

Treasury Management Mid-Year Review 2025/26

Introduction

In March 2021 the Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Authority to approve, as a minimum, treasury management mid-year and annual outturn reports.

The Authority's treasury management strategy for 2025/26 was approved at Council on 26th February 2025. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Authority's treasury management strategy.

External Context

Economic background: 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 with no change in September, still well above the Bank of England's 2% target.

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% year on year. However, monthly figures showed zero growth in July, in line with expectations, indicating a sluggish start to Q3.

The BoE's Monetary Policy Committee (MPC) cut Bank Rate from 4.5% to 4.25% in May and to 4.0% in August. 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.

Financial markets: 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.

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.

Local Context

On 31st March 2025, the Authority had net borrowing of £48.5m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.25 Actual £m	31.3.26 Forecast £m
General Fund CFR	61.8	68.5
Less: *Other debt liabilities	-	-
External borrowing**	64.5	66.5
Internal / (over) borrowing	(2.7)	2.0
Less: Balance sheet resources	(34.1)	(18.0)
Net Borrowing (External borrowing - Balance sheet resources)	30.4	48.5

* 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 Ave. Rate %
Long-term borrowing				
- PWLB	1.5	-	1.5	8.875
- LOBOs	-	-	-	-
- Other	-	-	-	-
Short-term borrowing	63.0	(3.0)	60.0	4.57
Total borrowing	64.5	(3.0)	61.5	
Long-term investments *	(9.9)	9.9	-	-
Short-term investments **	(2.9)	0.3	(2.6)	-
Cash and cash equivalents	(21.3)	(5.5)	(26.8)	3.97
Total investments ***	(34.1)	4.7	(29.4)	
Net borrowing	30.4	1.7	32.1	

* Reduction in long-term investments is due to the return of property funds & reclassification to short term investments.

** Short term investments relate to Lothbury Property Fund, moved from long term investments due to the fund being wound down.

*** Although property funds have been returned, investment levels, as at 30.09.25 have still reduced due to large expenditure items e.g. waste vehicles and bins, parish precepts.

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 first of this year 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 plans to borrow to invest primarily for financial return.

Loans Portfolio: At 30th September the Authority held £61.5m of loans, a decrease of £3m from 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 3 below.

Table 3: Borrowing Position

	31.3.25 Balance £m	Net Movement £m	30.9.25 Balance £m	30.9.25 Rate %	30.9.25 Maturity (years)
Public Works Loan Board	1.5	-	1.5	8.875	30 yrs
Public Works Loan Board	25.0	-	25.0	4.840	<1 yr
Public Works Loan Board	25.0	-	25.0	4.860	<1 yr
Local authorities (short-term)	10.0	-	10.0	4.150	<1 yr
Local authorities (short-term)	3.0	(3.0)	-	-	
Total borrowing	64.5	(3.0)	61.5		

The Authority is still opting to keep most borrowing short term, waiting for the longer term PWLB certainty rate to reduce.

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

Loans restructuring: The continuing rise in gilt yields since early 2022 resulted in some local authority PWLB loans being in or close to a discount position if repaid early. Unfortunately, due to the high-interest rate East Herts is locked into we are not yet in a discounted but are constantly reviewing this position with our advisors Arlingclose.

Other Debt Activity

None.

Treasury Investment Activity

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

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the half year, the Authority’s investment

balances ranged between £35 and £26 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.25 Balance £m	Net Movement £m	30.9.25 Balance £m	30.9.25 Income Return %	30.9.25 Weighted Average Maturity days
Banks & building societies (unsecured)	9.5	(0.2)	9.3	3.77	Call
Government	-	10.2	10.2	3.96	20 Days
Local authorities and other govt entities	7.0	(7.0)	-	-	-
Money Market Funds	4.8	2.5	7.3	4.18	Call
Property Funds	12.8	(10.2)	2.6	-	N/A
Total investments	34.1	(4.7)	29.4		

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

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

Bank Rate reduced from 4.50% to 4.25% in May 2025, followed by a further reduction to 4.00% in August 2025. Short term interest rates have largely followed these levels. The rates on DMADF deposits ranged between 4.45% and 3.95% and money market rates between 4.5% and 3.9%.

