Audit and Governance Committee
26th November 2025

EXECUTIVE HEAD OF FINANCE
REPORT NO: FIN2517

TREASURY MANAGEMENT AND NON-TREASURY INVESTMENT OPERATIONS 2025/26 – Quarter 2

SUMMARY:
This report sets out the activities of the Treasury Management and non-Treasury Investment Operations for quarter 2 in the financial year 2025/26, and reports on compliance with Prudential Indicators.

RECOMMENDATIONS:
Members are requested to:

(i) Make any recommendations, as appropriate, to the Cabinet on the contents of this report in relation to the treasury management and non-treasury investment operations carried out.

1. INTRODUCTION

1.1 This report sets out the Treasury Management and Non-Treasury Investment operation performance for Quarter 2 2025/26. This report is a statutory requirement under the CIPFA Code of Practice on Treasury Management.

1.1 Full Council approved the Annual Treasury Management Strategy and Non-Treasury Investment Strategy for the financial year 2025/26 in February 2025. The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management 2021 ("the Code") and is fully incorporated into the Council's adopted strategy.

2. PURPOSE

2.1 This report sets out compliance with the strategy and performance against Prudential Indicators to the end of September 2025/26 within appendices (1-4):

<u>Appendix 1</u>

- The **Treasury Management operations** which sets out how the Council's treasury service operated during the period to September 2025;
- The **Treasury Management Borrowing** which sets out the Council's borrowing during the period to September 2025, and;
- The **Treasury Management Investments** which sets out the Council's Treasury Management investment operations for the period to September 2025.

Appendix 2

- the **Prudential indicators** performance is compared to the indicators set out in the Annual Capital Strategy for the year 2025/26.

Appendix 3

- The list of borrowing counterparties as at end of September 2025.

Appendix 4

- Market commentary regarding from the Council's treasury management advisors Arlingclose

3 BACKGROUND

3.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) have issued guidance on the aims and requirements of a Capital Strategy focusing on a whole organisation approach to prudent, sustainable, and resilient local government investment.

3.2 CIPFA have also issued two professional Codes of Practice to which the Council is required to "have regard to". These Codes provide frameworks that are designed to support local strategic planning, local asset management planning and proper option appraisal:

- The Prudential Code – developed to support local authorities in taking decisions around their capital investment programmes. The objectives of the Prudential Code are to ensure, within a clear reporting framework, that a local authority's capital expenditure plans and investment plans are affordable and proportionate; that all external borrowing and other long-term liabilities are within prudent and sustainable levels; that the risks associated with investments for commercial purposes are proportionate to their financial capacity; and that treasury management decisions are taken in accordance with good professional practice.
- The Treasury Management Code - Treasury Management is defined as 'The management of the organisation's borrowing, investments, and cash flows, including 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'.

3.3 The primary purpose of the treasury management operation is to ensure that cash flow is adequately planned, with cash being available when it is needed to deliver the Councils services. The secondary function of the treasury management operation is the funding of the Council's capital programme and manage cashflow requirements over a longer-term period.

3.4 Non-treasury investment operations should ensure that all investments made primarily for service reasons. Then, second to this, the function of investment management is to generate returns.

3.5 This quarterly report provides an additional update and includes the requirement in the 2021 Code of quarterly reporting of the treasury management prudential indicators.

4 CONCLUSIONS ON THE TREASURY MANAGEMENT AND NON-TREASURY INVESTMENT OPERATIONS DURING Q2 2025/26

4.1 All treasury activity was conducted within the approved Treasury Management Practices (TMP's).

4.2 Borrowing has now started to move towards longer term rather than short term, to provide more interest rate stability on borrowing in line with the MTFS rate of 4.78%.

