POLICE AND CRIME COMMISSIONER FOR AVON AND SOMERSET

12th NOVEMBER 2024

TREASURY MANAGEMENT MID-YEAR REPORT 2024-25

Report of the Chief Finance Officer

1. Summary

1.1. The Treasury Management Strategy for 2024-25 is underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (Revised 2021), which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year. The Code also recommends that the Police and Crime Commissioner (PCC) is informed of Treasury Management activities at least twice a year.

1.2. This report gives a summarised account of Treasury Management activity and outturn for the first half of the year, and ensures the PCC is embracing Best Practice in accordance with CIPFA recommendations.

2. Background

2.1. Economic Background

UK headline consumer price inflation remained around the Bank of England (BoE) target later in the reporting period. It fell from an annual rate of 3.2% in March to 2.0% in May and then rebounded marginally to sit at 2.2% in July and August. 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% 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. 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) were 5.1%, down from 5.4% in the earlier period. Adjusting for inflation, 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 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.

The Councils' treasury team 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 3.5% by the end of 2025.

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 (and PWLB borrowers) 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 5.10% over the period to 30th September.

Gilt yields have a direct correlation to Public Works Loan Board (PWLB) rates. PWLB rates increased by 30-40 basis points between March and May. They peaked in May, and as the inflationary picture became clearer, rates had dropped by as much as 80bps by the middle of September, before gaining 20-25bps at the back end of September. This is clearly shown in Tables 2 and 3 and the graph in Appendix A.

Sterling Overnight Interbank Average (SONIA) money market rates also moved up between March and May before drifting lower, then dropping in line with the base rate reduction in August.

The 1-month, 3-month, 6-month, and 12-month SONIA rates averaged 5.10%, 5.10%, 5.08%, and 5.01% respectively over the period, and ended the period at 4.92%, 4.88%, 4.77%, and 4.56%, respectively.

The effect that economic conditions had on money market rates during the period, can be seen in Table 1, Appendix A.

2.2. Debt Management

The limited capital spending that has been incurred has been funded using internal resources in lieu of borrowing as it has been the most cost-effective means of financing capital expenditure. This has lowered overall treasury risk by reducing both external debt and temporary investments.

£555k of EIP PWLB Loans have been repaid during the period, as scheduled.

The debt position at the beginning and end of the period are shown below: -

	Balance on 31/03/2024 £m	**Debt Matured / Repaid £m**	**New Borrowing £m**	**Balance on 30/09/2024 £m**	**Increase/ Decrease in Borrowing**
Short Term Borrowing	5.00	5.00	0.00	0.00	-5.00
PWLB	30.176	0.555	0.00	29.621	-0.555
LOBOs	5.275	0.00	0.00	5.275	0.00
Other Market Loans	6.500	0.00	0.00	6.500	0.00
Total Borrowing	**46.951**	**0.555**	**0.00**	**41.396**	**-5.555**

The overall rate paid on PWLB loans has increased marginally from 3.34% on 31st March to 3.36% on 30th September. This is as a result of repayment of EIP loans at a lower rate than the average. The average market loan rate on 30th September remained the same at 4.30%.

The average rate of interest payable across the total debt portfolio of £41.396 was 3.63% on 30th September, up from 3.59% from the same time last year, again as a result of repayment of EIP loans at a lower rate than the average.

No temporary loans were taken out during the period, just repayment of the £5m loan taken over financial year-end.

2.3. Investment Activity

The Guidance on Local Government Investments in England gives priority to security and liquidity and the PCC's aim is to achieve a yield commensurate with these principles.

Security of capital remained the PCC's main investment objective. This was maintained by following the counterparty policy as set out in the Annual Treasury Strategy, and by the approval method set out in the Treasury Management Practices. Current approved counterparties are listed below. Those used during the first half of the year are denoted with a star.

