

AGENDA ITEM xx

**REPORT TO AUDIT AND
GOVERNANCE COMMITTEE**

24 NOVEMBER 2025

**REPORT OF CHIEF FINANCE
OFFICER**

TREASURY MANAGEMENT STRATEGY MID YEAR REPORT 2025/26

SUMMARY

This report informs Members of the performance against the treasury management and prudential indicators set in the 2025-26 Treasury Management & Capital Strategy reports approved by Council in February 2025.

Introduction

The Authority has 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 treasury management semi-annual and annual reports.

The Authority's Treasury Management Strategy for 2024/25 was approved by Council on 19th 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

Arlingclose, Stockton's Treasury Management advisors, have provided us with the following commentary on the external environment.

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%. 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.

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 most 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 affirmed OP Corporate's rating at Aa3.

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

Overall, at the end of the period 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 £111.43m 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 usable reserves and working capital 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
General Fund CFR	195.86
Less: Other debt liabilities	-9.15
Borrowing CFR	186.71
Less: Usable reserves	-86.15
Add: Working capital	10.87
Net Borrowing / (Investments)	111.43

The treasury management position at 30th September 2025 and the change over the six-month period is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.25 Balance £m	Movement £m	30.9.25 Balance £m
Long-term borrowing	86.07	-23.63	62.44
Short-term borrowing	64.71	0.33	65.04
Total borrowing	150.78	-23.30	127.48
Long-term investments	-13.28	-0.03	-13.31
Short-term investments	0.00	0.00	0.00
Cash and cash equivalents	-26.07	5.42	-20.65
Total investments	-39.35	5.39	-33.96
Net Borrowing	111.43	-17.91	93.52

Borrowing Strategy and Activity

As outlined in the treasury strategy, the Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low 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 H1 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.

At 30th September 2025 the Authority held £127.48m of loans, a decrease of £23.30m since 31st March 2025. This is due to the repayment of a short-term loan that has not been replaced and the repayment of principal on long term loans. Outstanding loans on 30th September 2025 are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.25	Q2	30.9.25	30.9.25	30.9.25
	Balance	Net	Balance	Weighted	Weighted
	£m	Movement	£m	Average	Average
		£m		Rate	Maturity
				%	(years)
Public Works Loan Board	73.39	-3.29	70.10	3.45	10.63
Banks (LOBO)	16.00	0.00	16.00	4.87	12.69
Local Authorities	61.39	-20.01	41.38	4.68	0.19
Others (fixed term)	0.00	0.00	0.00	2.50	0.84
Total borrowing	150.78	-23.30	127.48	4.00	8.02

LOBO loans: At the 30th September the Authority held £16m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the first six months of the year.

Over the medium term it is estimated the authority, based on the current capital programme and the fact the authority has internally borrowed over the previous years will be required to undertake significant borrowing. In the higher rate environment that we are currently operating in this will mean higher costs of borrowing. Future borrowing requirements and financial requirements are currently being analysed, and information will be provided as part of future MTFP and Treasury reports.

Treasury Investment Activity

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

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances fluctuated due to timing differences between income and expenditure. The investment position at the end of September is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.25 Balance £m	Net Movement £m	30.9.25 Balance £m
Banks & building societies (unsecured)	-0.57	0.52	-0.05
Government (incl. local authorities)	-3.20	3.20	0.00
Property Fund	-13.28	-0.03	-13.31
Shares / Cash	0.00	0.00	0.00
Money Market Funds	-22.30	1.70	-20.60
Total investments	-39.35	5.39	-33.96

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.

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 3.95% and 4.45% and money market rates between

3.95% and 4.5%.

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	WAM* (days)	Rate of Return %
31.03.2025	4.58	A+	87%	2	4.28%
30.06.2025	4.58	A+	87%	2	4.48%
30.09.2025	4.69	A+	100%	1	4.36%
Similar LAs	4.55	A+	62%	95	4.32%
All LAs	4.54	A+	62%	11	4.20%

*Weighted average maturity

Externally Managed Pooled Funds: £13.31m of the Authority's investments are held in an externally managed strategic pooled property fund where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. The fund generated a return of £0.664m (4.43%) during 2024/25 and has generated £0.302m (4.15%) in dividend payments for the first six months of the year. This income is being used to support the medium-term financial plan.

Because the Authority's externally managed funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's 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 will discuss with Arlingclose the implications for the investment strategy and what action may need to be taken.

The Authority has set up a reserve of £1.962m to mitigate the impact of the statutory override not being extended and unrealised losses on pooled investment funds are required to be recognised.