5 KEY RISKS

5.1 The Council has borrowed 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.

5.2 The key risks to the Councils delivery of successful treasury and non-treasury investment options include:

- Inflation levels
  Inflation rates are now reducing after a prolonged period of increased levels.
- Bank of England Base rate
  Base rate has reduced to 4%. Expectations are that this will reduce further, however a slow reduction is anticipated.
- Delivery of Capital Programme
  Will impact borrowing requirements and timing will impact rates achievable for both borrowing and investments during the years

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Treasury Management Report Q2 2025/26

Introduction

The Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code). This quarterly report includes the requirement in the 2021 Code of quarterly reporting of the treasury management provides an update of the treasury management prudential indicators. The non-treasury prudential indicators are included in Appendix 2.

The Council's treasury management strategy for 2025/26 was approved at a meeting on 27th February 2025. The Authority has borrowed 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 Council's treasury management strategy.

Local Context

On 31st March 2025, the Council had net borrowing of £127m 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) summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.25 Actual £m	31.3.26 Forecast £m
General Fund CFR	174.3	146.9
Less: Other debt liabilities*	0.3	0.6
Borrowing CFR	**173.9**	**147.5**
External borrowing**	166.0	144.0

* 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

	31.3.25 Balance £m	Movement £m	30.9.25 Balance £m	30.9.25 Rate %
Long-term borrowing				
- PWLB	2.0	5.0	7.0	4.64
- Other	62.0	40.0	102.0	4.81
Short-term borrowing	102.0	(72.0)	30.0	4.51
Total borrowing	**166.0**	**(27.0)**	**139.0**	
Long-term investments	16.0	(3.0)	13.0	5.57
Short-term investments	5.0	(5.0)	-	-
Cash and cash equivalents	18.0	(0.1)	17.9	4.25
Total investments	**39.0**	**(8.1)**	**30.9**	
Net borrowing	**127.0**	**(18.9)**	**108.1**	

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.

After substantial rises in interest rates since 2021 central banks have now begun to reduce their policy rates, albeit slowly. Gilt yields however have increased over the Q2 period amid concerns about inflation, the UK government's fiscal position and general economic uncertainty.

The PWLB certainty rate for 10-year maturity loans was 5.38% at the beginning of the period and 5.53% at the end. The lowest available 10-year maturity certainty rate was 5.17% and the highest was 5.62%. Rates for 20-year maturity loans ranged from 5.71% to 6.30% during the period, and 50-year maturity loans from 5.46% to 6.14%. The cost of short-term borrowing from other local authorities has been similar to Base Rate during the period at 4.0% to 4.5%.

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.

The Authority currently holds £148m in commercial investments primarily for financial return that were purchased prior to the change in the CIPFA Prudential Code. Before undertaking further additional borrowing the Authority will review the options for exiting these investments.

Loans Portfolio

At 30th September the Authority held £139m of loans, (a decrease of £27m from the position as of 31st March 2025), 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

	31.3.25 Balance £m	Net Movement £m	30.9.25 Balance £m	30.9.25 Weighted Average Rate %
Public Works Loan Board	62.0	30.0	102.0	4.81
Local authorities (long-term)	2.0	5.0	7.0	4.64
Local authorities (short-term)	102.0	(72.0)	30.0	4.51
Total borrowing	**166.0**	**(37.0)**	**139.0**	

The average rate on the Authority's short-term loans at 30th September 2025 on £30m was 4.51%, this compares with 4.92% on £47m loans 3 months ago.

Table 3B: Long-dated Loans borrowed

	Amount £m	Rate %	Period (Years)
PWLB Maturity Loan	102.0	4.81	2-4
Horsham District Council	2.0	5.10	2
South Yorkshire Mayoral Combined Authority	5.0	4.45	3
Total borrowing	**109.0**		

The Council's new borrowing decisions to replace existing borrowing as current loans mature are determined by a cashflow projection.

Forward starting loans
To enable certainty of cost to be achieved without suffering a cost of carry in the intervening period, the Authority arranged £5m of forward starting loans with fixed interest rates of 4.50% for the delivery of cash in 6 weeks' time, details of which are below.

