Midlothian Council
Tuesday 17 December 2024
Item No 8.3

Treasury Management Mid-Year Review Report 2024/25

Report by David Gladwin, Chief Financial Officer & Section 95 Officer

Report for Consideration

1 Recommendations

Council is recommended to:-

a) Note the report and the treasury activity undertaken in the period to 30 September 2024, as outlined in Section 5;
b) Note the current economic position and forecast for interest rates, and the actual and forecast Treasury Management activity during the second-half of the year, as outlined in Section 6; and in particular, given the clear differential that now exists between borrowing rates and fixed term deposit rates, the adoption of a strategy towards running down cash (fixed term deposit) balances to allow the Council to continue to defer costs associated with locking into longer-term borrowing at rates that are currently higher than normal, noting that this is similar to the majority of other Scottish Councils;
c) Note the technical revisions to the Prudential Indicators in Section 7 of this report;
d) Note the loans fund rate performance relative to other Scottish Local authorities, as outlined in Section 8, and the cash saving (compared to the Scottish Average) that the Treasury Management function brings to support the Council's in-year revenue budget.

2 Purpose of Report/Executive Summary

The purpose of this report is to inform Council of the Treasury Management activity undertaken during the first half of 2024/25 and the forecast activity for the second half of 2024/25 in accordance with the Treasury Management and Annual Investment Strategy approved in February 2024. It also provides an update to the Treasury and Prudential Indicators for 2024/25.

Council should note that in accordance with the Prudential Code, a draft of the report was considered by Audit Committee on 25 November 2024, with the report approved by Audit Committee as presented.

Date: 25 November 2024
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3 Background

Audit Committee Role

The Prudential Code recommends that the main Treasury Management reports are presented for scrutiny by Audit Committee in advance of consideration by Council. This report is being presented to Audit Committee on 25 November 2024 for consideration prior to being presented to Council on 17 December 2024. Any revisions arising from Audit Committee consideration of the report on 25 November 2024 will be incorporated into the final version of the report to Council on 17 December 2024.

Treasury management

Treasury management is defined in the Prudential Code 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."*

The main function of the treasury management service is the funding of the Council's capital investment plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending operations. The management of this long-term borrowing requirement involves arranging long or short-term loans or using cash balances; and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

As the Council operates a balanced budget, this broadly means cash raised during the year will meet its cash expenditure. As part of the treasury management operations, officers ensure this cash flow is adequately planned, with available cash balances being deposited in low-risk counterparties, providing adequate liquidity initially before considering optimising return on deposits.

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first half of the 2024/25 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy 2024/25 (TM&AIS 2024/25) approved by Council on 27 February 2024;
- The Council's capital expenditure, as set out in the General Services and HRA Capital Plan reports, and prudential indicators;
- A review of the Council's borrowing strategy for 2024/25;
- A review of the Council's deposit portfolio for 2024/25;
- A review of any debt rescheduling undertaken during 2024/25;
- A review of compliance with Treasury and Prudential Limits for 2024/25.

4 Economic update for first half of 2024/25

An economic update for the first part of the 2024/25 financial year is included as Appendix 1. PWLB borrowing rates for the first half of the year are outlined in Appendix 2, and Bank Rate / SONIA rates for the first half of the year are outlined in Appendix 3.

5 Treasury Activity during first half of 2024/25

The main points arising from treasury activity in the 6 months to 30 September 2024 were:-

- Long term borrowing of £20.000 million was secured on 13 August 2024, this being two £10 million PWLB Maturity loans with tenors of 4 and 5 years respectively and at interest rates of 4.15% and 4.13% respectively.

- Long term borrowing of £1.060 million matured, this being £0.626m of PWLB Maturities, £0.336 million of Market Loans, £0.070 million of Salix loans and £0.028 million PWLB Annuities;

- Funds on fixed term deposit of £10.000 million matured in September 2024;

- The average interest rate earned on external funds on deposit in the first half of the year was 5.12%.

<u>Loan Portfolio</u>

The Council's loan portfolio as at 30 September 2024 is shown in table 1 below (position at 31 March 2024 also shown for comparison):-

Table 1: Council's Loan Portfolio at 31 March 2024 and 30 September 2024.

Loan Type	**31 March 2024**		**30 September 2024**	
	Principal Outstanding £000's	**Weighted Average Rate**	**Principal Outstanding £000's**	**Weighted Average Rate %**
PWLB Annuity	452	8.91%	424	8.91%
PWLB Maturity	304,128	3.01%	323,502	3.07%
LOBO	20,000	4.51%	20,000	4.51%
Market Loans	16,221	2.68%	15,886	2.68%
Other Loans	70	0.00%	0	n/a
Total Loans	**340,871**	**3.09%**	**359,812**	**3.14%**
Underlying Borrowing Requirement*	**401,845**		**427,696**	
Over/(Under) Borrowing	**-60,974**		**-67,884**	

* *The Underlying Borrowing Requirement is the Capital Financing Requirement excluding the "Public Private Finance" (PPP) Contract Liabilities*

The balance of external and internal borrowing is generally driven by market conditions.

