SUBJECT:	**MID-YEAR TREASURY REPORT 2022/23**
MEETING:	**Governance & Audit Committee**
DATE:	**24th November 2022**
DIVISION/WARDS AFFECTED:	**Whole Authority**

1 PURPOSE

1.1 To provide a periodical update on treasury management activity for the first six months of the financial year 2022/23 in accordance with best practice and the requirements of the Authority's Treasury Management Strategy Statement for 2022/23.

2 RECOMMENDATIONS

2.1 That Governance & Audit Committee review and comment on the treasury management activities for the first six months of 2022/23, and note that all treasury and prudential indicators set as part of the Treasury strategy approved by full Council have been adhered to during the period.

3 KEY ISSUES

3.1 During the first six months of 2022/23, the Authority's treasury management activity was underpinned by 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 to allow scrutiny of the treasury management process. The Cipfa Code requires the Authority to have regard to the security & liquidity of its investments before seeking additional investment returns.

3.2 The Authority's treasury management strategy for 2022/23 was approved at Council on the 3rd March 2022. The Authority has since 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.

3.3 CIPFA published its revised Treasury Management Code of Practice [the TM Code] and Prudential Code for Capital Finance in December 2021. The key changes in the two codes are around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments. The principles within the two Codes took immediate effect although local authorities could defer introducing the revised reporting requirements until the 2023/24 financial year if they wish, which the Authority has elected to do.

External influences

3.4 The first six months of the 2022/23 financial year has seen a hugely turbulent period of economic uncertainty, driven initially by the ongoing conflict in Ukraine that has continued to put pressure on global inflation and with the economic outlook for UK and world growth remaining weak. The UK political situation towards the end of the period following the ‘fiscal event’ increased uncertainty further.

3.5 The economic backdrop during the April to September period continued to be characterised by high oil, gas and commodity prices, ongoing high inflation and its impact on consumers’ cost of living, no imminent end in sight to the Russia-Ukraine hostilities and its associated impact on the supply chain, and China’s zero-Covid policy.

3.6 On 23rd September the UK government, announced a raft of measures in a ‘mini budget’, loosening fiscal policy with a view to boosting the UK’s trend growth rate to 2.5%. With little detail on how government borrowing would be returned to a sustainable path, financial markets reacted negatively. Gilt yields rose dramatically by between 0.7% - 1% for all maturities with the rise most pronounced for shorter dated gilts.

3.7 The swift rise in gilt yields left pension funds vulnerable, as it led to margin calls on their interest rate swaps and risked triggering large scale redemptions of assets across their portfolios to meet these demands. It became necessary for the Bank of England to intervene to preserve market stability through the purchase of long-dated gilts, albeit as a temporary measure, which has had the desired effect with 50-year gilt yields falling over 100bps in a single day.

3.8 **Monmouthshire activity during the period**

	31.3.22 Balance £m	31.3.22 Rate %	Weighted Average Durations	Net Movement £m	30.09.22 Balance £m	30.09.22 Rate %	Weighted Average Durations
Borrowing	175.5	2.0	14 Years	(11.0)	164.5	2.8	18.4 Years
Investments	48.0	0.4	4 Days	(19.9)	28.1	2.7	16 days

3.9 At the 31st March 2022 the Authority had a borrowing Capital Financing Requirement (CFR) of £187.0m and total external borrowing of £175.5m. Total borrowing reduced considerably by £11.0m to £164.5m during the period, however our weighted average interest rate payable has increased from 2.0% to 2.8%, reflective of a rising interest rate environment.

3.10 Short-term borrowing interest rates have increased significantly over the period increasing borrowing costs for the authority. As an example, the rate for six-month borrowing has increased from 0.90% at the end of March to 3.90% at the end of September. Some of these increased costs have been mitigated through locking in lower rates through forward starting loans.

3.11 In an environment of increasing interest rates and further turbulence in financial markets following September’s mini budget statement, the authority has also locked into some longer-term borrowing to give greater certainty on future borrowing costs. In the first six months of the year a total of £30.8m of borrowing has been taken with durations between 5 and 40 years. These can be seen in table 3b.

3.12 This has had the effect of increasing the weighted average duration of our borrowing considerably from 14 years to 18.4 years, and has resulted in a sizeable shift in our maturity structure of borrowing as noted in table 10 to this report.

