Treasury Management

Borrowing and Investments

1. The table below shows the year's opening balance of borrowing and investments, current levels and those predicted for year-end. Forecast borrowing is currently based on month 9 capital monitoring and will be subject to review during the year.

Lower official interest rates have continued to lower the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing. The Authority maintained its strategy of keeping borrowing and investments below their underlying levels in order to reduce risk and make a net saving.

2.

	31-Mar-21 Actual £M	31-Mar-21 Average %	31-Dec-21 Actual £M	31-Dec-21 Average %	31-Mar-22 Forecast £M	31-Mar-22 Forecast %
Long Term Borrowing						
Public Works Loan	222.59	2.72	249.84	2.74	344.49	2.75
LOBO Loans from Banks	9.00	4.86	9.00	4.86	9.00	4.86
	231.59	**2.75**	**258.84**	**2.88**	**353.49**	**2.82**
Short Term Borrowing						
Other Local Authorities	10.00	0.28	0.00	0.00	10.00	0.04
Other	0.36	0.28	0.36	0.33	0.36	0.00
Total External Borrowing	**241.95**	**2.75**	**259.20**	**2.82**	**363.85**	**2.78**
Other Long Term Liabilities						
PFI Schemes	50.97	9.16	49.25	8.82	47.52	9.65
Deferred Debt Charges (HCC)	13.47	2.13	13.29	2.61	13.10	2.09
Total Gross External Debt	**306.39**	**3.78**	**321.73**	**4.08**	**424.47**	**3.81**
Investments:						
Managed In-House						
Government & Local Authority	0.00	0.00	(31.46)	0.05		
Cash (Instant access)	(30.13)	0.01	(43.84)	0.05	(10.00)	0.01
Cash (Notice Account)	0.00	0.00	0.00	0.00	0.00	0.00
Long Term Bonds	(3.17)	5.30	(1.06)	5.27	(1.10)	5.27
Managed Externally						
Pooled Funds (CCLA) & Shares	(27.00)	4.16	(27.00)	3.54	(27.00)	3.00
Total Investments	**(60.30)**	**4.26**	**(103.36)**	**2.68**	**(38.10)**	**2.28**
Net Debt	**246.09**		**218.37**		**386.37**	

3. After taking into account maturing and new debt requirements in year and a forecast reduction in investment balances, net borrowing is expected to increase by £140.28M for the year.

This will change throughout the year as capital plans firm up and actual cash flow are known and will be reported at the next quarter.

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

Borrowing

5. The forecast cost of financing the council's loan debt is £15.21M of which £4.90M relates to the HRA, however this will be subject to movement as the need for further borrowing for the remainder of the year becomes more certain.

6. Short term interest rates have remained low and are likely to do so for the remainder of the year and offer good value, which we will utilise to fund any further borrowing needs in the year, unless an opportunity arises to secure a long term loan at advantageous rates or to provide certainty for the portfolio.

Although we currently do not have any short term debt, we anticipate borrowing before year end to replace maturing long term debt, expected reduction in reserves and to fund the forecast capital programme for the year, until a decision is taken with regards to long term borrowing. Any increase in short term borrowing costs will be offset by a reduction in long term costs. This is later than previously reported as cash flows have remained higher than expected.

7. The Authority has previously raised the majority of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Authority intends to avoid this activity in order to retain its access to PWLB loans.

8. During the year 3 loans have been taken from the PWLB; these have been in respect of the HRA for unfinanced debt as the 31 March 2021 as part of the HRA 40 year business plan. Rates have been monitored during the year and timing of loans has been taken in consultation of our advisors to secure rates when rates have dipped in the year. Details are shown below:

Long Term Loans	Amount £M	Rate %	Period (Years)
PWLB EIP Loan 1	11.00	1.45%	20
PWLB EIP Loan 2	11.00	1.44%	20
PWLB Maturity Loan 1	11.00	1.50%	40
Total Borrowing	**33.00**		

Investment

9. The Authority received central government funding to support small and medium businesses during the coronavirus pandemic through grant schemes which was temporarily invested in short-dated, liquid instruments such as call accounts and Money Market Funds and led to higher than expected cash flow whilst the cash was being disbursed. Investment balances have ranged between £122.96M and £43.02M during the year and are currently £103.36M but are expected to reduce to £38M by year end.

Continued downward pressure on short-dated cash means net returns on money market funds are low between 0.08% and zero even after some managers have temporarily lowered their fees. This supports our decision to only borrow for cash flow purposes at this stage as savings on borrowing costs more than offset the loss on short term investments.