At 30 September 2024 the Council was under borrowed by £67.884 million – this is the extent to which the Council has yet to finance its current borrowing requirement from long term loans. This position reflects the Council's use of working capital and balance sheet useable reserves to fund part of the prior year and current in-year borrowing requirement.

This strategy of using internal borrowing (working capital) to fund the in-year CFR is prudent given the current plateau in medium to longer-term PWLB borrowing rates of c. 5.00%+, and the expected gradual drop in these medium to longer-term PWLB borrowing rates over the remainder of the current and forthcoming financial years as outlined in Appendix 4.

Debt Rescheduling

No Debt Rescheduling has taken place to date in the financial year.

However, debt repayment and rescheduling opportunities have increased in the past 6 months given that the whole of the yield curve has shifted and remains higher; and there may be opportunities for debt rescheduling in the future. See Section 6 below for more detail.

Funds on Deposit

The Council's funds on deposit portfolio as at 30 September 2024 is shown in table 2 below (position at 31 March 2024 also shown for comparison):-

Table 2: Council's Funds on Deposit Portfolio at 31 March 2024 and 30 September 2024

Type	31 March 2024		30 September 2024	
	Principal Outstanding £000's	**Weighted Average Rate**	**Principal Outstanding £000's**	**Weighted Average Rate %**
Money Market Funds	25,100	5.29%	27,042	5.01%
Bank Call Accounts	1,519	5.14%	2,508	4.88%
Bank Fixed Term Deposits	30,000	5.12%	20,000	5.06%
Total Deposits	**56,619**	**5.20%**	**49,550**	**5.02%**

The Chief Financial Officer & Section 95 Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first 6 months of 2024/25.

6 Actual/Expected Treasury Activity during second half of 2024/25

6.1 Economic Update

The Council has appointed Link Treasury Solutions Limited as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates.

Following the 30 October UK Government 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, Link, on 11 November 2024, have significantly revised their central forecasts for the Bank of England Base Rate, 3-12 month deposit rate earnings, and PWLB certainty rates. These are outlined in Table 3 below.

<u>Table 3: Link Treasury Solutions Limited Central Forecast for Interest Rates</u>

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

In summary, Bank Rate is now forecast to be 50bps – 75bps higher than was previously the case, whilst PWLB forecasts have been materially lifted to not only reflect increased concerns around the future path of inflation, but also the increased level of government borrowing over the term of the current Parliament.

Reflecting on the 30 October UK Government Budget, Link's central case is that those policy announcements will be inflationary, at least in the near-term. The Office for Budgetary Responsibility and the Bank of England concur with that view.

Link 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.

Link forecast that the short to medium part of the PWLB 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.

6.2 Expected Treasury Activity in Second Half of 2024/25

The expected activity in the second half of 2024/25, as outlined below, updates the treasury management position in light of the updated economic position as outlined in Section 6.1 above, and the General Services and HRA Capital Plans as presented to Councils at Quarter 1 Monitoring (27 August 2024) and Quarter 2 Monitoring (12 November 2024).

Borrowing

Long term borrowing of £0.367 million will mature in the second half of 2024/25, this being £0.338 million of Market Loans and £0.029 million PWLB Annuities.

Proactive Treasury Management by the Council in the last decade has placed the Council in a strong refinancing position for its existing external debt portfolio, with just 12.22% (£43.953m) of the Council's total Loan Portfolio of £359.812 million requiring refinancing over the remainder of the current, and forthcoming four, financial years, as shown in Table 4 below.

Table 4: Maturity Profile of Existing External Loan Portfolio

Financial Year	2024/25 Remaining £000's	2025/26 £000's	2026/27-2029/30 £000's	2030/31-2034/35 £000's	2035/36-2044/45 £000's	2045/46+ £000's
Debt Maturing	367	1,263	42,323	45,106	32,365	238,388
% of total portfolio	0.10%	0.35%	11.76%	12.54%	9.00%	66.25%

The majority of this (£40m) matures in the latter half of this decade (March 2027+) where borrowing in the last 12 months to fund the Council's in-year Capital Financing Requirements has been sourced in line with the approved TMIS – specifically, to borrow from PWLB for a relatively shorter term (3-5 years), to navigate past the current interest rate hump, with gilt yields expected to ease throughout the course of the next 12-36 months.

This relatively low short-term exposure to refinancing risk puts the Council in a strong position to plan its borrowings in advance, take advantage of any dips in longer-term borrowing rates from PWLB and other sources, and maintain a low weighted average coupon rate on external debt.

As noted in Section 6.1, the current PWLB yield curve remains fully above 5.00% (certainty rate) and is bell shaped with a peak in rates around the 20-30 year tenor (5.50%), with 5-10 year rates at c. 5.00-5.30% and 50 year rates are c. 5.30%.

The yield curve is expected to remain bell shaped over the short-medium term, with:-

- a gradual shift downwards of the entire curve by c. 40-50bps over the next 12 months and
- a further 30-40bps drop over the subsequent 12 months.