Table 3C: Forward starting loans

	Amount £m	Rate %	Loan Period (Years)	Forward Period (Months)
Torbay Borough Council	5.0	4.50	4	1.5
Total borrowing	**5.0**			

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

Treasury Investment Activity

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

The Council holds some invested funds, representing income received in advance of expenditure plus balances and reserves held. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.25 Balance £m	Net Movement £m	30.9.25 Balance £m	30.9.25 Income Return %
Banks & building societies	0.3	(0.2)	0.1	4.11
Local authorities and other govt entities	5.0	(0.5)	-	-
Money Market Funds	17.7	0.2	17.9	4.27
Other Pooled Funds				
- *Strategic bond funds*	6.0	0	6.0	4.93
- *Equity income funds*	5.0	0	5.0	9.89
- *Property funds*	3.0	(3.0)	-	-
- *Multi asset income funds*	2.0	0	2.0	6.59
Total investments	**39.0**	**(8.0)**	**31.0**	

Both the CIPFA Code and government guidance require the Council 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 Council'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 Council 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.

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 %
31.03.2025	5.14	A+	78%	7	5.65
30.09.2025	4.72	A+	100%	1	6.00
Similar LAs	**4.53**	**A+**	**64%**	**53**	**4.62**
All LAs	**4.54**	**A+**	**62%**	**11**	**4.47**

Externally Managed Pooled Funds

£13m of the Council's investments is invested in externally managed strategic pooled funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability.

Most asset classes achieved positive performance over the first half of the 2025/26 financial year, although conditions remained volatile and heavily influenced by political and macroeconomic developments.

The Authority has budgeted £540k income from these investments in 2025/26. Income received up to 30th September was £455k.

Because these 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 are regularly reviewed. 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.

Statutory override

Further to consultations in April 2023 and December 2024 MHCLG wrote to finance directors in England in February 2025 regarding the statutory override on accounting for gains and losses in pooled investment funds. On the assumption that when published regulations follow this policy announcement, the statutory override will be extended up until the 1st April 2029 for investments already in place before 1st April 2024. The override will not apply to any new investments taken out on or after 1st April 2024. The Authority had set up a reserve of £1m to mitigate the impact of the statutory override not being extended. Given current budgetary pressures and the extension of the override the authority decided to release £1m from this reserve.

Non-Treasury Investments

The definition of investments in the Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) 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 also held £155.9m of such investments in:

- directly owned property £148m
- loans to local businesses and landlords £6.5m
- Subsidiaries £1.4m

A full list of the Council's non-treasury investments is available.

Treasury Performance

The Council measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates.

Compliance

The Section 151 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

	30.9.25 Actual	2025/26 Limit	Complied?
Any group of pooled funds under the same management	0	15m	Yes
Negotiable instruments held in a broker's nominee account	0	15m	Yes
Limit per non-UK country	0	6m	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

	30.9.25 Actual	2025/26 Operational Boundary	2025/26 Authorised Limit	Complied?
Borrowing	139.0	150.0	180.0	Yes
PFI and Finance Leases	**0.6**	**1.8**	**2.0**	Yes
Total debt	**139.6**	**151.8**	**182.0**	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 Council'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 £21m. This incorporates £16m invested in strategic pooled funds, that cannot be sold at short notice, and an additional £5m liquidity buffer to manage short-term cashflow requirements. Whilst the £5m liquidity buffer has been maintained the pooled funds element has been reduced to £13m, due to the sale of some funds to mitigate the losses of a fund which was closing. The original £21m was set as the pooled funds were long term investments but had little impact on the liquidity for cashflow purposes hence the minimum level of cash held has not been increased. The updated minimum level of £18m will be reflected in the Treasury Management Strategy for 26/27.

