minimum Revenue Provision (MRP).

Treasury Performance

30. The Council measures the financial performance of its treasury management activities in terms of its impact on the revenue budget. Table 6 outlines the forecast for the interest payable and interest receivable budget for the full year of 2024/25.

Table 6: Revenue implications of treasury management activity

	Budget £m	**Full Year Forecast £m**	**Variance £m**
Interest Payable	29.7	29.7	-
Interest Receivable	(2.5)	(3.0)	(0.5)

10

31. The Council are currently forecasting a balanced position in relation to interest payable. There is a forecast over recovery on interest receivable due to continued high interest rates.

Treasury Advisors

32. The Council's current contract for treasury advisory services is with Arlingclose and runs for a four-year period which commenced on 1st January 2022. Arlingclose provide the Council with specific advice on investments, debt and capital finance matters.

Compliance Advisors

33. All treasury management activities undertaken during the first half of 2024/25 comply fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy. Compliance with specific investment limits, the authorised borrowing limit and operational boundary for external debt, is demonstrated in tables 7 and 8 below.

Table 7: Debt Limits

	01/04/24 to 30/09/23 Maximum £m	**30/09/24 Actual £m**	**2024/25 Operational Boundary £m**	**2024/25 Authorised Limit £m**	**Complied?**
Total debt Less: Other long-term liabilities			1,277 (77)	1,492 (77)	
Underlying Borrowing	**911**	**911**	**1,200**	**1,415**	✓

34. Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not considered a

compliance failure. Total debt did not exceed the operational boundary in any period during the first half of 2024/25.

Table 8: Investment Limits

	01/04/24 – 30/09/24 Maximum £m	30/09/24 Actual £m	2024/25 Limit £m	Complied?
UK Central Government	-	-	Unlimited	✓
Money Market Funds	152	15	Unlimited	✓
Any group of pooled funds under the same management	-	-	25	✓
Any group of organisations under the same ownership	-	-	20	✓
Any single organisation, except the UK Central Government	-	-	20	✓
Unsecured Investments with Building Societies	-	-	10	✓

10

Treasury Management Indicators

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

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

Table 9: Maturity Structure Borrowing

	30/09/24 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	49%	60%	0%	✓
12 months and within 24 months	0%	50%	0%	✓
24 months and within 5 years	0%	50%	0%	✓
5 years and within 10 years	3%	75%	0%	✓
10 years and above	48%	100%	25%	✓

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

38. Long-term Treasury Management Investments: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury management investments are:

Table 10: Long-term Treasury Management Investments

	2024/25 £m	2025/26 £m	2026/27 £m	No fixed date £m
Limit on principal invested beyond year end	40	20	10	40
Actual principal invested beyond year end	-	-	-	-
Complied?	✓	✓	✓	✓

39. Long-term investments with no fixed maturity date include strategic pooled funds, real estate investment trusts and directly held equity, but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

Other Implications

Financial and value for money implications

10

40. The direct financial implications of this report are highlighted in table 6 and form part of the monthly budget monitoring report to Cabinet.

Equalities and Diversity Implications

41. There are no direct implications of this report.

Risk Management Implications

42. The noteworthy risks posed by Treasury management are outlined in the body of the report and are monitored through the Council's compliance with the approved Prudential and Treasury Management Indicators.

43. The Council engages regularly with its treasury advisors to assess the risk environment and actively manage our portfolio of borrowing, including the balance of short and long term debt. In addition, the Council holds an interest rate risk reserve to protect again unanticipated fluctuations in interest rates.

Legal Implications – Monitoring Officer:

44. The Accounts and Audit Regulations 2015 place obligations on the Council to ensure that its financial management is adequate and effective and that it has a sound system of internal control which includes arrangements for management of risk.

45. In addition, the Council within its Annual Treasury Management Strategy has agreed to comply with the CIPFA Code of Practice on Treasury Management. This report sets out the work that Treasury Management is undertaking to ensure that it is meeting these requirements and adapting to changes as they arise.

46. There are no immediate legal implications arising from the report.

Next Steps

47. The Treasury Team will continue to monitor the UK and overseas economy and banking sector and will continue to update this Committee as appropriate.
48. In line with the requirements of CIPFA's Code of Practice for Treasury Management, a full-year report for 2024/25 will be bought to the Committee after financial year end.
49. Corporate Finance will prepare the annual Treasury Management Strategy for 2025/26, which will be presented to this Committee in January 2025 for approval.

Report authors: Joe Stockwell (Strategic Capital Accountant)

Contact details: joseph.stockwell@surreycc.gov.uk

Sources/background papers:

- Capital, Investment and Treasury Management Strategy 2024/25
- CIPFA Code of Practice for Treasury Management (2021 Edition)
- CIPFA Prudential Code for Capital Finance in Local Authorities (2021 Edition)

Annexes/Appendices:

Annex 1 - Arlingclose commentary on the External Context for Treasury Management activity
Annex 2 - Arlingclose and Market Projection

10

This page is intentionally left blank