As noted in Table 3 in Section 6.1, this is forecast to bring longer-term borrowing rates down to between 4.50%-5.00% by December 2025, and between 4.20%-4.60% by December 2026. This is a shallower drop than previously expected, meaning long-term borrowing rates remain higher and stickier for longer.

The funding of the Council's in-year and forward CFR is typically for infrastructure with long asset lives (50-60 years), and the tenor of PWLB and market loans are typically drawn with this in mind.

Consideration for any new borrowing in the remainder of the 2024/25 financial year, to fund the Council's in-year CFR, will seek to balance:-

a) the security/certainty of current relatively high longer-term borrowing rates of upwards of 5.40%% in the 30-50 year duration (which are forecast to drop by 40bps within one year and 80bps within 24 months) and the potential additional budgetary pressure that this brings in both the short/medium and longer term; with
b) the option to borrow initially for a shorter-term duration from PWLB or other markets, for 2 to 5 years (at say c. 4.90%), to allow the Council to fund the immediate in-year borrowing requirement. Based on current interest rate forecasts (see Appendix 4), this would then allow the Council the option to refinance this borrowing at initial maturity with less expensive, longer term borrowing, e.g. a 45 to 48 year tenor in, say, 36 months at a forecast rate of c. 4.30%.

As noted above, the Council's proactive Treasury Management over the last decade has put the Council in a strong refinancing position for its external debt portfolio which allows the Council to slot in shorter dated external borrowing into the current debt maturity profile to fund the in-year borrowing required, in order to navigate past the current expected hump in longer-term borrowing rates.

It is expected that any further long-term borrowing that is undertaken in 2024/25 to finance the current & future year capital plans will be sourced by drawing new PWLB loans at the Certainty Rate (which has been available to the Council since 2012 and is priced at Gilts+80bps), and/or the HRA rate. The HRA rate is available to all Councils (the availability of which was extended out in the UK Government Budget to the 31 March 2026) to fund HRA capital expenditure, at a rate that is 40bps lower than the current certainty rate available from the PWLB (so priced at Gilts + 40bps).

Both the General Services and HRA capital programmes are being kept under regular review due to the effects of inflationary pressures, shortages of materials and labour, and the ratios of financing costs to the net revenue streams and impact on the Council's Medium Term Financial Strategy. The Council's borrowing strategy will, therefore, also be regularly reviewed and then revised, if necessary, to achieve optimum value and risk exposure in the long-term. The impact particularly of the finalisation of the General Services Capital Plan Prioritisation will have a significant bearing on this. Council officers, in conjunction with Link, will continue to monitor daily long-term borrowing rates in order to take advantage of any dips in the market or to de-risk any change in the medium-longer term forecast for gilt yields.

Debt Rescheduling

Now that the whole of the yield curve has shifted and remains higher there may be opportunities for debt rescheduling in the remainder of the financial year.

This would involve the Council repaying loans prematurely (both market and PWLB) whilst high discount rates on premature repayment prevail.

Any debt rescheduling will be considered when the difference between the refinancing rate and the redemption rate is most advantageous and the situation will be continually monitored in order to take advantage of any perceived anomalies in the yield curve. The reasons for any rescheduling taking place would include:

- the generation of cash savings at minimum risk;
- to reduce the average interest rate;
- to amend the maturity profile and/or the balance of volatility of the debt portfolio.

Council officers will explore debt rescheduling opportunities with Link Treasury Solutions; with only prudent and affordable debt rescheduling that considers both the short and medium-longer term impact being considered.

<u>Funds on Deposit</u>

In accordance with the Prudential and Treasury Management Codes, it is the Council's priority for funds on deposit to ensure:-

- security of capital first
- liquidity, and
- finally to obtain an appropriate level of return which is consistent with the Council's risk appetite.

In the current economic climate, it is considered appropriate to keep any deposits short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit quality financial institutions, using the Link suggested creditworthiness approach, which includes a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

Based on the interest rate forecasts as outlined in Section 6.1 above, there is now a clear differential between any borrowing costs taken for new PWLB loans (whether 5 year, 25 year or 50 year), and interest earned on Fixed Term Deposits (FTD's) of up to 12 months.

Specifically, the cost of borrowing is now currently 5.00%-5.60% (PWLB certainty rates); whereas maximum interest earnable on FTD's is 4.70% (so a differential of 0.30% to 0.90%).

The forecast position in 12 months is similar – borrowing rates of 4.50%-5.20% (certainty rates) compared to interest earnable on FTD's of max 4.00% (so a differential of 0.50%-1.20%)

In 24 months, borrowing rates of 4.20%-4.80% (certainty rates) compared to interest earnable on FTD's of 3.80% (so a differential of 0.40%-1.00%)

This would suggest that the optimum Treasury strategy would be to run down cash balances to allow borrowing to (continue to) be deferred for as long as possible i.e. no cash backing of reserves.