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 Department for Levelling Up Housing and Communities (DLUHC) and Welsh Government also includes within the definition of investments all such assets held partially or wholly for financial return.

The Council also held £18.551m of such investments in;

- directly owned property £18.322m
- loans to local businesses £0.025m
- other £0.204m

These investments generated £0.931m of investment income for the Council after taking account of direct costs in 2024/25 representing a rate of return of 5.02%.

Compliance

The Chief Finance Officer reports that most of the treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated below.

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

	Maximum in Year £m	30.9.25 Actual £m	2025/26 Operational Boundary £m	2025/26 Authorised Limit £m	Complied? Yes/No
Borrowing	157.14	127.48	212.30	227.30	
PFI and Finance Leases	5.06	5.06	5.06	5.06	
Total debt	162.20	132.54	217.36	232.36	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.

Compliance with specific investment limits is demonstrated in table 7 below;

Table 7: Investment Limits

Sector	Counterparty limit	Sector limit	Maximum	30.9.25 Actual	Complied? Yes/No
The UK Government	Unlimited	n/a	£8,200,000	£0	Yes
Local authorities & other government entities	£5,000,000	Unlimited	£0	£0	Yes
Secured investments	£5,000,000	Unlimited	£0	£0	Yes
Banks (unsecured)	£2,500,000	Unlimited	£460,000	£46,000	Yes
Building societies (unsecured)	£2,500,000	£5,000,000	£0	£0	Yes
Registered providers (unsecured)	£2,500,000	£12,500,000	£0	£0	Yes
Money market funds	£5,000,000	Unlimited	£25,000,000	£20,600,000	Yes
Strategic pooled funds	£15,000,000	£25,000,000	£13,309,000	£13,309,000	Yes
Real estate investment trusts	£5,000,000	£12,500,000	£0	£0	Yes
Other investments	£2,500,000	£5,000,000	£0	£0	Yes

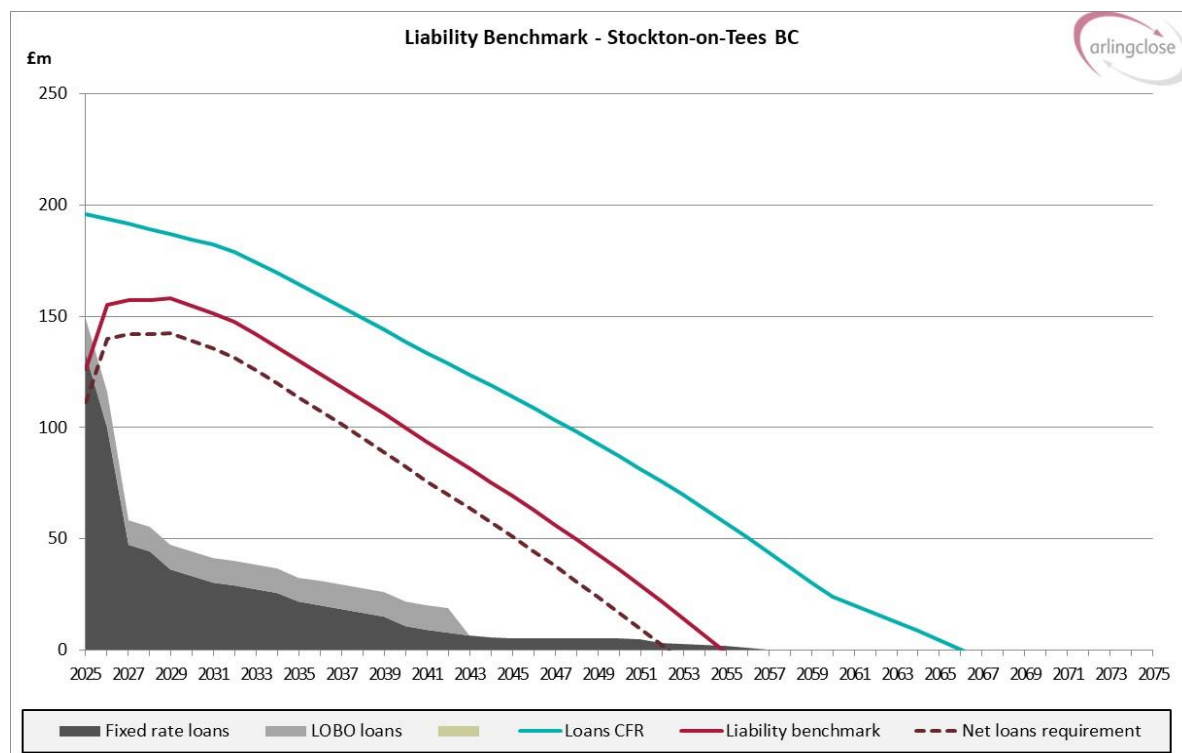
Treasury Management Indicators

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

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 a level required to manage day-to-day cash flow.

