Treasury Management

Borrowing and Investments

1. Table 1 below shows the year's opening balance of borrowing and investments, current levels, and the year-end forecast. Forecast borrowing is based on the forecast capital programme and will be subject to review during the year.

The strategy of keeping borrowing and investments below their underlying levels to reduce risk and make a net saving, has been maintained.

2. **Table 1 - Borrowing and Investments**

	31-Mar-24 Actual £M	31-Mar-24 Average %	30-Jun-24 Actual £M	30-Jun-24 Average %	31-Mar-25 Forecast £M	31-Mar-25 Forecast %
Long Term Borrowing						
Public Works Loan	288.59	3.47	288.09	3.47	446.40	2.96
LOBO Loans from Banks	4.00	4.86	4.00	4.86	4.00	4.85
	292.59	**3.58**	**292.09**	**3.58**	**450.40**	**3.00**
Short Term Borrowing						
Other Local Authorities	20.00	5.79	24.00	5.35	0.00	5.79
Total External Borrowing	**312.59**	**2.98**	**316.09**	**2.97**	**450.40**	**3.11**
Other Long Term Liabilities						
PFI Schemes	41.08	9.82	41.08	9.56	37.11	9.82
Deferred Debt Charges (HCC)	12.37	4.99	12.37	3.27	12.01	4.99
Total Gross External Debt	**366.04**	**3.97**	**369.54**	**4.08**	**499.52**	**3.97**
Investments:						
Managed In-House						
Cash (Instant access)	(7.83)	5.27	(27.21)	5.21	(20.00)	5.40
Long Term Bonds	(1.03)	5.27	(1.02)	5.27	(1.00)	5.27
Managed Externally						
Pooled Funds (CCLA) & Shares	(27.00)	4.76	(27.00)	4.76	(27.00)	3.00
Total Investments	**(35.86)**	**4.78**	**(55.23)**	**4.78**	**(48.00)**	**4.05**
Net Debt	**330.18**		**314.31**		**451.52**	

3. After taking into account maturing and new debt requirements in year and a forecast reduction in investment balances, net borrowing is expected to increase by £121.34M, to £451.52M.

This forecast remains subject to change; most notably regarding the increased use of balances, (which increase borrowing need as use of internal borrowing will reduce) and changes to the capital programme, which due to the current financial environment is subject to ongoing review against the backdrop of rising construction costs and higher interest rates which has seen the cost of borrowing increase in the last year.

4. The interest cost of financing the council's long and short term loan debt is charged to the general fund revenue account and is detailed below together with a summary of performance to date.

Borrowing

5.	As of June 2024, the forecast cost of financing the council's loan debt is £22.61M of which £5.95M relates to the HRA However this will be subject to movement as the need for further borrowing for the remainder of the year becomes more certain.
6.	As outlined in the treasury strategy, the primary objective when borrowing is to strike an appropriately balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should long-term plans change being a secondary objective. The borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.
7.	Interest rates have risen substantially since 2021 although they have largely plateaued over the last year. Over the last quarter gilt yields have risen slightly overall, having had a number of peaks and troughs. There has been downward pressure from lower inflation figures, but also upward pressure from unexpectantly positive economic data. Data from the US continues to impact global markets including UK gilt yields. The PWLB certainty rate for 10-year maturity loans was 4.80% at the beginning of the quarter and 4.96% percent at the end. The lowest available 10-year maturity rate during the quarter was 4.80% and the highest was 5.18%. Rates for 20-year maturity loans ranged from 5.24% to 5.57% during the quarter, and 50-year maturity loans from 5.06% 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 5.25% through the quarter.
8.	The PWLB HRA rate which is 0.4% below the certainty rate is available until to June 2025. The 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 £10.3M loans relating to HRA maturing during this time frame.
9.	Previously the majority of long-term borrowing has been raised from the PWLB but we will consider long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; there is no intention to do this and therefore access to PWLB loans will be retained.
10.	**Loans restructuring**: The continuing rise in gilt yields since early 2022 resulted in some loans being in or close to a discount position if repaid early. However, as the prepaid loans would need to be replaced by new loans at higher interest rates, this isn't a cost-effective option.
11.	**LOBO loans**: LOBO (Lender's Option Borrower's Option) loans are where the lender has the option to propose an increase in the interest rate at set dates, which can either be accepted or repay the loan at no additional cost. As reported previously with market interest rates having risen, the probability of LOBOs being called increased and in September 2023 one lender exercised their option. We currently have £4M remaining in LOBO loans with call dates within the next 12 months, we will continue to monitor and take appropriate action.