Bank or Building Society			
Australia & NZ Bank	*	Landesbank Hessen-Thuringen	*
Barclays Bank Plc		National Westminster	*
DBS Bank	*	Santander UK	*
HSBC Bank		Standard Chartered Bank	
Lloyds Bank	*	Toronto-Dominion Bank	
Sterling LVNAV Money Market Funds		**Other Counterparties**	
Deutsche	*	Debt Management Office	*
Federated Prime Rate	*	Local Authorities (15)	*
Invesco Aim	*	CCLA Property Fund	*
Insight	*		
LGIM	*		
Aberdeen Standard	*		
Aviva	*		
SSGA	*		

Somerset Council (SC), as Treasury Management contractor, has continuously monitored counterparties, and all ratings of proposed counterparties have been subject to verification on the day, immediately prior to investment. Other indicators considered have been:

- Credit Default Swaps and Government Bond Spreads.
- GDP and Net Debt as a Percentage of GDP for sovereign countries.
- Likelihood and strength of Parental Support.
- Banking resolution mechanisms for the restructure of failing financial institutions i.e. bail-in.
- Share Price.
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.

Counterparty Update

SC Treasury advisors, Arlingclose maintained its advised recommended maximum unsecured duration limit on all banks on its counterparty list at 100 days.

Moody's placed National Bank of Canada on Rating Watch for a possible upgrade, revised the outlook on Standard Chartered to Positive, and the outlook to Negative on Toronto Dominion Bank.

S&P upgraded the rating on National Bank of Canada to A+ from A.

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.

SC continued to monitor and assess credit default swap levels for signs of ongoing credit stress. Heightened market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the PCC's counterparty list remain under constant review.

Liquidity: In keeping with the CLG guidance, the PCC maintained a sufficient level of liquidity through the use of call accounts, Money Market Funds, and short-term deposits. One temporary loan that was taken out during the previous year to aid cash flow was repaid.

One hundred and twenty-two deposits totalling just over £452m were made during the first half of the year. The average weighted maturity, or duration of investments on 30th September was 120 days, or 4 months. A number of deposits have been made into 2025, to take advantage of higher current rates, in anticipation that rates will fall further in the near future.

CCLA Property Fund: The Authority has a £3m investment in the CCLA Property Fund. As a reminder, this Fund has been in existence for more than 25 years and is only available to Local Authorities. It is an actively managed, diversified portfolio of UK Commercial Property with a stated investment objective "to provide investors with a high level of income and long-term capital appreciation."

The current yield of circa 4.77% net will provide approximately £143,000 of income per annum.

Yield: As at 30th September investment balances (Inc-Property) stood at £106.77m (£74.69m in 2023-24) and had averaged just over £84.52m for the year-to-date (£79.02m 2023-24). The average return for the year-to-date was 5.28% Including Property, 5.30% excluding (4.75% and 4.77% respectively for 2023-24). When compared to the target of 7-day SONIA + 50 bps (5.07% + 0.5%) overall returns have under-performed by 0.27%. However, performance is 0.13% above the average base rate for the period. This has produced investment income in the order of £2.24m during the period (£358k more than for the same period 2023-24) on average balances of £5.5m more.

By comparing returns with money market rates in Table 1 of Appendix A, it can be seen that average investment cash performance (Ex-Prop) of 5.30% has outperformed the average market rate for overnight, 1-month SONIA, and 3-month SONIA, all 5.10%, by 0.20%.

The significant one-off pension top-up payment of £80.8m (more than £30m more than 2023-24) in July again had an effect, meaning that short-term (and thereby lesser paying) counterparties had to be used. Deposits with Local Authorities have been made to all month ends up to August 2025 to ensure sufficient liquidity whilst taking advantage of elevated rates that are expected to drop further in the rest of the financial year.

