HARLOW COUNCIL
TREASURY MANAGEMENT STRATEGY
MID-YEAR REVIEW 2024/25

Introduction

In December 2017, the Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Authority to approve, as a minimum, treasury management semi-annual and annual outturn reports.

The Authority's treasury management strategy for 2024/25 was approved at a meeting on 22nd February 2024. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Authority's treasury management strategy.

External Context

Economic background: UK headline consumer price inflation remained around the Bank of England (BoE) target later in the period, falling from an annual rate of 3.2% in March to 2.0% in May and then rebounding marginally to June to 2.2% in July and August, as was expected, due to base effects from energy prices. Core and services price inflation remained higher at 3.6% and 5.6% respectively in August.

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

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

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

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

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

Arlingclose, the authority'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.

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

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

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

Over the period, the 10-year UK benchmark gilt yield started at 3.94% and ended at 4.00% but hit a high of 4.41% in May and a low of 3.76% in mid-September.

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

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

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

Moody's also placed National Bank of Canada on Rating Watch for a possible upgrade, revising the outlook on Standard Chartered to Positive, the outlook to Negative on Toronto Dominion Bank, and downgrading the rating on Close Brothers to A1 from Aa3.

S&P upgraded the rating on National Bank of Canada to A+ from A, and together with Fitch, the two rating agencies assigned Lancashire County Council with a rating of AA- and A+ respectively.

Credit default swap prices were generally lower at the end of the period compared to the beginning for the vast majority of the names on UK and non-UK lists. Price volatility over the period was also generally more muted compared to previous periods.

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

Local Context

On 31st March 2024, the Authority had net investments of £8.2m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying resources available for investment. These factors are summarised in Table 1.

Table 1: Balance Sheet Summary

	31.3.24 Actual £m
Total CFR	371.2
External borrowing**	(270.0)
Internal borrowing	101.1
Less: Balance Sheet Resources	(109.3)

Net investments	(8.2)

* finance leases, PFI liabilities and transferred debt that form part of the Authority's total debt
** shows only loans to which the Authority is committed and excludes optional refinancing

The treasury management position at 30th September and the change over the six months is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.24 Balance £m	Movement £m	30.9.24 Balance £m
Long-term borrowing			
- PWLB	211.0	-	211.0
Short-term borrowing	59.0	16.0	75.0
Total borrowing	**270.0**	**16.0**	**286.0**
Long-term investments	4.0	-	4.0
Cash and cash equivalents	4.9	1.6	6.5
Total investments	**8.9**	**1.6**	**10.5**
Net borrowing	**261.1**	**14.4**	**275.5**

Borrowing Strategy and Activity

As outlined in the treasury strategy, the Authority's chief objective when borrowing has been to strike an appropriate risk balance between securing lower interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective. The Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. At the present time short term interest rates are higher than long term interest rates.

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 including UK gilt yields.

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%.

Whilst the cost of short-term borrowing from other local authorities spiked to around 7% in late March 2024, primarily due a dearth of LA-LA 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%.

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 Authority. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield unless these loans are for refinancing purposes. The Authority has no new plans to borrow to invest primarily for financial return.

In March 2024, the Authority completed on an acquisition of a block of flats known as 'Burnt Mills'. This purchase is primarily for wider regeneration and for the council to have control of the asset within Harlow Town. This asset has been categorised as an investment asset. This acquisition has initially been funded by short-term borrowing from other Local Authorities, but this short-term borrowing will be repaid upon the receipt of long-term capital financing due to be received by the end of 2024/25.

The Authority currently holds £1.4m in commercial investments that Harlow have owned for historical reasons, these were purchased prior to the change in the CIPFA Prudential Code. Before undertaking further additional borrowing, the Council will review the options for exiting these investments. This review will include an option to sell them, although sale is not mandatory, particularly if the market conditions are not desirable.

The PWLB HRA rate which is 0.4% below the certainty rate is available up to March 2026. This discounted rate is to support local authorities borrowing for the Housing Revenue Account and for refinancing existing HRA loans, providing a window of opportunity for HRA-related borrowing and to replace the Authority's £41.767m loans relating to the HRA maturing during this time frame.

Loans Portfolio: At 30th September, the Authority held £286.837m of loans, an increase of £16m since 31st March 2024, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30th September are summarised in Table 3A below.