12.	**Short-term borrowing:** Short-term borrowing costs have remained high with the currently high Base Rate and short-dated market rates. The average rate on short-term loans at 30th June 2024 on £24M was 5.35%. Any borrowing will be done in consultation with our advisors as although short term borrowing is currently higher than 20 year maturity debt at 4.87% (5.37% less 0.40% certainty discount), long term debt is expected to fall in the medium term and the overall costs assessed.
13.	There is an increasing CFR due to the capital programme, and after future debt maturities currently has an estimated borrowing requirement of £168.37M for the year, as determined by the Liability Benchmark, which considers capital spend, maturing debt, usable reserves and working capital and is summarised in Table 2 below.

Table 2 – Estimated Borrowing Requirement

	2024/25 £M	Outturn £M	Movement £M
New Capital Expenditure	173.83	159.98	13.85
Repayment of Principle (MRP)	(15.53)	(15.53)	(0.00)
Maturing Debt	30.60	30.60	(0.00)
Movement in Resources	3.47	3.47	(0.00)
	192.37	**178.52**	**13.85**
New Borrowing Taken in Year (short term)	(24.00)	0.00	(24.00)
Cumulative Borrowing Need	**168.37**	**178.52**	**(10.15)**

	Other Debt Activity
14.	Although not classed as borrowing the Council has previously raised capital finance via Private Finance Initiative (PFI). The balance at 31 March 2024, after allowing for repayment in year of £3.29M is £41.08M.
15.	In addition, the council holds debt in relation to debt transferred from Hampshire County Council on the 1 April 1997 when we became a unitary authority, of £12.37M. This is being repaid over 50 years at £0.36M per annum.
	Investment
16.	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 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 in table 2 above, 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 sectors and boost investment income.
17.	Invested funds represent income received in advance of expenditure plus balances and reserves. During the year investment balances have ranged between £80.40M and £35.83M and are currently £55.23M and expected to reduce to £48M by year end.

18.	Bank Rate remained at 5.25% through the quarter with short term interest rates largely being around this level. The rates on DMADF deposits ranged between 5.19% and 5.20% and money market rates between 5.11% and 5.26%. Forecast income is now £2.50M, slightly higher (£0.27M) than originally budgeted £2.23M which helps to partly mitigate the increase in borrowing costs.
	Investment Performance
19.	The council's advisors undertake quarterly investment benchmarking across its client base. We previously had a more diversified portfolio and at higher interest rates than the average as a result of moving into the bond programme earlier than most clients, but there is now more competition for bonds from both government bodies and other local authorities, so opportunities to replace maturing bonds are limited and we have seen a fall in suitable instruments. With this in mind, and the changes to Prudential code to only borrow when cash flows dictate, our investments primarily now consist of a previous long-term investment in property funds and short term investments for cash flow purposes.
20.	Current investment in bonds remains at £1M and the pooled property fund at £27M, with all other cash being placed in short term deposits as shown in table 1.
21.	As detailed in paragraph 17 cash balances have fallen during the quarter in line with the target of a £20M working balance, to reduce borrowing and therefore net interest costs.
22.	Investments managed internally are currently averaging a return of 5.21% (which is slightly higher than both the average unitary authority at 5.16% and other LA's at 5.07%), whilst maintaining the same credit rating of A+. Total income returns at 5.17% is in line other unitary (5.16%) and above LA's (5.06%). As we are now operating on a cash flow basis for investments to avoid higher borrowing costs and maintained lower cash balances, £28.2M compared to £61.3M for other Unitaries and £63.9M for other Local Authority. Cash is performing well in the current financial environment which accounts for our total return (after allowing for loss on our strategic funds) is lower 3.19% compared to 5.05% for other Unitaries and 5.24% for other Local Authority but has performed better over the last the medium term, see paragraph 28 below. We hold 51% of our investments in strategic funds which offer higher return over the long term, as detailed in paragraphs 23 to 28. The capital value of our external strategic funds has fallen by a further £0.12M in the quarter. The income return over the longer term was and remains the driver to invest, although this is kept under review for opportunities to divest.
	External Managed Investments
23.	The council has invested £27M in pooled property funds as an alternative to buying property directly. As previously reported these funds offer the potential for enhanced returns over the longer term but may be more volatile in the shorter term. They are managed by professional fund managers which allows the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments.
24.	These funds have no defined maturity date but are usually available for withdrawal after a notice period (180 days). The performance and continued suitability in meeting the investment objectives is regularly reviewed.
25.	Strategic fund investments are made 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. Considering the performance over the long-term and the latest cash flow forecasts, these