£20.000 million of fixed term deposits held at 30 September 2024 mature in the latter half of the 2024/25 financial year. Based on the above, this £20.000 million deposit would mature in March 2025 and the funds would not be refinanced (i.e. not be placed back out on Fixed Term Deposit) and instead be used to allow the Council to continue to defer borrowing at the current plateaued PWLB borrowing yield curve.

Clearly this position results in an increase in refinancing risk as the internal-borrowing / under-borrowed position is higher (c. £88m) at 31/03/2025 compared to 31/03/2024 (£67m); however the flipside of this is that there is (a) an offsetting reduction in counterparty risk on deposits (no FTD's placed) – thereby replacing one additional risk with an offsetting mitigation in risk elsewhere; and (b) furthermore that all the market led and economic forecast intelligence still points to the medium term forecast of a path of long-term borrowing rates gradually easing off over the next 24-36 months.

Day to day liquidity to meet cashflow requirements is sourced from the Council's three Money Market Funds, which all operate on an instant access basis. Interest rates receivable from these are currently between 4.95%-4.97%, reflective of the current Bank of England Base Rate, and will meander towards 4.75% in the coming month. The Council would keep enough liquidity in our MMF's on a month-to-month basis to ensure we can manage our daily cashflow needs (£15m-£20m).

An updated list of Countries for Deposits as at 14 November 2024 is included as Appendix 4.

6.3 Expected Loan & Fund on Deposit Portfolio at 31 March 2025

Taking all of the above into account, the expected loan and funds on deposit portfolios at 31 March 2025 is shown in Tables 6 and 7 below:-

Table 6: Council's forecast Loan Portfolio at 31 March 2025

Loan Type	31 March 2025	
	Principal Outstanding £000's	**Weighted Average Rate**
PWLB Annuity	395	8.91%
PWLB Maturity	358,502	3.24%
LOBO	20,000	4.51%
Market Loans	15,548	2.68%
Total Loans	**394,445**	**3.28%**
Underlying Borrowing Requirement	**483,271**	
Over/(Under) Borrowing	**-88,826**	

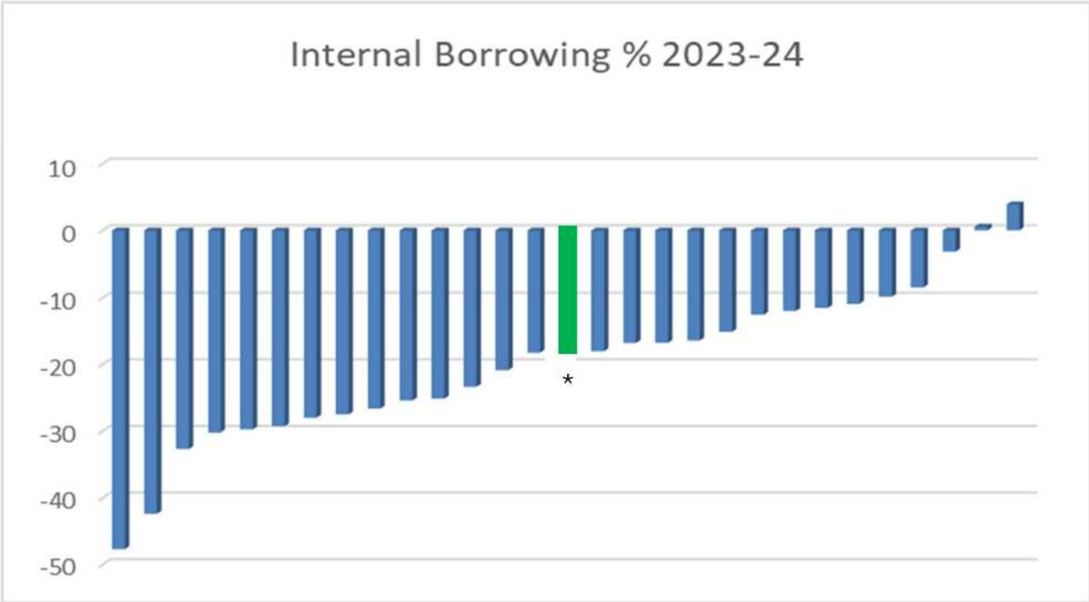
Table 7: Council's forecast Funds on Deposit Portfolio at 31 March 2025

Type	31 March 2025	
	Principal Outstanding £000's	**Weighted Average Rate**
Money Market Funds	20,000	4.50%
Total Deposits	**20,000**	**4.50%**

The forecast Under-Borrowed position of £88.826m at 31/03/2025 as outlined in Table 5 above equates to 23% of the Council's Total External Debt of £394.445m. The equivalent position at 31/03/2024 was 18% (£60.974m under-borrowed of a £340.871m Total External Debt Portfolio).

Graph 1 below outlines the Under-Borrowed position of Scottish Councils as at the most recent balance sheet date (31/03/2024). A negative borrowing % indicates that the Council is Internally Borrowed, with this ratio calculated as the % of Under-Borrowing against the Council's total External Debt Portfolio.