3.13 Total Investments have reduced by £19.9m during the period to stand at £28.1m at the end of September 2022. The weighted average rate of income return on these investments has increased considerably from 0.4% to 2.7%.

3.14 The reduction in total investments for the period can be explained by the continuation of the internal borrowing strategy (which uses internal cash balances in lieu of borrowing), and the comparatively high investment balance that the Authority was carrying at the start of the year driven by receipt of significant grant funding during March and April 2022, which is gradually being expended.

3.15 The Authority continues to hold a minimum of £10m of investments to meet the requirements of a professional client under the Mifid II regulations (Markets in financial instruments directive).

3.16 £4m of the Authority's investments are held in externally managed strategic pooled multi-asset and property funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. As at 30th September 2022 it is pleasing to note that these funds continue to generate an average annualised income return of 4.44% which is used to support the revenue budget in year. However it should be noted that at the end of the period there were unrealised capital losses of £476,000 on these investments, reflective of the wider turbulence in financial markets. It is important to note that under current regulations these capital losses are not recognised in the Authority's income & expenditure account until such time that the investments are actually sold. The investments were initially made with a view to the longer term to provide consistent income returns and allow for fluctuations in capital value.

Compliance with Prudential Indicators approved by Council

3.17 As reported in section 10, during the period the Authority complied with the Cipfa code of practice on treasury management and with all treasury and prudential indicators as set in the 2022/23 Treasury strategy approved by full Council.

4 EXTERNAL CONTEXT

4.1 **Economic background (as at 30th September 2022):** The ongoing conflict in Ukraine has continued to put pressure on global inflation and the economic outlook for UK and world growth remains weak. The UK political situation towards the end of the period following the 'fiscal event' increased uncertainty further.

4.2 The economic backdrop during the April to September period continued to be characterised by high oil, gas and commodity prices, ongoing high inflation and its impact on consumers' cost of living, no imminent end in sight to the Russia-Ukraine hostilities and its associated impact on the supply chain, and China's zero-Covid policy.

4.3 Central Bank rhetoric and action remained robust. The Bank of England, Federal Reserve and the European Central Bank all pushed up interest rates over the period and committed to fighting inflation, even when the consequences were in all likelihood recessions in those regions.

4.4 UK inflation remained extremely high. Annual headline CPI hit 10.1% in July, the highest rate for 40 years, before falling modestly to 9.9% in August. RPI registered 12.3% in both July and August. The energy regulator, Ofgem, increased the energy price cap by 54% in April, while a further increase in the cap from October, which would have seen households with average energy consumption pay over £3,500 per annum, was dampened by the UK government stepping in to provide around £150 billion of support to limit bills to £2,500 annually until 2024.

4.5 The labour market remained tight through the period but there was some evidence of easing demand and falling supply. The unemployment rate 3m/year for April fell to 3.8% and declined further to 3.6% in July. Although now back below pre-pandemic levels, the recent decline was driven by an increase in inactivity rather than demand for labour. Pay growth in July was 5.5% for total pay (including bonuses) and 5.2% for regular pay. Once adjusted for inflation, however, growth in total pay was -2.6% and –2.8% for regular pay.

4.6 With disposable income squeezed and higher energy bills still to come, consumer confidence fell to a record low of –44 in August, down –41 in the previous month. Quarterly GDP fell -0.1% in the April-

June quarter driven by a decline in services output, but slightly better than the 0.3% fall expected by the Bank of England.

4.7 The Bank of England increased the official Bank Rate to 2.25% over the period. From 0.75% in March, the Monetary Policy Committee (MPC) pushed through rises of 0.25% in each of the following two MPC meetings, before hiking by 0.50% in August and again in September. August's rise was voted by a majority of 8-1, with one MPC member preferring a more modest rise of 0.25%. the September vote was 5-4, with five votes for an 0.5% increase, three for an 0.75% increase and one for an 0.25% increase. The Committee noted that domestic inflationary pressures are expected to remain strong and so given ongoing strong rhetoric around tackling inflation further Bank Rate rises should be expected.