funds have been maintained but will be monitored carefully especially as the statutory override on accounting for gains and losses on pooled investment funds ends on 31st March 2025, when any difference between initial investment and the current value will be a cost/gain. A reserve of £0.80M was created to mitigate the impact of the statutory override not being extended and unrealised losses being required to be recognised.

Tables 3 and 4 below shows current value and income due in year together with the performance of the fund since we invested and how it has performed against cash.

We have ongoing discussions with Arlingclose about the implications for the investment strategy and what action may need to be taken, current advice is to give notice on part of the fund once we have seen two consecutive increases in the value of fund.

26. Dwindling prospects of policy rate cuts weighed on consumer discretionary stocks as well as on the UK real estate sector. Improvement in commercial property capital values was dampened by property's sensitivity to higher interest rates.

This was evident in the capital value of the CCLA fund which were below those in March and September (£25.46M). The change in the funds' capital values and income earned over the 3-month period is shown in Table 3 below.

The dividend for this quarter is forecast to be £0.34M and £1.28M for the year.

Table 3 - Pooled Fund Performance (Year to Date)

Quarter Ending	Valuation £M	Movement since Reported in SOA	Dividends £M
1st April	24.79		
30th June	24.67	(0.12)	0.34 *
Total			0.34
**Forecast*			

27. Although there is currently an unrealised capital loss of £2.33M at 30 June 2024, since investing £9.42M of dividends have been earned, a net return of £7.09M which equates to an annualised income return of 3.86% compared to the average bank rate of 1.18% for the same period. This also compares favourably to the investments that were made directly in property, which gave a net return of 2.13% in 2023/24 after financing costs.

STRATEGIC POOLED FUND PORTFOLIO			SOUTHAMPTON CITY				From:	01/05/2014	To:	30/06/2024
FUND NAME	ASSET CLASS	No of Units Held in Period	Current Value £	Capital Growth £	Dividends Earned £	Holding Period (yrs)	Capital Return	Income Return	Total Return	Volatility
CCLA - LAMIT PROPERTY FUND	PROPERTY	9,091,173	24,671,625	-2,328,380	9,415,510	7.9	-8.62%	34.87%	26.25%	5.1%
GRAND TOTAL			24,671,625	-2,328,380	9,415,510	7.9	-8.62%	34.87%	26.25%	5.1%
			Unrealised capital loss since purchase:	-2,328,380		Annualised income return:		3.86%		
						Average Bank Rate:		*1.18%*		

Non – Treasury Investments

28. The definition of investments in CIPFA's revised 2021 Treasury Management Code 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 Department

for Levelling Up Housing and Communities (DLUHC) also broadens the definition of investments to include all such assets held partially or wholly for financial return.