Graph 1: Under-borrowed (Internal Borrowing) % of Scottish Councils at 31/03/2024



* Midlothian

As can be noted, the majority of Scottish Councils are under-borrowed, with a median around the 20% mark. The proposed approach outlined above keeps the Council well within this Scotland-wide position.

7 Prudential & Treasury Management Indicators 2024/25

It is a statutory duty for the Council to determine and keep under review the affordable capital expenditure and borrowing limits as outlined in the prudential and treasury management indicators reported as part of the Council's suite of treasury management reports.

The following prudential indicators have therefore been refreshed from those reported to Council on 27 February 2024 in the original Treasury Management and Annual Investment Strategy Statement 2024/25.

These are technical revisions to the Prudential Indicators as a consequence of the revisions to the Council's General Services and HRA Capital Plans and are based on the actual capital plan outturns for 2023/24, and revisions to the capital expenditure and income budgets for 2024/25. The Authorised Limit has been retained at the value set in the Treasury Management & Investment Strategy for 2024/25 as approved by Audit Committee and Council in February 2024.

Table 8: Prudential Indicators 2024/25 – Mid Year Update

Indicator	**2024/25 Original Estimate £000's**	**2024/25 Current Position £000's**	**2024/25 Revised Estimate £000's**
2024/25 Capital Expenditure	181,578	41,764	124,138
2024/25 Required Borrowing	126,188	25,851	91,820
2024/25 Underlying Borrowing Requirement*	534,105	427,696	483,271
2024/25 Gross External Borrowing	509,105	359,811	394,445
2024/25 Over/(Under) Borrowing	-25,000	-67,885	-88,825
Operational Boundary – Borrowing	534,105	483,271	483,271
2024/25 Capital Financing Requirement**	618,920	514,624	568,086
2024/25 Authorised Limit***	534,105	534,105	534,105
Net Income from Service Investments as % of Net Revenue Stream	0.01%		0.01%
Ratio of Financing Costs to Net Revenue Stream – General Services	2.40%		1.27%
Ratio of Financing Costs to Net Revenue Stream – HRA	48.13%		43.24%
Ratio of HRA Debt to Net Revenue Stream	920%		809%
Ratio of HRA Debt per Dwelling	41		38

* *Excludes "On balance sheet" PPP schemes.*
** *Includes "On balance sheet" PPP schemes.*
*** *Equates to the original estimate of the 2024/25 Underlying Borrowing Requirement*

The **Capital Financing Requirement (CFR)** denotes the Council's underlying need to borrow for capital purposes. The CFR includes borrowing arising as a result of the Council's Capital Plans, plus the long-term liability arising from the Council’s PPP and DBFM contracts. The Underlying Borrowing Requirement strips out the latter of these (long-term liability arising from the two PPP contracts) from the CFR.

The **Authorised Limit** represents the statutory limit determined under section 3 (1) of the Local Government Act 2003, and is the limit beyond which borrowing is prohibited. This limit needs to be set and revised by Members. For 2024/25 this was calculated to equate to the forecast value of the 2024/25 Underlying Borrowing Requirement.

During the half year ended 30th September 2024, the Council has operated within the treasury and prudential indicators set out in the Council’s Treasury Management Strategy Statement for 2024/25.

All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

8 Performance Indicators 2023/24 – Comparison with Other Scottish Local Authorities

The Treasury Management Forum collates performance indicators for all Scottish Local Authorities. The indicators relating to financial year 2023/24 have been published and once again demonstrate the continuing effectiveness of the Council's Treasury function in maximising efficiency in Treasury Management activity, with the Council having the 2nd lowest weighted average borrowing & investment (loans fund) rate across all Scottish mainland authorities in 2023/24 (2.08%).

The Council has consistently maintained the loans fund rate as one of the lowest across all Scottish mainland authorities for the last decade and more. Appendix 5 outlines the loans fund rate for each Scottish Local Authority in 2023/24.

Were the internal loans fund rate for 2023/24 to have equated to the Scottish weighted average for 2023/24 of 3.66%, this would have generated loan charges for Midlothian Council in 2023/24 of £23.3m. The Council's actual 2023/24 loan charges for General Services and HRA were £17.3m, representing a cash saving (compared to the Scottish average) of £5.9m in 2023/24.

The forecast loans fund rate of 2.53% for 2024/25 is expected to once again be one of the lowest for all Scottish Local Authorities.

9 Summary

Treasury Management activity during the year to 30 September 2024 has been effective within the parameters set by the strategy for the year.

Any further long-term borrowing for the remainder of 2024/25 will be in line with the approved strategy, and reflective of the borrowing requirement arising from the General Services and HRA capital plans reported to Council on 12 November 2024.

Officers will continue to review the opportunities available to the Council for deposit of funds as governed by the approved strategy.

The Prudential and Treasury Management Indicators have been updated to reflect current capital expenditure and income projections.

10 Report Implications

10.1 Resource

Expenditure from Treasury Management activity i.e. loan charges, was reported in the quarterly financial positions to Council, with Quarter 2 monitoring reflected in the Financial Monitoring 2024/25 – General Fund Revenue report that was presented to Council on 12 November 2024.