4.8 On 23rd September the UK government, following a change of leadership, announced a raft of measures in a 'mini budget', loosening fiscal policy with a view to boosting the UK's trend growth rate to 2.5%. With little detail on how government borrowing would be returned to a sustainable path, financial markets reacted negatively. Gilt yields rose dramatically by between 0.7% - 1% for all maturities with the rise most pronounced for shorter dated gilts. The swift rise in gilt yields left pension funds vulnerable, as it led to margin calls on their interest rate swaps and risked triggering large scale redemptions of assets across their portfolios to meet these demands. It became necessary for the Bank of England to intervene to preserve market stability through the purchase of long-dated gilts, albeit as a temporary measure, which has had the desired effect with 50-year gilt yields falling over 100bps in a single day.

4.9 Bank of England policymakers noted that any resulting inflationary impact of increased demand would be met with monetary tightening, raising the prospect of much higher Bank Rate and consequential negative impacts on the housing market.

4.10 After hitting 9.1% in June, annual US inflation eased in July and August to 8.5% and 8.3% respectively. The Federal Reserve continued its fight against inflation over the period with a 0.5% hike in May followed by three increases of 0.75% in June, July and September, taking policy rates to a range of 3% - 3.25%.

4.11 Eurozone CPI inflation reached 9.1% y/y in August, with energy prices the main contributor but also strong upward pressure from food prices. Inflation has increased steadily since April from 7.4%. In July the European Central Bank increased interest rates for the first time since 2011, pushing its deposit rate from –0.5% to 0% and its main refinancing rate from 0.0% to 0.5%. This was followed in September by further hikes of 0.75% to both policy rates, taking the deposit rate to 0.75% and refinancing rate to 1.25%.

4.12 **Financial Markets:** Uncertainty remained in control of financial market sentiment and bond yields remained volatile, continuing their general upward trend as concern over higher inflation and higher interest rates continued to dominate. Towards the end of September, volatility in financial markets was significantly exacerbated by the UK government's fiscal plans, leading to an acceleration in the rate of the rise in gilt yields and decline in the value of sterling.

4.13 Due to pressure on pension funds, the Bank of England announced a direct intervention in the gilt market to increase liquidity and reduce yields.

4.14 Over the period the 5-year UK benchmark gilt yield rose from 1.41% to 4.40%, the 10-year gilt yield rose from 1.61% to 4.15%, the 20-year yield from 1.82% to 4.13% and the 50-year yield from 1.56% to 3.25%. The Sterling Overnight Rate (SONIA) averaged 1.22% over the period.

4.15 **Credit review:** In July Fitch revised the outlook on Standard Chartered from negative to stable as it expected profitability to improve thanks to the higher interest rate environment. Fitch also revised the outlook for Bank of Nova Scotia from negative to stable due to its robust business profile.

4.16 Also in July, Moody's revised the outlook on Bayerische Landesbank to positive and then in September S&P revised the GLA outlook to stable from negative as it expects the authority to remain resilient despite pressures from a weaker macroeconomic outlook coupled with higher inflation and interest rates.

4.17 Having completed its full review of its credit advice on unsecured deposits at UK and non-UK banks, in May Arlingclose extended the maximum duration limit for five UK banks, four Canadian banks and four German banks to six months. The maximum duration for unsecured deposits with other UK and non-UK banks on Arlingclose's recommended list is 100 days. These recommendations were unchanged at the end of the period.

4.18 Arlingclose continued to monitor and assess credit default swap levels for signs of credit stress but made no changes to the counterparty list or recommended durations. Nevertheless, increased market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remains under constant review.

4.19 **Arlingclose's Economic Outlook for the remainder of 2022/23 (based on 7th November 2022 interest rate forecast)**

	Current	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
Official Bank Rate													
Upside risk	0.00	0.25	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25
Arlingclose Central Case	3.00	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	3.50	3.50	3.50	3.50
Downside risk	0.00	0.25	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00

4.20 Arlingclose expects Bank Rate to rise further during 2022/23 to reach 4% by the end of the year.

4.21 Following the exceptional 75bp rise in November, we believe the MPC will slow the rate of increase at the next few meetings. Arlingclose now expects Bank Rate to peak at 4.25%, with a further 50bp rise in December and smaller rises in 2023.

4.22 The UK economy likely entered into recession in Q3, which will continue for some time. Once inflation has fallen from the peak, the MPC will cut Bank Rate.