	31.3.25 Actual	31.3.26 Forecast	31.3.27 Forecast	31.3.28 Forecast
Loans CFR	173.6	147.5	133.4	131.4
Less: Balance sheet resources	45.4	42.8	41.5	42.0
Net loans requirement	128.1	104.7	91.9	89.4
Plus: Liquidity allowance	21.0	18.0	18.0	18.0
Liability benchmark	**149.1**	**122.7**	**109.9**	**107.4**
Existing borrowing*	**166.0**	**144.0**	**70.0**	**60.0**

* shows only loans to which the Authority is committed and excludes optional refinancing

Following on from the medium-term forecast above, the long-term liability benchmark assumes capital expenditure funded by borrowing, minimum revenue provision on new capital expenditure based on a variable year asset life and income, expenditure and reserves all increasing by inflation. This is shown in the chart below together with the maturity profile of the Council's existing borrowing.

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	Actual	Forecasts	£m								
Position at 31 March	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**	**2031**	**2032**	**2033**	**2034**	**2035**
Loans CFR	173.6	147.5	133.4	131.4	124.7	122.8	121.0	119.1	117.3	115.5	113.6
External borrowing	-166.0	-144.0	-70.0	-60.0	-20.0	0.0	0.0	0.0	0.0	0.0	0.0
Internal (over) borrowing	7.6	3.5	63.4	71.4	104.7	122.8	121.0	119.1	117.3	115.5	113.6
Balance sheet resources	-45.4	-42.8	-41.5	-42.0	-42.2	-43.2	-44.2	-45.2	-46.2	-47.3	-48.3
Investments (new borrowing)	37.9	39.3	-21.9	-29.4	-62.5	-79.7	-76.8	-74.0	-71.1	-68.2	-65.3
Treasury investments	37.9	39.3	18.0	18.0	18.0	18.5	18.9	19.4	19.9	20.4	20.9
New borrowing	0.0	0.0	39.9	47.4	80.5	98.1	95.8	93.4	91.0	88.6	86.1
Net loans requirement	128.1	104.7	91.9	89.4	82.5	79.7	76.8	74.0	71.1	68.2	65.3
Liquidity allowance	21.0	18.0	18.0	18.0	18.0	18.5	18.9	19.4	19.9	20.4	20.9
Liability benchmark	149.1	122.7	109.9	107.4	100.5	98.1	95.8	93.4	91.0	88.6	86.1

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

2. Maturity Structure of Borrowing

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 (%)	30.9.25 Actual (%)	Complied?
Under 12 months	100	0	14	Yes
12 months and within 24 months	100	0	60	Yes
24 months and within 5 years	100	0	25	Yes
5 years and within 10 years	100	0	0	Yes
10 years and above	100	0	0	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 Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury management limits are:

	2024/25	2025/26	2026/27
Limit on principal invested beyond year end	£30m	£30m	£20m
Actual principal invested beyond year end	£13m	£13m	£13m
Complied?	Yes	Yes	Yes

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

Additional indicators

Security

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating and 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.

	2025/26 Target	30.9.25 Actual	Complied?
Portfolio average credit rating	A+	A+	Yes
Portfolio average credit score	5	4.72	Yes

Liquidity

The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

	30.9.25 Actual	2025/26 Target	Complied?
Total cash available within 3 months	17.9	5	Yes

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

	01/04/25	30/09/25
Bank Rate	4.50%	4.00%
1-year PWLB certainty rate, maturity loans	4.82%	4.58%
5-year PWLB certainty rate, maturity loans	4.94%	4.95%
10-year PWLB certainty rate, maturity loans	5.38%	5.53%
20-year PWLB certainty rate, maturity loans	5.88%	6.14%
50-year PWLB certainty rate, maturity loans	5.63%	5.98%

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.

APPENDIX 2

Prudential Indicators Q2 - 2025/26

The Council measures and manages its capital expenditure, and borrowing with references to the following indicators.

It is now a requirement of the CIPFA Prudential Code that these are reported on a quarterly basis.

Capital Expenditure
The Council has undertaken and is planning capital expenditure as summarised below:

	2024/25 actual	2025/26 Budget	2026/27 Forecast	2027/28 Forecast
Capital expenditure	14.6	14	2.2	2

The main General Fund capital projects to date have included Union Yard, and Aldershot Crematorium.

Capital Financing Requirement
The Council's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt.