10.2 Digital

None.

10.3 Risk

As the Council follows the requirements of the CIPFA Code of Practice for Treasury Management, and the Prudential Code, there is a reduced level of risks involved in Treasury Management activities. Those risks that do exist are further controlled through written Treasury Management Practices which define the responsibilities of all staff involved, which were reviewed and approved by Audit Committee as part of the presentation of the 2022/23 Mid-Year Review Report on 6 December 2022.

10.4 Ensuring Equalities

There are no equalities issues arising directly from this report.

10.5 Additional Report Implications

See Appendix A.

Appendix A: Report Implications

A.1 Key Priorities within the Single Midlothian Plan

Not applicable.

A.2 Key Drivers for Change

A.3 Key Delivery Streams

Themes addressed in this report:

- [ ] One Council Working with you, for you
- [x] Preventative and Sustainable
- [ ] Efficient and Modern
- [ ] Innovative and Ambitious
- [ ] None of the above

A.4 Delivering Best Value

The report does not directly impact on Delivering Best Value.

A.5 Involving Communities and Other Stakeholders

Although no external consultation has taken place, cognisance has been taken of professional advice obtained from Link Treasury Solutions Limited, the Council's appointed Treasury Consultants.

A.6 Impact on Performance and Outcome

The strategies adopted are an integral part of the corporate aim to achieve Best Value as they seek to minimise the cost of borrowing by exercising prudent debt management and investment. This in turn helps to ensure that the Council's capital expenditure is sustainable in revenue terms.

A.7 Adopting a Preventative Approach

Not applicable.

A.8 Supporting Sustainable Development

Not applicable.

Background Papers:

Appendix 1: Economic Update for first part of 2024/25 financial year
Appendix 2: PWLB Borrowing Rates 1 April 2023 to 30 September 2024
Appendix 3: Bank Rate and SONIA Rates 1 April 2023 to 30 September 2024
Appendix 4: Approved Countries for Deposits as at 25 November 2024
Appendix 5: Loans Fund Rate Comparison Scottish Local Authorities 2023/24

Appendix 1: Economic Update for first part of 2024/25 financial year

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

- GDP growth stagnating in July following downwardly revised Q2 figures (0.5% q/q)
- A further easing in wage growth as the headline 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 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% 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 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 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 at gilt movements in the first half of 2024/25, 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%.

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.

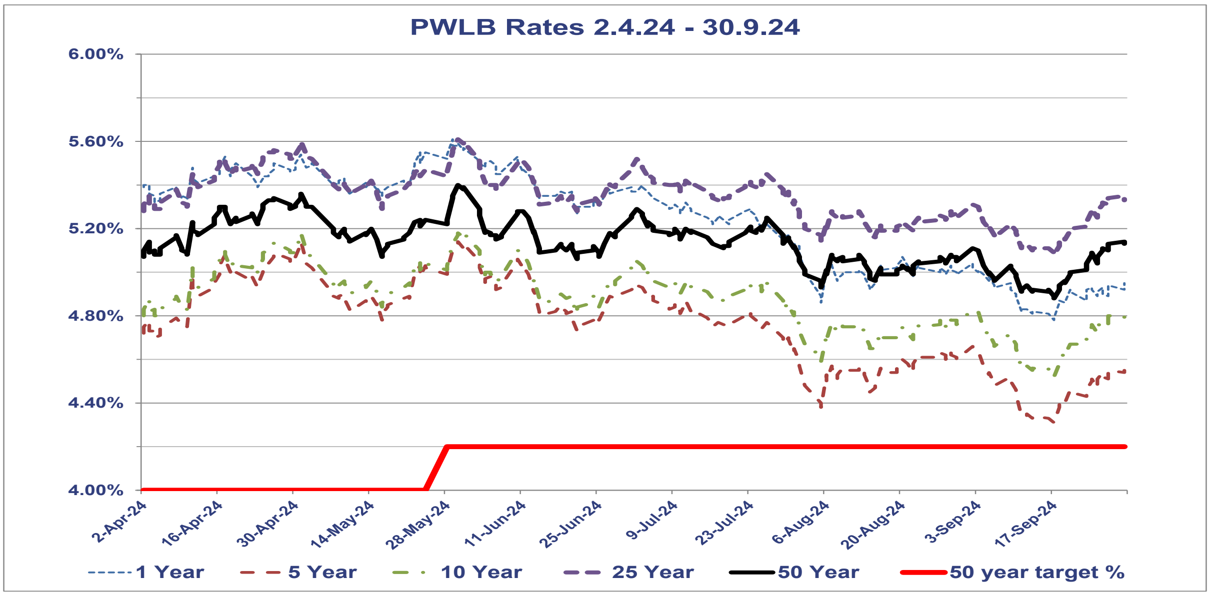
Markets thought there may be an outside chance of a further Bank Rate reduction in September, following the 50bps cut by the FOMC, but this came to nothing.