4.23 Arlingclose expects gilt yields to remain broadly steady despite the MPC's attempt to push down on interest rate expectations. Without a weakening in the inflation outlook, investors will price in higher inflation expectations given signs of a softer monetary policy stance.

5 LOCAL CONTEXT

5.1 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, or to offset external borrowing requirements. On 31st March 2022, the Authority had a capital financing requirement of £187.0m alongside external borrowing of £175.5m and total investments of £48m.

Table 1: Balance Sheet Summary (Start of year)

	31.3.22 Actual £m	31.9.22 Actual £m
General Fund capital financing requirement	(189.4)	(189.4)
Less: *Other debt liabilities	2.4	2.4

Borrowing capital financing requirement	**(187.0)**	**(187.0)**
External borrowing	(175.5)	(164.5)
Internal borrowing	**11.5**	**22.5**
Less: Usable reserves	(42.7)	(42.7)
Less: Working capital	(16.8)	(7.9)
Total Investments at 31st March 2022	**(48.0)**	**(28.1)**

* finance leases, PFI liabilities and transferred debt that form part of the Authority's total debt

5.2 The above table demonstrates that at the start of the year, that of the £57.5m of internal resources that the authority had available (usable reserves plus working capital), £11.5m of this was being used to offset the overall borrowing requirement of £187.0m, with the remaining £48m at that time invested.

5.3 This position has changed over the period with external borrowing reducing to £164.5m, and internal borrowing increasing to £22.5m. This movement is to be expected and is in line with the Authority's policy of maintaining the use of internal borrowing up to a maximum level which could ultimately result in investment balances reducing to a baseline of £10m.

5.4 The overall treasury management position on 30th September 2022 and the change over the six months is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.22 Balance £m	31.3.22 Rate %	Net Movement £m	30.09.22 Balance £m	30.09.22 Rate %
Long-term borrowing	104.3	3.1	26.8	131.1	3.2
Short-term borrowing	71.2	0.2	(37.8)	33.4	1.5
Total borrowing	**175.5**	**2.0**	**(11.0)**	**164.5**	**2.8**
Long-term investments	0.0	N/A	0.0	0.0	N/A
Short-term investments	(14.0)	0.12	0.0	(14.0)	2.34
Strategic Pooled Funds	(4.0)	3.40	0.0	(4.0)	**4.44
Cash and cash equivalents	(30.0)	0.1	20.0	(10.1)	1.99
Total investments	**(48.0)**	**0.4**	**19.9**	**(28.1)**	**2.7**
Net Borrowing	**127.5**		**8.9**	**136.4**	

** Annualised return

6 BORROWING UPDATE

6.1 Borrowing Strategy during the period

6.2 As outlined in the Authority's approved 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.

6.3 Whilst the Authority has significant long-term borrowing requirements, the current strategy of funding capital expenditure remains to maximise 'internal borrowing', where the Authority seeks to use its existing cash & reserve balances to afford its capital expenditure prior to taking out external borrowing i.e. deferring taking out new long term borrowing and funding capital expenditure from the Authority's own cash resources for as long as is possible, which it has because of its 'cash-backed' reserves and, to a lesser extent, day to day positive cash-flows.

6.4 By using an internal borrowing strategy, the Authority can also minimise cash holding at a time when counterparty risk remains relatively high, especially within the current economic climate. The interest rates achievable on the Authority's investments are also significantly lower than the current rates payable on long-term borrowing so this remains a sensible consideration in operating an 'internal borrowing' arrangement – i.e. it would cost more to borrow than it would to utilise existing investment balances and forego interest receivable. Whilst the strategy minimises investment counterparty risk, the risk of interest rate exposure is increased as the current longer term borrowing rates may rise into the future.

6.5 Over the period short term PWLB rates rose dramatically, particular in late September after the Chancellor's 'mini-budget', including unfunded tax cuts and additional borrowing to fund consumer energy price subsidies. Exceptional volatility threatened financial stability, requiring Bank of England intervention in the gilt market. Over a twenty-four-hour period some PWLB rates increased to 6%, before the intervention had the desired effect, bringing rates back down by over 1% for certain maturities. A truly wild and unprecedented period in fixed income markets, with a direct impact on PWLB rates.