	31.3.2025 actual	31.3.2026 forecast	31.3.2027 forecast
CFR	174.2	148.5	134.0

Gross Debt and the Capital Financing Requirement
Statutory guidance is that debt should remain below the capital financing requirement, except in the short term. The Authority has complied and expects to continue to comply with this requirement in the medium term as is shown below.

	31.3.2025 actual	31.3.2026 forecast	31.3.2027 forecast	Debt at 30.9.2025
Debt (incl. PFI & leases)	166.6	164.5	157.9	139.0
Capital Financing Requirement	174.2	148.5	134.0	

Debt and the Authorised Limit and Operational Boundary
The Council is legally obliged to set an affordable borrowing limit (also termed the Authorised Limit for external debt) each year. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

	Debt at 30.6.25	2025/26 Authorised Limit	2025/26 Operational Boundary	Complied?
Borrowing	139.0	180.0	150.0	Yes
Leases	0.6	2.0	1.8	Yes
Total debt	**139.6**	**182.0**	**151.8**	Yes

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

Net Income from Commercial and Service Investments to Net Revenue Stream
The Council's income from commercial and service investments as a proportion of its net revenue stream has been and is expected to be as indicated below.

	2024/25 actual	2025/26 forecast	2026/27 forecast
Total net income from service and commercial investments	7.9	7.9	8.0
Proportion of net revenue stream	56.99%	56.54%	57.96%

Proportion of Financing Costs to Net Revenue Stream
Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue.

The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants.

	2024/25 actual	2025/26 forecast	2026/27 forecast
Financing costs (£m)	7.0	6.9	6.5
Proportion of net revenue stream	50.59%	49.15%	46.85%

Treasury Management Indicators
These indicators (Liability Benchmark, Maturity Structure of Borrowing, Long-Term Treasury Management Investments) are within the Treasury Management Report Q2 2025/26 at Appendix 1.

APPENDIX 3

LIST OF DEBT COUNTERPARTIES AS AT 30 SEPTEMBER 2025

	Amount
PWLB	5,000,000
PWLB	5,000,000
South Yorkshire Mayoral Combined	5,000,000
PWLB	10,000,000
South Yorkshire Mayoral CA Police Fund	10,000,000
Furness Building Society	5,000,000
Lancashire Combined Fire Authority	5,000,000
PWLB	20,000,000
PWLB	12,000,000
PWLB	20,000,000
PWLB	10,000,000
PWLB	15,000,000
PWLB	5,000,000
Bolton Metropolitan Borough Council	5,000,000
Thames Valley PCC	5,000,000
Horsham District Council	2,000,000
	139,000,000

External Context

Economic background: The first quarter was dominated by the fallout from the US trade tariffs and their impact on equity and bond markets. The second quarter, still rife with uncertainty, saw equity markets making gains and a divergence in US and UK government bond yields, which had been moving relatively closely together.

From late June, amid a UK backdrop of economic uncertainty, concerns around the government's fiscal position and speculation around the autumn Budget, yields on medium and longer term gilts pushed higher, including the 30-year which hit its highest level for almost 30 years.

UK headline annual consumer price inflation (CPI) increased over the period, rising from 2.6% in March to 3.8% in August, still well above the Bank of England's 2% target. Core inflation also rose, from 3.4% to 3.6% over the same period, albeit the August reading was down from 3.8% the previous month. Services inflation also fell from July to August, to 4.7% from 5.0%.

The UK economy expanded by 0.7% in the first quarter of the calendar year and by 0.3% in the second quarter. In the final version of the Q2 2025 GDP report, annual growth was revised upwards to 1.4% y/y. However, monthly figures showed zero growth in July, in line with expectations, indicating a sluggish start to Q3.

Labour market data continued to soften throughout the period, with the unemployment rate rising and earnings growth easing, but probably not to an extent that would make the more hawkish MPC members comfortable with further rate cuts. In addition, the employment rate rose while the economic inactivity rate and number of vacancies fell.