The table below sets out changes in the lending portfolio over the period: -

	Balance on 31/03/2024 £m	**Percentage of portfolio**	**Balance on 30/09/2024 £m**	**Percentage of portfolio**	**Increase/ Decrease in Lending £m**
Call A/cs & MMFs (Short-term)	1.36	3.64%	27.77	26.01%	+£26.41
Notice A/cs (95, 35,& 32 day)	0.00	0.00%	7.00	6.56%	+£7.00
Deposits (Banks)	0.00	0.00%	8.00	7.49%	+£8.00
Deposits (Local Authorities)	33.00	88.33%	61.00	57.13%	+£28.00
CCLA Property Fund	3.00	8.03%	3.00	2.81%	+£0.00
Total Lending	**37.36**	**100.0%**	**106.77**	**100.0%**	**+£69.41**

	Balance on 31/03/2024 £m	**Rate as at 31/03/2024**	**Balance on 30/09/2024 £m**	**Rate as at 30/09/2024**	**Change in Rate**
Total	**37.36**	**5.61%**	**106.77**	**5.03%**	**-0.58%**

2.4 Compliance and Prudential Indicators

The PCC can confirm that it has complied with its Prudential Indicators for 2024-25. Indicators agreed by the Finance Committee and actual figures as at 30th September are included below: -

	2024-25 £m	As at 30-09 £m
Authorised limit (Excludes PFI)	57	41.4
Operational boundary (borrowing only)	55	41.4

Maturity structure of borrowing

	Upper Limit	Lower Limit	As at 30-09-24
Under 12 months	30%	0%	9.38%
>12 months and within 24 months	30%	0%	2.68%
>24 months and within 5 years	25%	5%	14.30%
>5 years and within 10 years	25%	0%	8.58%
>10 years and within 20 years	30%	0%	22.64%
>20 years and within 30 years	15%	0%	9.81%
>30 years and within 40 years	35%	10%	32.61%
>40 years and within 50 years	10%	0%	0%
>50 years and within 75 years	0%	0%	0%

	2024-25 £m	As at 30-09 £m
Prudential Limit for principal sums invested for periods longer than 365 days	10	3

Credit Risk Indicator

The PCC has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating / credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Credit risk indicator (Actual to be below)	Target	Actual
Portfolio average credit rating (score)	A (6.0)	AA- (2.93)

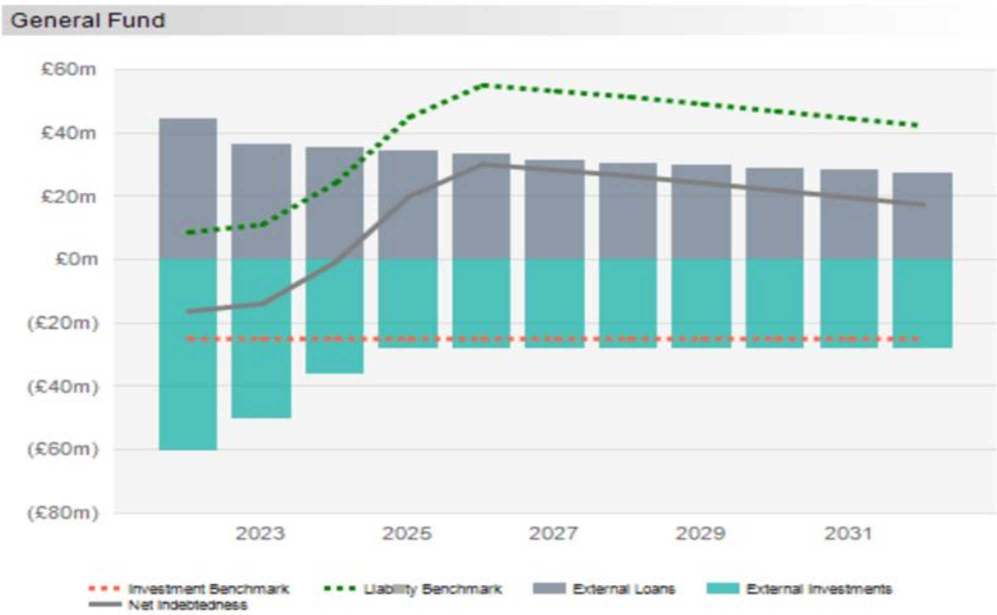
Liability Benchmark

This new indicator compares the PCC'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 PCC 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 PCC must hold to fund its current capital and revenue plans while keeping treasury investments at a pre-determined minimum level required to manage day-to-day cash flow (including allowances for certain contingencies).