Table 3A: Borrowing Position

	31.3.24 Balance £m	Net Movement £m	30.9.24 Balance £m	30.9.24 Weighted Average Rate %	30.9.24 Weighted Average Maturity (years)
Public Works Loan Board	211.0	-	211.0	3.3	9.7
Local authorities (short-term)	59.0	16.0	75.0	5.1	0.45
Total borrowing	**270.0**	**16.0**	**286.0**		

The Authority's short-term borrowing cost has remained high with the currently high Base Rate and short-dated market rates. The average rate on the Authority's short-term loans at 30th September 2024 on £75m was 5.1%, this compares with 4.8% on £11m loans 12 months ago. Short-term loans are borrowed from other local authorities.

Table 3B: Long-dated Loans borrowed

	Amount £m	Rate %	Period Remaining (Years)
PWLB Maturity Loan 1	3.00	4.49	24
PWLB Maturity Loan 2	41.76	3.50	18
PWLB Maturity Loan 3	41.76	3.46	14
PWLB Maturity Loan 4	41.76	3.21	6
PWLB Maturity Loan 5	41.76	3.37	10
PWLB Maturity Loan 6	41.76	2.92	2
Total borrowing	**211.8**		

PWLB Loan 1 was borrowed in 2008, PWLB loans 2 – 6 were borrowed in March 2012 for HRA self-financing.

The Authority's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short-term and long-term borrowing was maintained.

There remains a strong argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields + 0.80%. The Authority will evaluate and pursue these lower cost solutions and opportunities with its advisor Arlingclose.

Other Debt Activity

Although not classed as borrowing, the Council also owned vehicles that were funded via a finance lease as at 30th September. The outstanding liability for these vehicles calculated at the most recent year end figure of 31st March 2024 was £1.1m.

Treasury Investment Activity

The CIPFA Treasury Management Code defines treasury management investments as those investments which arise from the Authority'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.

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the half year, the Authority's investment balances ranged between £8 and £25 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.24 Balance £m	Net Movement £m	30.9.24 Balance £m	30.9.24 Income Return %	30.9.24 Weighted Average Maturity days
Banks & building societies (unsecured)	0.9	(0.4)	0.5	4.45%	1
Money Market Funds	4	2	6	4.98%	1
Other Pooled Funds:					
Cash Plus Funds	2	0	2	5.70%	N/A*
Property Funds	2	0	2	5.12%	N/A*
Total investments	**8.9**	**1.6**	**10.5**		

* The Council's cash plus and property funds do not have a set period to maturity. Cash can be redeemed on request after a notice period is given. They are considered a long-term investments as there is price risk associated with needing to make a withdrawal at short notice.

Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

As demonstrated by the liability benchmark in this report, the Authority expects to be a long-term borrower and new treasury investments are therefore primarily made to manage day-to-day cash flows using short-term low risk instruments. The existing portfolio of strategic pooled funds will be maintained to diversify risk into different asset classes and boost investment income.

Bank Rate reduced from 5.25% to 5.00% in August 2024 with short term interest rates largely being around these levels. The rates on DMADF deposits ranged between 4.9% and 5.2% and money market rates between 4.9% and 5.3%.

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 – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
31.03.2024	5.09	A+	100%	1	4.4
30.09.2024	4.99	A+	100%	1	4.59
Similar LAs	4.63	A+	61%	51	5.85
All LAs	4.6	A+	62%	11	5.41

Externally Managed Pooled Funds: £4m of the Council's investments are invested in externally managed pooled funds (£2m in a 'cash plus' fund and £2m in a property fund) where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. Over the 6 months to 30/9/24, the funds generated income at 5.48% (annualised) which is used to support services in year, the unrealised capital loss over the 6 months is 0.18%.

Because the funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's medium to long-term investment objectives is regularly reviewed. Strategic fund investments (i.e. the property fund) are made for the longer term and in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three to five-year period total returns will exceed cash interest rates.

The first six months of 2024/25 were marked by ongoing market volatility, with global bond yields remaining elevated, although trending downward as policymakers kept rates at a restrictive level in light of persistent core inflation until nearly the end of the period, when the MPC, Federal Reserve, and ECB began to deliver rate cuts and signal a shift towards loosening monetary policy.

After a sustained period of high interest rates, central banks began to reverse course towards the second half of the year. The European Central Bank began to cut rates in June, the Bank of England delivered its first rate cut in August, and the Federal Reserve surprised markets with an outsized rate cut of 50bps in September. The stabilisation in interest rates and well telegraphed move towards rate cuts, albeit at a much more conservative pace than previously expected, has allowed fund managers to position for a falling rate environment.