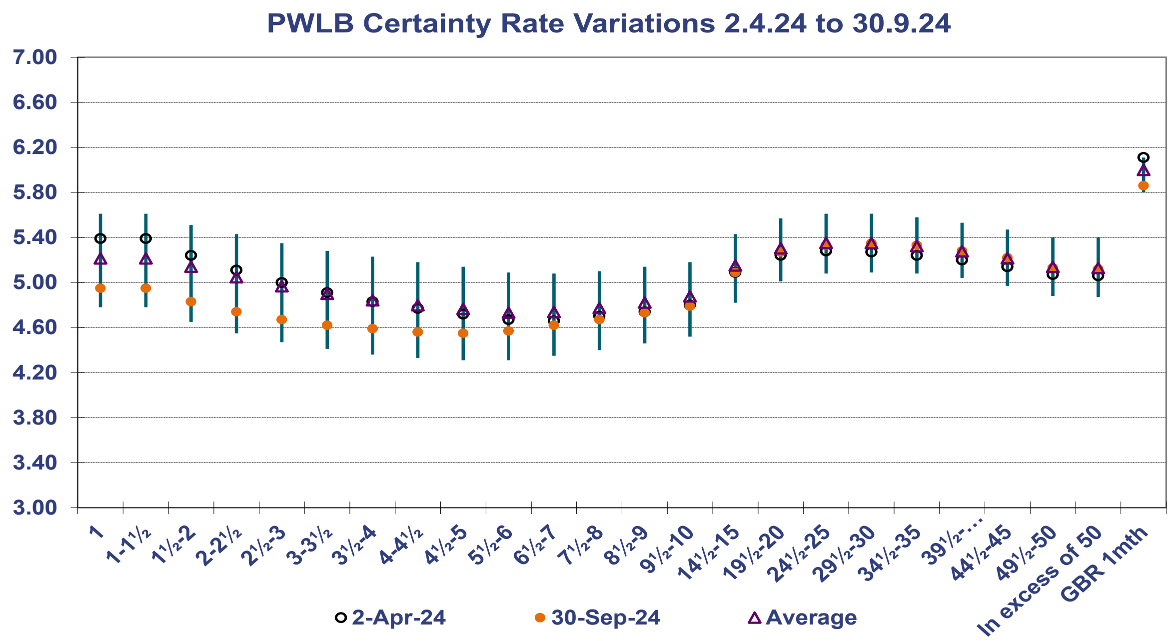
Appendix 2: PWLB Borrowing Rates 1 April 2024 to 30 September 2024

The graphs and table below show the movement in PWLB certainty rates for the first six months of the year to date:

PWLB certainty rates 1 April 2024 to 30th September 2024

	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%





The current PWLB rates are set as margins over gilt yields as follows:-

- PWLB Standard Rate is gilt plus 100 basis points (G+100bps)
- PWLB Certainty Rate (GF) is gilt plus 80 basis points (G+80bps)
- PWLB Local Infrastructure Rate is gilt plus 60 basis points (G+60bps)
- PWLB Certainty Rate (HRA) is gilt plus 40bps (G+40bps)

PWLB maturity certainty rates (gilts plus 80bps) year to date to 30 September 2024

Gilt yields and PWLB certainty rates were less volatile than at this time last year. Overall, the 10, 25 and 50-year part of the curve endured a little volatility but finished September very much as it started in April.

Where there was some movement downwards, this came in the shorter part of the curve as markets positioned themselves for Bank Rate cuts in the second half of 2024 and into 2025, although the continued stickiness of inflation and the prevailing tight labour market is a concern for those looking for more sizeable falls ahead.