	31.3.25 Actual £m	31.3.26 Forecast £m	31.3.27 Forecast £m	31.3.28 Forecast £m
Loans CFR	195.9	193.7	191.5	189.3
External Borrowing	-150.8	-118.0	-60.1	-57.2
Internal (over) Borrowing	45.1	75.7	131.4	132.0
Less: Balance sheet resources	-84.4	-53.9	-49.6	-47.4
Investments (New Borrowing)	-39.3	21.9	81.8	84.7
Treasury Investments	39.3	15.2	15.3	15.5
New Borrowing	0.0	37.0	97.1	100.1
Net Loans Requirement	111.4	139.9	141.9	141.9
Liquidity Allowance	15.0	15.2	15.3	15.5
Liability Benchmark	126.4	155.0	157.2	157.4

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



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

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:

	30.9.25 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	51.02%	25%	0%	No
12 months and within 24 months	0.00%	40%	0%	Yes
24 months and within 5 years	10.25%	60%	0%	Yes
5 years and within 10 years	1.99%	80%	0%	Yes
10 years and above	36.74%	100%	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. Due to the strategy of only taking out short term loans the upper limit indicator for the percentage of total loans under 12 months was breached. Once longer-term interest rates reduce the authority will replace short term loans with longer term loans.

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:

	2024/25	2025/26	2026/27
Actual principal invested beyond year end	£13.28m	£13.31m	£13.50m
Limit on principal invested beyond year end	£60m	£40m	£20m
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.

Prudential Indicators

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

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

	2024/25 actual	2025/26 forecast	2026/27 budget	2027/28 budget
General Fund Services	£56.568m	£93.591m	£54.343m	£38.903m

The main focus of future capital expenditure will be centred around various town centre redevelopment schemes, Splash Redevelopment and highways and bridge works.

Capital Financing Requirement: The Authority'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 budget	31.3.2028 budget
General Fund CFR	£195.86m	£207.81m	£218.63m	£253.48m

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 budget	31.3.2028 budget
Debt	£150.78m	£187.20m	£213.49m	£250.63m
Capital Financing Requirement	£195.86m	£207.81m	£218.63m	£253.48m

Net Income from Commercial and Service Investments to Net Revenue Stream: The Authority'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 budget	2027/28 budget
Total net income from service and commercial investments £m	£0.931m	£0.903m	£0.903m	£0.903m
Proportion of net revenue stream	0.49%	0.48%	0.46%	0.45%

The table identifies that the authority is not reliant on commercial and service investment income to maintain its core functions.

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 budget	2027/28 budget
Financing costs (£m)	£4.3m	£9.0m	£10.1m	£10.4m
Proportion of net revenue stream	2.3%	4.6%	5.0%	5.0%

Arlingclose - Economic and Interest Rate Forecast 10th November 2025

The economic data, monetary and fiscal commentary have heightened the downside risks to our Bank Rate forecast, making rate cuts beyond 3.75% increasingly likely. As noted in the September forecast, however, we expect the Budget on 26th November 2025 to be the deciding factor for the path for interest rates. We will therefore review our interest rate forecast after this event.

The MPC maintained Bank Rate at 4.0% in a dovish 5-4 vote, but a cut to 3.75% looks increasingly likely as the Governor teeters precariously on the divide between the hold and cut camps. While denying the Budget was an influence on his decision, it surely played into his desire to have more information before easing policy.

Inflation surprised by holding at 3.8% in September and is forecast to fall to 3.5% by year end. However, household inflation expectations have picked up, likely largely the result of the noticeable rise in food prices, feeding caution among some policymakers.

While services inflation remains somewhat elevated, spare capacity has opened up in the labour market and wage growth is moderating, which should place further downward pressure on inflation. Continuation of the rapid growth in administered prices is also unlikely to occur to the same extent.

Underlying GDP growth remains subdued. While 2025 has been relatively strong, Q3 GDP growth has slowed, with July/August's figures suggesting a lack of momentum. Business investment is lacklustre and private sector output constrained by weaker domestic demand and spending. Ongoing uncertainty over the global outlook is still discouraging capital investment, particularly in the manufacturing sector. Downside risks persist, most notably the high probability of a tighter fiscal environment after the Budget, which may place downward pressure on consumption and growth.

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