Between 2016 and 2017, SCC implemented a strategy to invest in commercial properties with the expected return on investment being used to fund council services, known as the Property Investment Fund (PIF), and purchased 3 properties.

The rate of return on investment for 2024/25 is forecast at 6.03%. Borrowing costs are 3.90% giving a forecast net rate of return of 2.13% before any realised gains or losses.

All the properties remain fully let and the tenants are meeting their financial obligations under the leases (although one tenant has vacated the premises but continues to honour the lease).

A full review of all assets is underway and may result in the disposals.

Details of the properties purchased are shown in table 4 below.

29. **Table 4 – Property Investment Fund**

Property	Actual	31.03.2023 Actual		31.03.2024 Actual		Outstanding Debt 31.03.2024	Outstanding Debt 31.03.2025
	Purchase Cost £M	Value in Accounts	Gain or (Loss) in Year	Value in Accounts	Gain or (Loss) in Year	£M	£M
Property 1	6.47	4.79	(0.09)	5.43	0.64	5.75	5.68
Property 2	14.69	10.61	(1.03)	11.52	0.91	13.05	12.91
Property 3	8.53	8.42	(0.74)	8.24	(0.18)	7.57	7.49
	29.69	**23.82**	**(1.86)**	**25.19**	**1.37**	**26.37**	**26.08**

Financial Review and Outlook

30. A summary of the external factors, which sets the background for Treasury, as provided by the council's treasury advisors, Arlingclose Ltd, is summarised below:

Table 5 - Arlingclose's Economic Outlook (June 2024 interest rate forecast)

	Current	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27
Official Bank Rate													
Upside risk	0.00	0.25	0.50	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	5.25	5.00	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Downside risk	0.00	0.00	-0.25	-0.50	-0.50	-0.50	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00

31. The economic interest rate outlook provided by Arlingclose Ltd, for June 2024 is based on the following underlying assumptions:

- The MPC held Bank Rate at 5.25%.
- The MPC will cut rates to stimulate the UK economy but will be reluctant to do so significantly until it is sure there will be no lingering second-round effects. Rate cuts from Q3 2024 to a low of around 3% by late 2025.
- The balance of risks around Bank Rate lie to the upside; the Bank could hold rates until September or even Q4, and the developing upside risks to inflation could limit the extent of monetary easing.
- Long-term gilt yields have dipped a little following softer US data. Arlingclose's central case is for yields to be volatile around a relatively narrow range, reflecting the likelihood for monetary loosening in the Eurozone, UK and US.