The BoE's Monetary Policy Committee (MPC) cut Bank Rate from 4.5% to 4.25% in May and to 4.0% in August after an unprecedented second round of voting. The final 5-4 vote was for a 25bps cut, with the minority wanting no change. In September, seven MPC members voted to hold rates while two preferred a 25bps cut. The Committee's views still differ on whether the upside risks from inflation expectations and wage setting outweigh downside risks from weaker demand and growth.

The August BoE Monetary Policy Report highlighted that after peaking in Q3 2025, inflation is projected to fall back to target by mid-2027, helped by increasing spare capacity in the economy and the ongoing effects from past tighter policy rates. GDP is expected to remain weak in the near-term while over the medium term outlook will be influenced by domestic and global developments.

Arlingclose, the authority's treasury adviser, maintained its central view that Bank Rate would be cut further as the BoE focused on weak GDP growth more than higher inflation. One more cut is currently expected during 2025/26, taking Bank Rate to 3.75%. The risks to the forecast are balanced in the near-term but weighted to the downside further out as weak consumer sentiment and business confidence and investment continue to constrain growth. There is also considerable uncertainty around the autumn Budget and the impact this will have on the outlook.

Against a backdrop of uncertain US trade policy and pressure from President Trump, the US Federal Reserve held interest rates steady for most of the period, before cutting the Fed Funds Rate to 4.00%-4.25% in September. Fed policymakers also published their new economic projections at the same time. These pointed to a 0.50% lower Fed Funds Rate by the end of 2025 and 0.25% lower in 2026, alongside GDP growth of 1.6% in 2025, inflation of 3%, and an unemployment rate of 4.5%.

The European Central Bank cut rates in June, reducing its main refinancing rate from 2.25% to 2.0%, before keeping it on hold through to the end of the period. New ECB projections predicted inflation averaging 2.1% in 2025, before falling below target in 2026, alongside improving GDP growth, for which the risks are deemed more balanced and the disinflationary process over.

<u>Financial markets</u>

After the sharp declines seen early in the period, sentiment in financial markets improved, but risky assets have generally remained volatile. Early in the period bond yields fell, but ongoing uncertainty, particularly in the UK, has seen medium and longer yields rise with bond investors requiring an increasingly higher return against the perceived elevated risk of UK plc. Since the sell-off in April, equity markets have gained back the previous declines, with investors continuing to remain bullish in the face of ongoing uncertainty.

Over the period, the 10-year UK benchmark gilt yield started at 4.65% and ended at 4.70%. However, these six months saw significant volatility with the 10-year yield hitting a low of 4.45% and a high of 4.82%. It was a broadly similar picture for the 20-year gilt which started at 5.18% and ended at 5.39% with a low and high of 5.10% and 5.55% respectively. The Sterling Overnight Rate (SONIA) averaged 4.19% over the six months to 30th September.

Credit review

Arlingclose maintained its recommended maximum unsecured duration limit on the majority of the banks on its counterparty list at 6 months. The other banks remain on 100 days.

Early in the period, Fitch upgraded NatWest Group and related entities to AA- from A+ and placed Clydesdale Bank's long-term A- rating on Rating Watch Positive. While Moody's downgraded the long term rating on the United States sovereign to Aa1 in May and also affirmed OP Corporate's rating at Aa3.

Then in the second quarter, Fitch upgraded Clydesdale Bank and also HSBC, downgraded Lancashire CC and Close Brothers while Moody's upgraded Transport for London, Allied Irish Banks, Bank of Ireland and Toronto-Dominion Bank.

After spiking in early April following the US trade tariff announcements, UK credit default swap prices have since generally trended downwards and ended the period at levels broadly in line with those in the first quarter of the calendar year and throughout most of 2024.

European banks' CDS prices has followed a fairly similar pattern to the UK, as have Singaporean and Australian lenders while Canadian bank CDS prices remain modestly elevated compared to earlier in 2025 and in 2024.

Overall, at the end of the period CDS prices for all banks on Arlingclose's counterparty list remained within limits deemed satisfactory for maintaining credit advice at current durations.

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.