Following the increase in the base rate to 0.25% in December interest rates on short term investments are expected to rise during the next quarter.

The impact of COVID-19 will continue during the year and will be reported at each quarter and as part of Treasury Reports to Governance Committee.

External Managed investments

10. The council has invested £27M in property funds as an alternative to buying property directly. As previously reported these funds offer the potential for enhanced returns over the longer term but may be more volatile in the shorter term and are managed by professional fund managers which allows the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments.

11. Because these funds have no defined maturity date but are usually available for withdrawal after a notice period (90 days), their performance and continued suitability in meeting the Authority's investment objectives is regularly reviewed.

12. 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. In light of their performance over the long-term and the Authority's latest cash flow forecasts, investment in these funds has been maintained.

13. The market has continued to improve since year end when the value was reported at and at £26.28M and at December 2021 has a value of £29.53M (September 2021, £28.11M) an increase of £3.25M since March and is now £2.53M above the initial investment of £27M.

The dividend for April to December has been estimated at £0.26M, 3.78% against the original investment. This is lower than 2020/21 which was boosted by a significant level of one-off receipts. If rates remain at this level the total forecast dividend for the year is £1.03M.

Financial Review and Outlook

14. A summary of the external factors, which sets the background for Treasury, as provided by the council's treasury advisors, Arlingclose Ltd, is summarised below. The low for longer interest rate outlook theme that has been at the core of the recommended strategic advice for over a decade remains.

Arlingclose's Economic Outlook for the remainder of 2021/22 (based on the December 2021 interest rate forecast)

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25

15. The economic interest rate outlook provided by the Council's treasury advisor, Arlingclose Ltd, for December 2021 is detailed below and is based on the following Underlying Assumptions:

- The global recovery from the pandemic has entered a more challenging phase. The resurgence in demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. The advent of the Omicron variant of coronavirus is affecting activity and is also a reminder of the potential downside risks.
- Despite relatively buoyant activity survey data, official GDP data indicates that growth was weakening into Q4 2021. Other data, however, suggested continued momentum, particularly for November. Retail sales volumes rose 1.4%, PMIs increased, and the labour market continued to strengthen. The end of furlough did not appear to have had a significant impact on unemployment. Wage growth is elevated.
- The CPI inflation rate rose to 5.1% for November and will rise higher in the near term. While the transitory factors affecting inflation are expected to unwind over time, policymakers' concern is persistent medium term price pressure.
- These factors prompted the MPC to raise Bank Rate to 0.25% at the December meeting. Short term interest rate expectations remain elevated.
- The outlook, however, appears weaker. Household spending faces pressures from a combination of higher prices and tax rises. In the immediate term, the Omicron variant has already affected growth – Q4 and Q1 activity could be weak at best.
- Longer-term government bond yields remain relatively low despite the more hawkish signals from the BoE and the Federal Reserve. Investors are concerned that significant policy tightening in the near term will slow growth and prompt the need for looser policy later. Geo-political and coronavirus risks are also driving safe haven buying. The result is a much flatter yield curve, as short-term yields rise even as long-term yields fall.
- The rise in Bank Rate despite the Omicron variant signals that the MPC will act to bring inflation down whatever the environment. It has also made clear its intentions to tighten policy further. While the economic outlook will be challenging, the signals from policymakers suggest their preference is to tighten policy unless data indicates a more severe slowdown.

16. Arlingclose expects Bank Rate to rise again in Q1 2022, they believe the MPC will want to build on the strong message it delivered in December month by tightening policy despite Omicron uncertainty.

Arlingclose therefore expects Bank Rate to rise to 0.50% in Q1 2022, but then remain there. Risks to the forecast are initially weighted to the upside but becoming more balanced over time. The Arlingclose central forecast remains below the market forward curve.

Gilt yields are expected to remain broadly flat from current levels. Yields have fallen sharply at the longer end of the yield curve, but expectations of a rise in Bank Rate have maintained short term gilt yields at higher levels.

Easing expectations for Bank Rate over time could prompt the yield curve to steepen, as investors build in higher inflation expectations.

The risks around the gilt yield forecasts vary. The risk for short and medium term yields is initially on the upside but shifts lower later. The risk for long-term yields is weighted to the upside.