	Economic background
32.	UK headline consumer price inflation (CPI) continued to decline over the quarter, falling from an annual rate of 3.2% in March to 2.0% in May, in line with the Bank of England's target. The core measure of inflation, however, only declined from 4.2% to 3.5% over the same period, which, together with stubbornly services price inflation at 5.7% in May, helped contribute to the BoE maintaining Bank Rate at 5.25% during the period, a level unchanged since August 2023. Data released during the period showed that showed the UK economy had emerged from the technical recession at the end of 2023 to expand by 0.7% (upwardly revised from the initial estimate of 0.6%) in the first quarter of the calendar year. Monthly GDP data showed zero growth in April following an expansion of 0.4% in the previous month. Labour market data continued to provide mixed messages for policymakers, exacerbated by issues the Office for National Statistics is having compiling the labour force survey. In the three months between February and April 2024, unemployment was up, employment fell, while the decline in vacancies slowed and wage growth remained elevated. Unemployment rose to 4.4% (3mth/year) while average regular earnings (excluding bonuses) was 6.0% and total earnings (including bonuses) was 5.9%. Adjusting for inflation, real regular pay rose by 2.3% and total pay by 2.2%. Given how keenly the 'second-round' impact of inflation on wages is watched by the BoE, policymakers will likely want to see more downward movement before cutting interest rates. Having started the financial year at 5.25%, the Bank of England's Monetary Policy Committee (MPC) maintained Bank Rate at this level throughout the quarter. In line with expectations, at its June meeting, the Committee voted by a majority of 7-2 in favour of maintaining the status quo. The two dissenters preferred an immediate 0.25% reduction in Bank Rate to 5.0%. This continued dovish tilt by the Committee increased financial market expectations that the first cut in Bank Rate will likely be in August. Earlier in May, in addition to an identical MPC rate decision and voting pattern, the Bank published the latest version of its Monetary Policy Report (MPR). Within the Report, the Committee noted that it expected four-quarter GDP growth to increase over the forecast period, reflecting the declining negative effects of past Bank Rate increases and the predicted downward path of interest rates which should provide support to economic activity. The trajectory of inflation was broadly similar to that in the previous MPR, albeit slightly lower towards the end of the forecast horizon due to the Committee's revised assessment of falling external inflationary pressures from past import price increases. This meant the Committee expected headline inflation to hit the 2% target two quarters sooner than in the February MPR. As was highlighted earlier, inflation data published in June showed that CPI inflation fell to the 2% target in May. Arlingclose, the authority's treasury adviser, maintained its central view that 5.25% is the peak in Bank Rate and that interest rates will most likely be cut later in H2 2024. The risks over the medium term are deemed to be to the upside as while inflation has fallen to target, it is expected to pick up again later in the year and as services price inflation and wage growth are still on the firmer side, the MPC could well delay before delivering the first rate cut. The US Federal Reserve also maintained interest rates over the period, holding the Fed Funds Rate at 5.25%-5.50% for the seventh consecutive month in June, as was expected. US policymakers have maintained a relatively dovish stance throughout the period but have steadily reduced their predictions around the pace and timing of rate cuts in the face of higher inflation and firmer economic growth. At the meeting, economic projections pointed to one rate cut in calendar 2024 and four in 2025. The European Central Bank cut rates in June, reducing its main refinancing rate from 4.50%

	to 4.25%. Inflation in the region fell to 2.5% in May, having increased in the previous month, but since February has been fairly sticky at between 2.4% and 2.6%. Economic growth in the region has picked up but remains weak, and with inflation above the ECB's target this continues put pressure on policymakers on how to balance these factors when setting monetary policy.
	Financial Markets
33.	Sentiment in financial markets showed signs of improvement over the quarter, but bond yields remained volatile. Early in the period yields climbed steadily, but mixed signals from economic data and investors' constant reassessment of when rate cuts might come caused a couple of fairly pronounced but short lived dips in yields. Towards the end of the quarter yields rose once again and were generally higher than at the start of the period. Over the quarter, the 10-year UK benchmark gilt yield started at 3.94% and ended at 4.18% having reached 4.41% in May. While the 20-year gilt started at 4.40%, hit 4.82% in May, before ending the period at 4.61%. The Sterling Overnight Rate (SONIA) averaged 5.20% over the quarter to 30th June.
	Credit Review
34.	Arlingclose maintained its advised and recommended maximum unsecured duration limit on all banks on its counterparty list at 100 days. During the quarter, Fitch revised its outlook on Transport for London (TfL) to stable from negative while S&P upgraded its long-term rating for TfL to AA- from A+, in line with its rating of the UK sovereign. Fitch also upgraded the long-term ratings for the main four Australian banks – Australia & New Zealand Banking Group, Commonwealth Bank of Australia, National Australia Bank and Westpac. Having placed Warrington Borough Council on review for a downgrade in March, Moody's subsequently withdrew its ratings for the council in June. Credit default swap prices started and ended the quarter at broadly similar levels in the UK as they did for the European, Singaporean and Australian lenders on Arlingclose's counterparty list, while Canadian banks generally trended modestly downwards. 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.
	Prudential Indicators
35.	As required by the 2021 CIPFA Treasury Management Code, the Authority monitors and measures the following treasury management prudential indicators, which together with Capital Prudential Indicators can be seen in Appendix 4. • Liability Benchmark • Maturity Structure of Borrowing • Long-term Treasury Management Investments • Security • Liquidity • Interest Rate Risk Indicator