The concept is that the chart below allows a comparison of current borrowing against the need to borrow, looking at both the amount (on the y axis) and the term (on the x axis). Where actual loans exceed the Liability Benchmark, the authority can make long-term investments for cash flow management or repay loans early; where the Liability Benchmark exceeds loans, the authority can take long-term borrowing or sell investments.

There is no requirement to borrow exactly to the Liability Benchmark, but a decision to borrow more or less, or longer or shorter, than the Liability Benchmark implies a deliberate decision to accept additional risk. This may be entirely appropriate if it is accompanied by a reduction in cost, for example through short-term borrowing at lower margins. The Liability Benchmark provides the tool for local authorities to measure this risk and make such risk/reward decisions openly and explicitly.

As there has been no significant movement in debt or debt requirement the chart has not noticeably changed since the beginning of the year.



2.5 Outlook for Quarters 3 & 4

As expected, the MPC held Bank Rate at 5.0% in September. While the "no change" majority of eight to one was unexpectedly strong, the minutes suggested some policymakers believed a gradual approach to loosening policy was warranted given the persistence of services inflation, rather than no loosening at all. This is in line with the market view that Bank Rate will initially reduce gradually before a more rapid decline in 2025 as services inflation eases.

CPI inflation remained just above the 2% target in August. Private sector wage growth has eased back but remains elevated and services inflation remains high at 5.6%. However, both will continue to decline over time.

UK GDP growth has been relatively strong in H1 2024, although this partly reflects a rebound from the H2 2023 technical recession. The expected continuation of restrictive monetary policy and the appreciation in sterling will likely bear down on activity and therefore require more substantial loosening in 2025 to boost activity and inflation.

Market commentators see further rate cuts from Q4 2024 to a low of around 3%-3.5% by late 2025. Long-term gilt yields are expected to eventually fall from current levels reflecting the lower medium-term path for Bank Rate. However, yields will remain relatively higher than in the past, partly due to quantitative tightening, with continued elevated volatility.

The table below shows a forecast for base rate to September 2027 and includes an assessment of the relative risks to both the upside and downside of the forecast.

	Dec 24	Mar 25	Jun 25	Sep 25	Dec 25	Mar 26
Upside Risk	0.25	0.25	0.75	1.00	1.00	1.00
Base Rate	4.75	4.25	3.75	3.25	3.00	3.00
Downside Risk	-0.25	-0.50	-0.50	-0.50	-0.50	-0.50

	Jun 26	Sep 26	Dec 26	Mar 27	Jun 27	Sept 27
Upside Risk	1.00	1.00	1.00	1.00	1.00	1.00
Base Rate	3.00	3.00	3.00	3.00	3.00	3.00
Downside Risk	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50

2.6 Summary

In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during the first six months of 2024-25. As indicated in this report all treasury activity was conducted within the benchmarks set as Prudential limits for prudent and sustainable capital plans, financing, and investment. A risk-averse approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

The average return for the year-to-date was 5.28% Including Property, 5.30% excluding (4.75% and 4.77% respectively for 2023-24). When compared to the target of 7-day SONIA + 50 bps (5.07% + 0.5%) overall returns have under-performed by 0.27%. However, performance is 0.13% above the average base rate for the period. This has produced investment income in the order of £2.24m during the period (£358k more than for the same period 2023-24) on average balances of £5.5m more.

The PCC has pursued a passive borrowing strategy. The limited capital spending that has been incurred to date has been funded using internal resources in lieu of borrowing as it has been the most cost-effective means of financing capital expenditure.

Monthly performance papers are produced by SC Treasury Officers and virtual meetings have been held quarterly to discuss performance, the economic and financial environment, and any tactical and strategic responses to be implemented.

Appendix A

Money Market Data and PWLB Rates

The average low and high rates correspond to the rates during the financial year-to-date, rather than those in the tables below.