UK commercial property values started to stabilise, then improve slightly towards the end of the period, with interest rates being cut from their peak and investor attention turning to the timing of further interest rate cuts. Transaction activity remains somewhat subdued but signs of recovery in the occupier and rental markets as well as moderate economic growth and further falling interest rates are hoped to be favourable for an improving property sector outlook over the medium term. Capital growth is expected to be gradual while income levels remain strong for many sub-sectors.

The combination of the above had a marginal effect on the combined value of the Authority's strategic funds since March 2024. Income from the Authority's cash plus fund has stayed broadly stable.

The Authority's funds' capital values and income return are shown in Table 4.

Income returns remained broadly consistent at 5.48%. Income for the 6 months up to 30th September was £103,400, of which £22,500 declared on 30th September is due to be paid by 31st October.

Statutory override: In April 2023 the Ministry for Housing, Communities and Local Government published the full outcome of the consultation on the extension of the statutory override on accounting for gains and losses on pooled investment funds. The override has been extended for 2 years until 31st March 2025, but no other changes have been made; whether the override will be extended beyond the new date is unknown but commentary to the consultation outcome suggests not.

Non-Treasury Investments

The definition of investments in the Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority 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) and or for commercial purposes (made primarily for financial return).

Investment Guidance issued by the Ministry of Housing, Communities and Local Government (MHCLG) and Welsh Government also includes within the definition of investments all such assets held partially or wholly for financial return.

The Authority held £25m of investments made for services purposes. This included the newly acquired Harvey Centre at £22.4m which was purchased to assist with the wider regeneration plans for Harlow Town Centre, a £0.9m property loan to wholly owned subsidiary HTS (Housing and Property) Ltd, and two vehicle loans totaling £1.7m made to wholly owned subsidiaries HTS (Property and Environment) Ltd as at 31st March 2024.

The Authority also has an equity investment of £0.45m as at 31st March 2024 in HTS (Housing & Property) Ltd.

The Authority held £1.1m of investments made for commercial purposes as at 30th March 2024. These consisted of four historically owned properties. These generated a small income of £38k in the first half of the 2024/25 financial year.

MRP Regulations

On 10th April 2024 amended legislation and revised statutory guidance were published on Minimum Revenue Provision (MRP). The majority of the changes take effect from the 2025/26 financial year, although there is a requirement that for capital loans given on or after 7th May 2024 sufficient MRP must be charged so that the outstanding CFR in respect of the loan is no higher than the principal outstanding less the Expected Credit Loss (ECL) charge for that loan.

The regulations also require that local authorities cannot exclude any amount of their CFR from their MRP calculation unless by an exception set out in law. Capital receipts cannot be used to directly replace, in whole or part, the prudent charge to revenue for MRP (there are specific exceptions for capital loans and leased assets).

Compliance

The Chief Finance Officer reports that all treasury management activities undertaken during the half year complied fully with the principles in the Treasury Management Code and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 7 below.

Table 7: Investment Limits

	2024/25 Maximum	30.9.24 Actual	2024/25 Sector Limit	Complied? Yes/No
The UK Government	6.5	-	Unlimited	Yes
Local authorities & other government	-	-	Unlimited	Yes

entities				
Secured investments	-	-	Unlimited	Yes
Banks (unsecured)*	4.0	0.5	Unlimited	Yes
Building Societies (unsecured)	-	-	£2m	Yes
Registered providers (unsecured)	-	-	£5m	Yes
Money Market Funds	10.0	6.0	Unlimited	Yes
Strategic pooled funds	4.0	4.0	£10m	Yes
Real Estate Investment Trusts	-	-	£5m	Yes
Other investments	-	-	£2m	Yes

Compliance with the Authorised Limit and Operational Boundary for external debt is demonstrated in table 8 below.

Table 8: Debt and the Authorised Limit and Operational Boundary

	H1 2024/25 Maximum	30.9.24 Actual	2024/25 Operational Boundary	2024/25 Authorised Limit	Complied? Yes/No
Borrowing	291.8	286.8	400.00	410.0	Yes
PFI and Finance Leases	1.1	1.1	61.8	62.0	Yes
Total debt	292.9	287.9	461.8	472.0	Yes

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 counted as a compliance failure.