6.6 Interest rates rose by over 2% during the period in both the long and short term. As an indication the 5-year maturity certainty rate rose from 2.30% on 1st April to 5.09% on 30th September; over the same period the 30-year maturity certainty rate rose from 2.63% to 4.68%

6.7 The Authority chose to lock into some longer-term borrowing during the period to give greater certainty to future borrowing costs. In the first six months of the year a total of £30.8m of longer term borrowing has been taken with durations between 5 and 40 years. These can be seen in table 3b.

6.8 At 30th September 2022 the Authority held £164.5m of loans, (a decrease of £11.0m from 31st March 2022), as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30th September are summarised in Table 3 below. New long-term borrowing undertaken in year can be seen in Table 3b below.

Table 3: Borrowing Position

	31.3.22 Balance £m	31.3.22 Weighted Average Rate %	31.3.22 Weighted Average Maturity (years)	Net Movement £m	30.09.22 Balance £m	30.09.22 Weighted Average Rate %	30.09.22 Weighted Average Maturity (years)
Public Works Loan Board	86.8	3.1	24.8	30.2	117.0	3.3	23.3
Banks (LOBO)	13.6	4.8	19.8	0.0	13.6	4.8	19.3
Welsh Gov Interest Free	6.0	0.0	3.3	(0.1)	5.9	0.0	3.2
Local authorities/Other	69.0	0.1	0.3	(41.1)	28.0	0.5	0.4
Total borrowing	**175.5**	**2.0**	**14.0**	**(11.0)**	**164.5**	**2.8**	**18.4**

Table 3b: Long-dated Loans Borrowed

	Amount £m	Rate %	Period (Years)
PWLB EIP Loan 1	1.8	2.31	8
PWLB Maturity Loan 1	2.0	2.80	26
PWLB Maturity Loan 2	2.0	2.82	27
PWLB Maturity Loan 3	5.0	3.24	38
PWLB Maturity Loan 4	5.0	3.22	40
PWLB Maturity Loan 5	2.0	4.78	5
PWLB Maturity Loan 6	2.0	4.80	6
PWLB Maturity Loan 7	2.0	4.80	7
PWLB Maturity Loan 8	2.0	4.81	8
PWLB Maturity Loan 9	3.5	4.82	9
PWLB Maturity Loan 10	3.5	4.84	10
Total borrowing	**30.8**		

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

6.10 LOBO loans: The Authority continues to hold £13.6m 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 period, however in a rising interest rate environment, the possibility of this occurring increases.

7 INVESTMENT UPDATE

7.1 The 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.

7.2 The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the period, the Authority's investment balances ranged between £17.0m and £73.1m due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investments

	31.3.22 Balance £m	Net Movement £m	30.09.22 Balance £m	30.09.22 Capital Return %	30.09.22 Income Return %
Banks & building societies (unsecured)	(2.0)	0.5	(1.5)	n/a	0.00%
Government (incl. local authorities	(14.0)	0.0	(14.0)	n/a	1.46%
Money Market Funds	(28.0)	19.5	(8.5)	n/a	1.16%
Strategic Pooled funds	(4.0)	0.0	(4.0)	-11.05%	4.44%
Total investments	**(48.0)**	**19.9**	**(28.1)**		

** Annualised return

7.3 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.

7.4 Bank Rate increased over the period, and with the prospect of more increases to come. Short-dated cash rates, which had ranged between 0.7% - 1.5% at the end of March, rose by around 1.5% for overnight/7-day maturities and by nearly 3.5% for 9-12 month maturities.

7.5 By end September, the rates on DMADF deposits ranged between 1.85% and 3.5%. The return on the Authority's sterling low volatility net asset value (LVNAV) Money Market Funds ranged between 0.5% - 0.64% p.a. in early April and between 1.96% and 2.13% at the end of September.

7.6 The reduction in total investments for the period can be explained by the continuation of the internal borrowing strategy (which uses internal cash balances in lieu of borrowing), and the comparatively high investment balance that the Authority was carrying at the start of the year driven by receipt of significant grant funding during March and April 2022, which is gradually being expended.

7.7 It is anticipated that investments will continue to reduce during 2022/23 as an alternative to borrowing and towards the minimum balance of £10m, which will remain invested for compliance with MiFID II regulations.