Table 1: Bank Rate, Money Market Rates -SONIA (Sterling Overnight Interbank Rates - BID)

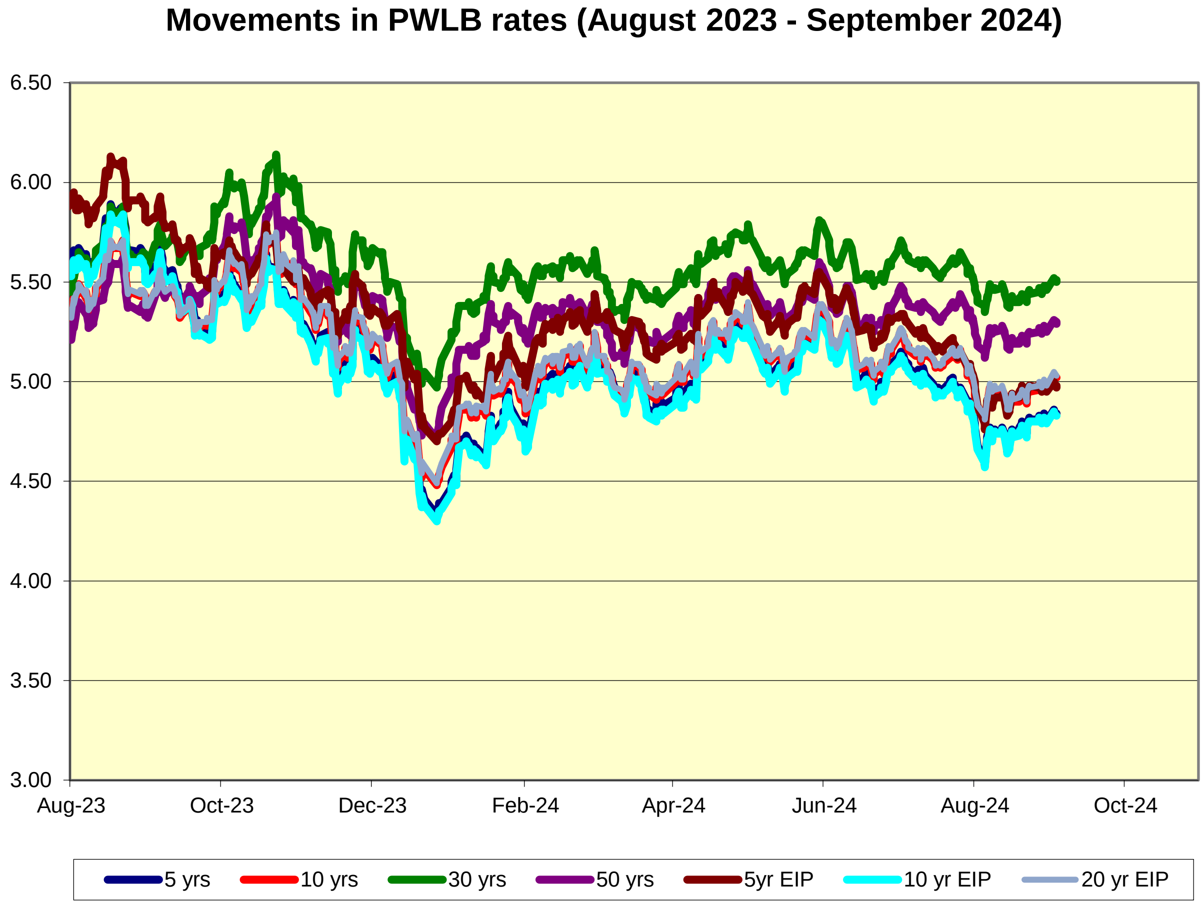
Date	Bank Rate	O/N SONIA	7-day SONIA	1-month SONIA	3-month SONIA	6-month SONIA	12-month SONIA
01/04/2024	5.25	5.19	5.17	5.27	5.26	5.15	5.11
30/04/2024	5.25	5.09	5.19	5.20	5.22	5.22	5.27
31/05/2024	5.25	5.13	5.21	5.21	5.27	5.31	5.35
30/06/2024	5.25	5.20	5.15	5.18	5.19	5.19	5.19
31/07/2024	5.25	5.20	5.03	5.03	5.08	5.05	4.95
31/08/2024	5.00	4.92	4.90	4.92	4.92	4.89	4.75
30/09/2024	5.00	4.90	4.88	4.92	4.88	4.77	4.56
Minimum	**5.00**	**4.85**	**4.86**	**4.90**	**4.81**	**4.74**	**4.45**
Maximum	**5.25**	**5.25**	**5.22**	**5.27**	**5.28**	**5.31**	**5.37**
Average	**5.17**	**5.10**	**5.07**	**5.10**	**5.10**	**5.08**	**5.01**
Spread	**0.25**	**0.40**	**0.36**	**0.37**	**0.46**	**0.57**	**0.92**