Treasury Management Prudential Indicators

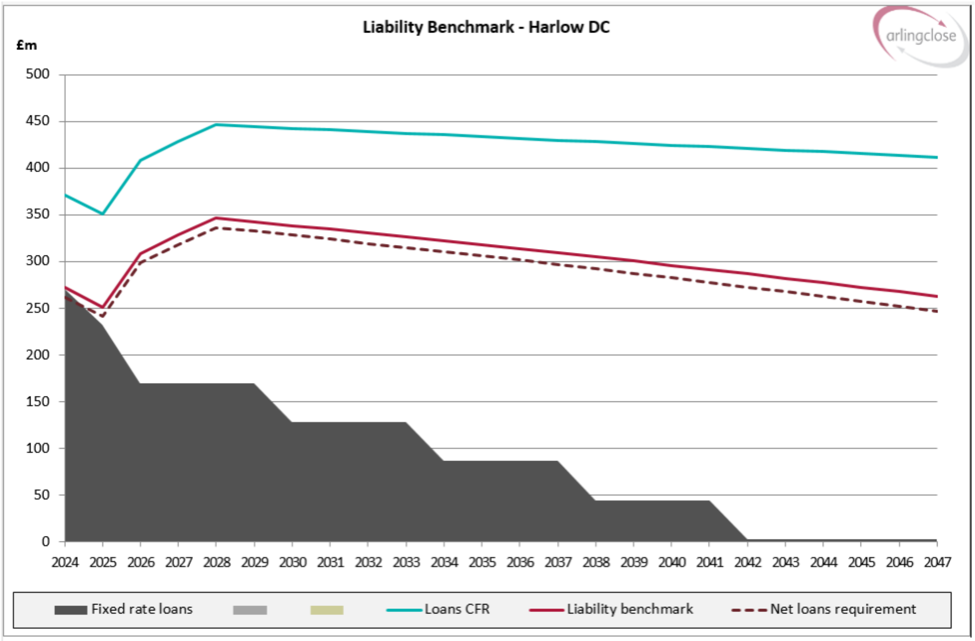
As required by the 2021 CIPFA Treasury Management Code, the Authority monitors and measures the following treasury management prudential indicators.

1. Liability Benchmark**:**

This indicator compares the Authority's actual existing borrowing against a liability benchmark that has been calculated to show the lowest risk level of borrowing. The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. It represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level of £10m required to manage day-to-day cash flow.

	31.3.24 Actual	31.3.25 Forecast	31.3.26 Forecast	31.3.27 Forecast
Loans CFR	371.2	351.3	408.4	428.3
Less: Balance sheet resources	(109.3)	(109.9)	(109.9)	(109.9)
Net loans requirement	261.9	241.4	298.5	318.4
Plus: Liquidity allowance	10.0	10.0	10.0	10.0
Liability benchmark	**271.9**	**251.4**	**308.5**	**328.4**
Existing borrowing	**270.8**	**293.8**	**293.8**	**293.8**

Following on from the medium-term forecasts above, the long-term liability benchmark assumes no capital expenditure funded by borrowing after the 2027/28 financial year. Over the long-term, reserves are assumed to increase by inflation of 2.5%. This is shown in the chart below together with the maturity profile of the Council's existing borrowing:



Whilst borrowing may be above the liability benchmark, strategies involving borrowing which is significantly above the liability benchmark carry higher risk.

2. <u>Maturity Structure of Borrowing</u>**:** This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	Upper Limit	Lower Limit	30.9.24 Actual	Complied?
Under 12 months	25%	0%	22%	Yes
12 months and within 24 months	50%	0%	15%	Yes
24 months and within 5 years	100%	0%	0%	Yes
5 years and within 10 years	100%	0%	31%	Yes
10 years and above	100%	0%	32%	Yes

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.

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

	2024/25	2025/26	2026/27	No fixed date
Limit on principal invested beyond year end	£5m	£5m	£5m	£5m
Actual principal invested beyond year end	£4m	£4m	£4m	£4m
Complied?	Yes	Yes	Yes	Yes

The £4m consists of the Authority's investment in a cash plus fund and a property fund. Although the funds can be accessed within a year, volatility means that they should be considered as a long-term investment. £4m is the actual amount invested at 30th September 2024, it is assumed that this will not change for the sake of the indicator above.

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk.

Interest rate risk indicator	2024/25 Target	30.9.24 Actual	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	£400,000	£107,558	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	-£500,000	-£107,558	Yes

For context, the changes in interest rates during the half year were:

	31/3/24	30/9/24
Bank Rate	5.25%	5.00%
1-year PWLB certainty rate, maturity loans	5.36%	4.95%
5-year PWLB certainty rate, maturity loans	4.68%	4.55%
10-year PWLB certainty rate, maturity loans	4.74%	4.79%
20-year PWLB certainty rate, maturity loans	5.18%	5.27%
50-year PWLB certainty rate, maturity loans	5.01%	5.13%

The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at new market rates.