7.8 Given the continuing risk and low returns from short-term unsecured bank investments, aside from deposits with its operational bank, the Authority has continued to look to diversify into more secure and/or higher yielding asset classes as shown in table 4 above.

7.9 The progression of risk and return metrics are shown in the 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 %
31.03.2022	AA-	3.81	59%	4	0.64
30.09.2022	AA-	4.38	76%	16	0.99
Similar LAs	AA-	4.18	40%	62	0.96
All LAs	AA-	4.46	64%	16	0.92

7.10 **Externally Managed Pooled Funds**: £4m of the Authority's investments are held in externally managed strategic pooled multi-asset and property funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. As at 30^{th} September 2022 these funds had generated an average annualised income return of 4.44% which is used to support services in year, and -11.05% of unrealised capital losses, which total £476,000.

7.11 The increase in policy rates in the UK, US and Eurozone and the prospect of low to no growth and a recessionary period ahead was also a challenging period for equities, the FTSE All Share index falling from 4187 on 31st March to 3763 on 30th September, whilst the MSCI World Index fell from 3053 to 2378 over the same period. The fall in equity valuations is reflected in the equity and multi-asset income funds.

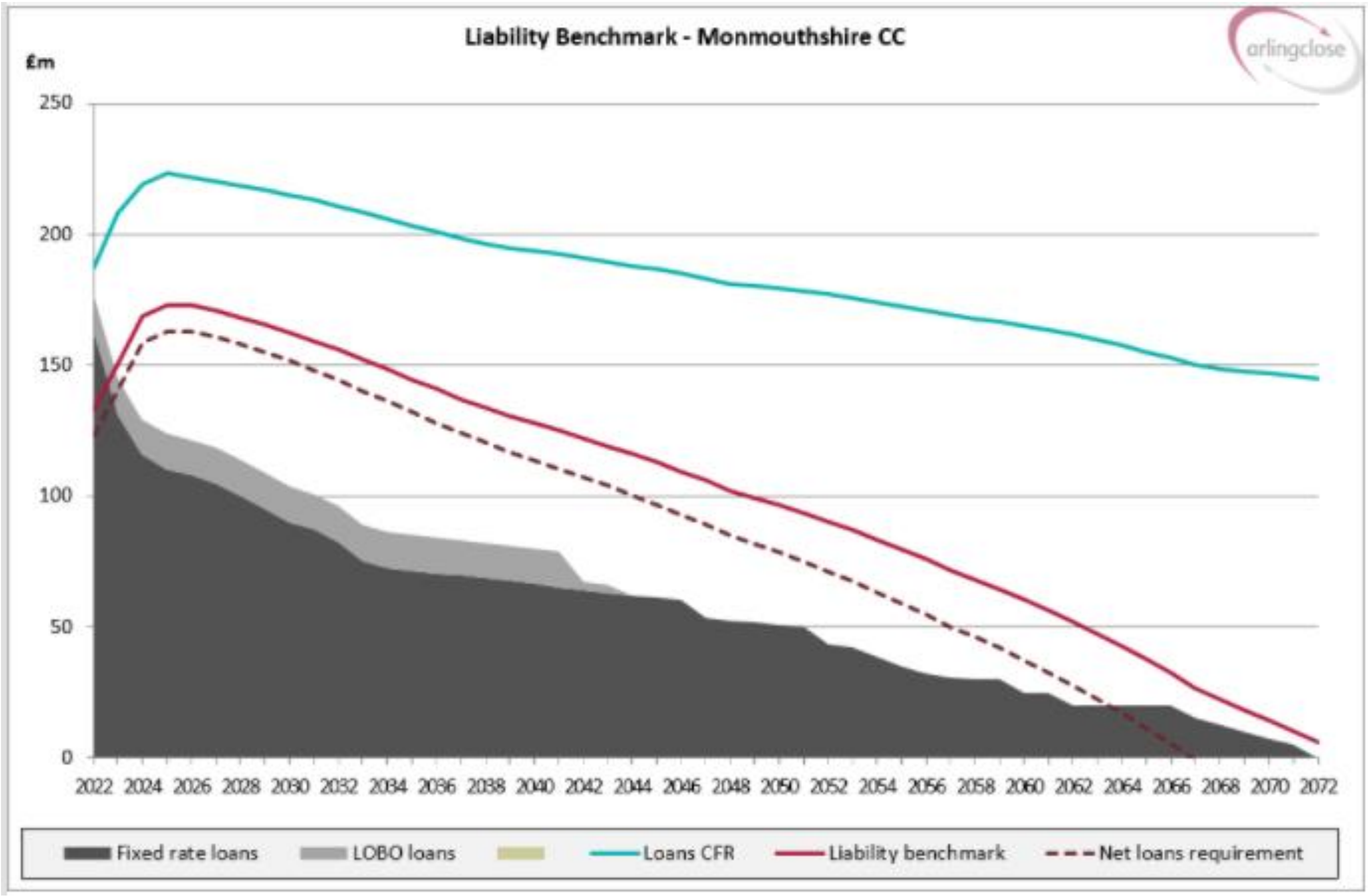
7.12 Significant financial market volatility and uncertainty remain due to stagflation fears, little sight of the war in Ukraine ending soon and ongoing supply chain issues, a lingering problem over the past 30 months, yet to be fully resolved.