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	<u>Credit background</u>
17.	Since the start of 2021, relatively benign credit conditions have led to credit default swap (CDS) prices for the larger UK banks to remain low and had steadily edged down throughout the year up until mid-November when the emergence of Omicron has caused them to rise modestly. However, the generally improved economic outlook during 2021 helped bank profitability and reduced the level of impairments many had made as provisions for bad loans. However, the relatively recent removal of coronavirus-related business support measures by the government means the full impact on bank balance sheets may not be known for some time.
18.	The improved economic picture during 2021 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several financial institutions, revising them from negative to stable and even making a handful of rating upgrades.
19.	The ongoing vaccine rollout programme is credit positive for the financial services sector in general but there remains uncertainty around the full extent of the losses banks and building societies will suffer due to the pandemic-related economic slowdown, but the sector is in a generally better position now compared to earlier this year and 2020. At the end of the period Arlingclose had completed its full review of its credit advice on unsecured deposits for UK and non-UK institutions whereby the maximum duration for all recommended counterparties were extended to 100 days. As ever, the institutions and durations on the Authority's counterparty list recommended by treasury management advisors Arlingclose remain under constant review.
	<u>Investment Performance</u>
20.	The council's advisors undertake quarterly investment benchmarking across its client base. As reported previously our portfolio was more diversified and at higher interest rates than the average as a result of moving into the bond programme earlier than most clients, but there is now more competition for bonds from both government bodies and other local authorities, so opportunities to replace maturing bonds are limited and we will see a fall in suitable instruments. With this in mind, and following discussions with our advisors, it was decided to move more into property funds, which are a longer term investment, and to short term investments for cash flow purposes.
21.	Our current investments in bonds has reduced from £3M to £1M following maturities in 2021/22 and we maintained the property funds at £27M, with all other cash being placed in short term deposits as shown in paragraph 2.
22.	As detailed in paragraph 11 our cash balances have continued to be higher than forecast. As a result, we had £75.30M in short term investment which is above our normal working balances. Our target is to reduce this to a £10M working balance to reduce borrowing and therefore net interest costs but this will be dependent on actual capital spend and movement in balances.
23.	Investments managed internally are currently averaging a return of 0.12% which is slightly higher than the average unitary authority at 0.08% whilst maintaining a higher average credit rating at AA-. Total income returns at 1.20% is also higher than the average for both unitary

	(0.69%) and LA's (0.66%), this is primarily due to historic investment in EIB bonds which return 5.27%, although on a small balance of £1M, since maturities cannot be replaced at the same level. We hold 28% of our investments in strategic funds which offer higher return over the long term as detailed in paragraphs 11 to 14 above. This is higher than the average but in line with our strategy. In addition, due to the increase in the capital value of our external funds of +14.76% our total investment return at 5.32% is significantly higher than the average LA's at 1.95% and the average unitary at 2.46% across Arlingclose's client base, but as previously reported it is the income return that is the driver to invest plus, they are deemed less risky than buying individual properties and do not constitute capital spend.
	<u>Revision to CIPFA Codes</u>
24.	CIPFA published revised Prudential and Treasury Management Codes in December 2021. The Prudential Code takes immediate effect although detailed reporting requirements may be deferred until the 2023/24 financial year and not been included in this report whilst we are reviewing the impact of the proposed changes. There is no mention of the date of initial application of the TM Code.
25.	The accompanying guidance notes to the Codes including the treasury management prudential indicators have not yet been published. The main changes or expected changes from previous codes include: • Additional reporting requirements for the Capital Strategy. • For service and commercial investments, in addition to assessments of affordability and prudence, an assessment of proportionality in respect of the Authority's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services). • Forward looking prudential code indicators must be monitored and reported to members at least quarterly. • A new indicator for net income from commercial and service investments to net revenue stream. • Inclusion of the liability benchmark as a treasury management prudential indicator. CIPFA recommends this is presented as a chart of four balances – existing loan debt outstanding; loans CFR, net loans requirement, liability benchmark – over at least 10 years and ideally cover the authority's full debt maturity profile. • Excluding investment income from the definition of financing costs. • Credit and counterparty policies should set out the Authority's policy and practices relating to Environmental, Social and Governance (ESG) investment considerations. • Additional focus on the knowledge and skills of officers and elected members involved in decision making
26.	We are currently reviewing the impact of the proposed changes which could have an impact on us holding long term investments such as CCLA. Early indications are that future long term investments will be prohibited but we will not need to unwind existing investments. A further update will be included in future reports.