Externally Managed Pooled Funds: The Authority held two property funds at the beginning of the financial year, both of which were being wound down. One fund has now been returned, the other is still being wound down but likely to complete by the end of the financial year.

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 most notable market shock came early in the period when US President Trump announced his 'Liberation Day' tariffs on 2 April, triggering sharp falls in global equity and bond markets. Sentiment improved once the US administration softened its stance and markets recovered relatively swiftly, although uncertainty lingered.

Global trade tensions easing, resilient profits, optimism on artificial intelligence, interest rate cuts, rising gold prices, and other factors contributed to equity markets generally performing strongly across the half year despite economic uncertainties. The likes of the S&P 500 in the US and FTSE 100 in the UK hit all-time highs during the period.

Fixed income (bond) markets remained volatile as investors weighed political risks alongside concerns over fiscal sustainability. While not matching the strength of equities, corporate bonds generally achieved positive returns. However major longer-dated government bonds saw a rise in yields over the period (meaning prices fell), particularly in the UK where concerns over fiscal issues and sticky inflation saw 30-year gilt yields reaching highs not seen since the late 1990s.

The gradual improvement in UK commercial property continued. Capital values recorded marginal gains, while total returns were driven largely by rental income.

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 1 April 2029 for investments already in place before 1 April 2024. The override will not apply to any new investments taken out on or after 1 April 2024. The Authority is using its interest equalisation reserve to mitigate any losses on principal value, from the two property funds, that we held. One fund has already been returned, and the last fund is almost completely wound down, with the last few asset sales expected to complete by year end. Therefore, we should be unaffected by the statutory override as we have no plans to invest in pooled funds in the future.

Non-Treasury Investments

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

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

The Authority also held £5.156m of such investments in

- shareholding in subsidiaries £1.656m
- loans to subsidiaries £3.5m

Which represents the Authorities loans to and shareholding in Millstream Property Investments Ltd.

Compliance

The Director for Finance, Risk and Performance 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 5 below.

Table 5: Investment Limits

	2025/26 Maximum	30.9.25 Actual	2025/26 Time Limit	Complied
The UK Government	Unlimited	£10.2m	50 years	Yes
Local authorities & other government entities	£20m	-	3 years	Yes
Secured investments *	£20m	-	3 years	Yes
Banks (unsecured) *	£20m	£9.3m	13 months	Yes
Building societies (unsecured) *	£20m	-	13 months	Yes
Registered providers (unsecured) *	£5m	-	3 years	Yes
Money market funds *	£20m	£7.3m	n/a	Yes
Strategic pooled funds	£20m	£2.6m	n/a	Yes
Real estate investment trusts	£20m	-	n/a	Yes
Other investments *	£1m	-	3 years	Yes

Compliance with the Authorised Limit and Operational Boundary for external debt is demonstrated in table 6 below.

Table 6: Debt and the Authorised Limit and Operational Boundary

	30.9.25 Actual	2025/26 Operational Boundary	2025/26 Authorised Limit	Complied?
Borrowing	£61.5m	£75m	£100m	Yes
PFI and Finance Leases	-	N/A	N/A	Yes
Total debt	£61.5m	-	-	-

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

Treasury Management Prudential Indicators

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

1. Liability Benchmark:

This indicator compares the Authority's actual existing borrowing against a liability benchmark that has been calculated to show the lowest risk level of borrowing. The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. It represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level of £5m required to manage day-to-day cash flow.

	31.3.25 Actual	31.3.26 Forecast
CFR	61.8	68.5
Less: Balance sheet resources	(36.6)	(20.0)
Net loans requirement	25.2	48.5
Plus: Liquidity allowance	5.0	5.0
Liability benchmark	30.2	53.5
Existing borrowing	64.5	68.0

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%	97.6%	Yes
12 months and within 24 months	100%	0%	0%	Yes
24 months and within 5 years	50%	0%	0%	Yes
5 years and within 10 years	50%	0%	0%	Yes
10 years and above	75%	0%	2.4%	Yes

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

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

	2025/26	2026/27	2027/28	No fixed date
Limit on principal invested beyond year end	£0m	£0m	£0m	£10m
Actual principal invested beyond year end	£0m	£0m	£0m	£0m
Complied	Yes	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.

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

	<u>01/04/25</u>	<u>30/09/25</u>
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%