Table 2: PWLB Borrowing Rates – Fixed Rate, Maturity Loans

Change Date	**Notice No**	**4½-5 yrs**	**9½-10 yrs**	**19½-20 yrs**	**29½-30 yrs**	**39½-40 yrs**	**49½-50 yrs**
01/04/2024	127/24	4.92	5.00	5.44	5.47	5.40	5.26
30/04/2024	168/24	5.27	5.31	5.70	5.73	5.64	5.50
31/05/2024	210/24	5.33	5.38	5.76	5.80	5.72	5.58
30/06/2024	250/24	5.09	5.16	5.57	5.60	5.51	5.37
31/07/2024	296/24	4.85	5.02	5.47	5.53	5.47	5.32
31/08/2024	338/24	4.80	4.96	5.39	5.46	5.40	5.24
30/09/2024	380/24	4.75	4.99	5.47	5.55	5.48	5.32
	Low	**4.51**	**4.72**	**5.21**	**5.29**	**5.24**	**5.07**
	High	**5.34**	**5.38**	**5.77**	**5.81**	**5.73**	**5.60**
	Average	**4.96**	**5.08**	**5.50**	**5.55**	**5.48**	**5.33**
	Spread	**0.83**	**0.66**	**0.56**	**0.52**	**0.49**	**0.53**

Table 3: PWLB Borrowing Rates – Fixed Rate, Equal Instalment of Principal (EIP Loans)

Change Date	**Notice No**	**4½-5 yrs**	**9½-10 yrs**	**19½-20 yrs**	**29½-30 yrs**	**39½-40 yrs**	**49½-50 yrs**
01/04/2024	127/24	5.20	4.89	5.02	5.30	5.44	5.48
30/04/2024	168/24	5.48	5.24	5.32	5.57	5.71	5.74
31/05/2024	210/24	5.53	5.30	5.39	5.63	5.77	5.80
30/06/2024	250/24	5.31	5.06	5.17	5.43	5.57	5.61
31/07/2024	296/24	5.04	4.83	5.03	5.32	5.48	5.53
31/08/2024	338/24	4.95	4.79	4.98	5.24	5.39	5.45
30/09/2024	380/24	4.87	4.76	5.01	5.30	5.47	5.54
	Low	**4.67**	**4.50**	**4.74**	**5.04**	**5.21**	**5.28**
	High	**5.55**	**5.31**	**5.40**	**5.64**	**5.78**	**5.81**
	Average	**5.17**	**4.94**	**5.09**	**5.36**	**5.51**	**5.55**
	Spread	**0.88**	**0.81**	**0.66**	**0.60**	**0.57**	**0.53**



Movements in PWLB rates (August 2023 - September 2024)
6.50
6.00
5.50
5.00
4.50
4.00
3.50
3.00
Aug-23
Oct-23
Dec-23
Feb-24
Apr-24
Jun-24
Aug-24
Oct-24
5 yrs
10 yrs
30 yrs
50 yrs
5yr EIP
10 yr EIP
20 yr EIP