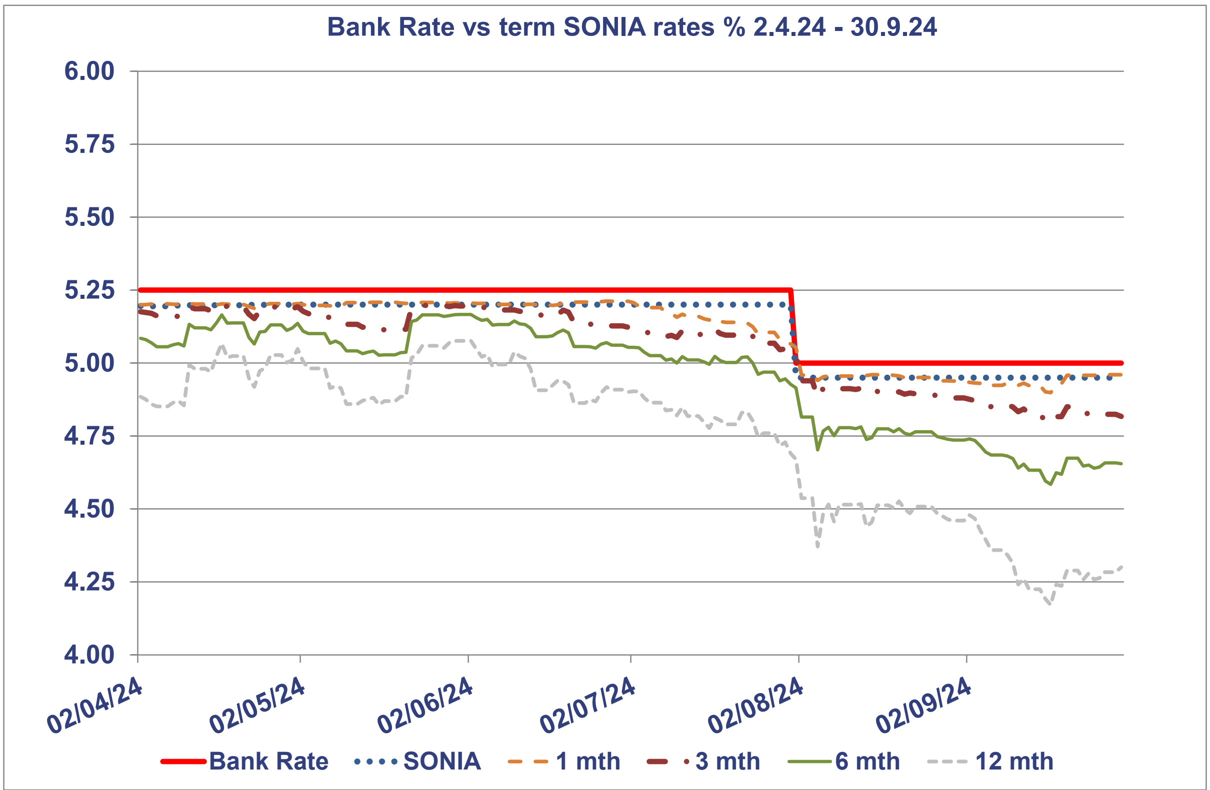
At the beginning of April, the 5-year certainty rate was the cheapest part of the curve at 4.72% whilst the 25-year rate was relatively expensive at 5.28%. May saw yields at their highest across the whole curve.

Conversely, 17 September saw the low point for the whole curve, with the 5-year certainty rate falling to 4.31% before rebounding to 4.55% by the end of the month. Similarly, the 50-year certainty rate fell to 4.88% but finished the month at 5.13%, slightly higher than at the start of April.

At this juncture, PWLB rates are still forecast to fall back over the next two to three years as inflation dampens, although there is upside risk to the Bank Rate forecast at present. The CPI measure of inflation is expected to fall below 2% in the second half of 2025, however, and we forecast 50-year rates to stand at 4.20% by the end of September 2026. The major caveats are that there is considerable gilt issuance to be digested by the market over the next couple of years, and geo-political uncertainties – which are generally negative for inflation prospects – abound in Eastern Europe and the Middle East, in particular.

Appendix 3: Bank Rate and SONIA Rates 1 April 2024 to 30 September 2024

The graphs and table below show the movement in Bank and SONIA rates for the first six months of the year to date:



	Bank Rate	SONIA	1 mth	3 mth	6 mth	12 mth
High	5.25	5.20	5.21	5.20	5.17	5.08
High Date	02/04/2024	03/05/2024	27/06/2024	17/04/2024	31/05/2024	30/05/2024
Low	5.00	4.95	4.90	4.79	4.58	4.17
Low Date	01/08/2024	01/08/2024	17/09/2024	17/09/2024	17/09/2024	17/09/2024
Average	5.17	5.12	5.11	5.06	4.96	4.75
Spread	0.25	0.25	0.31	0.41	0.58	0.91

Creditworthiness: The UK's sovereign rating has proven robust through the first half of 2024/25.

Deposit Counterparty criteria: The current deposit counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

CDS prices: It is noted that sentiment in the current economic climate can easily shift, so it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances.

Appendix 4: Approved Countries for Deposit as at 25 November 2024

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.**

Appendix 5: Loans Fund Rate Comparison Scottish Local Authorities 2023/24 & 2022/23

Authority	Loans Fund Rate	
	2022/23	2023/24
Argyll & Bute	2.52%	0.91%
Midlothian	2.41%	2.08%
East Lothian	2.66%	2.80%
Perth & Kinross	2.71%	2.80%
Aberdeenshire	2.53%	2.87%
Fife	3.54%	3.16%
East Ayrshire	3.24%	3.39%
Shetland	3.45%	3.45%
Dumfries & Galloway	3.43%	3.72%
Moray	3.54%	3.77%
South Ayrshire	3.24%	3.77%
Aberdeen City	3.51%	3.87%
East Renfrewshire	3.34%	3.89%
Glasgow City	3.68%	3.92%
North Ayrshire	3.45%	4.02%
Highland	3.49%	4.04%
West Dunbartonshire	2.47%	4.05%
West Lothian	3.65%	4.06%
East Dunbartonshire	3.63%	4.14%
Angus	4.03%	4.19%
Edinburgh City	3.96%	4.29%
North Lanarkshire	2.96%	4.45%
Inverclyde	3.85%	4.46%
Orkney	3.32%	4.48%
Falkirk	3.66%	4.56%
Stirling	4.18%	4.87%