7.13 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 Authority'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.

Liability Benchmark Indicator

7.14 CIPFA recommends that the optimum position for external borrowing should be at the level of the Liability Benchmark (i.e. all balance sheet resources should be used to maximise internal borrowing). If the outputs show future periods where external loans are less than the Liability Benchmark, then this indicates a borrowing requirement thus identifying where the authority is exposed to interest rate, liquidity and refinancing risks. Conversely, where external loans exceed the Liability Benchmark then this will highlight an over borrowed position which will result in excess cash in the organisation requiring investment thus exposing the authority to credit and reinvestment risks and a potential cost of carry. The treasury strategy should explain how the treasury risks identified by the Liability Benchmark are to be managed over the coming years.

7.15 A recent change in guidance recommended publishing a benchmark liability periodically as part of treasury performance updates. The Liability Benchmark is effectively the Net Borrowing Requirement of a local authority plus a liquidity allowance. In its simplest form, it is calculated by deducting the amount of investable resources available on the balance sheet (reserves, cash flow balances) from the amount of outstanding external debt and then adding the minimum level of investments required to manage day to-day cash flow. Monmouthshire's latest liability benchmark is demonstrated below:



7.16 Our underlying need to borrow is shown by the top blue line. However, due to the use of reserves and working capital, the Authority is expected to need total external borrowing between the full red lower line and the dotted line below it. As our existing loans portfolio (shown in grey) reduce as loans mature, new loans will therefore be required to fill the gap between the grey area and the red lines over the longer term. The Authority intends to maintain a risk assessed balance between short term and long term borrowing which will fill this gap over time.

8 NON-TREASURY INVESTMENTS

8.1 The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds that generate a financial return. This is replicated in the Investment Guidance issued by Ministry of Housing, Communities and Local Government's (MHCLG) and Welsh Government, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

8.2 The Authority held a net book value of £66.7m of such non-financial asset investments at the 31st March 2022 made up of:

- Oak Grove Solar Farm - £5.4m
- Castlegate Business Park & service loan - £6.1m
- Newport Leisure Park & service loan - £18.9m
- Agricultural Properties - £32.9m
- Industrial Properties and Retail Units - £3.4m

These investments are budgeted to generate approximately £1.0m of income for the Authority in 2022/23 after accounting for direct costs, and continue to represent an important income stream to support the revenue budget.

9 COMPLIANCE

9.1 The Section 151 officer reports that all treasury management activities undertaken during the first six months of the year have complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated below.

9.2 Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 7 below.

Table 7: Debt limits

	2022/23 Maximum during year £m	30.09.22 Actual £m	2022/23 Operational Boundary £m	2022/23 Authorised Limit £m	Complied? Yes/No
Borrowing	179.2	164.3	238.0	268.2	Yes
PFI, Finance Leases & Other LT liabilities	2.4	2.4	2.9	4.4	Yes
Total debt	**181.6**	**166.7**	**240.9**	**272.6**	

9.3 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.

9.4 Compliance with agreed Investment limits is shown below:

Table 8: Investment limits

	2022/23 Maximum	2022/23 Limit	Complied? Yes
The UK Government	£38.2m	Unlimited	Yes
Local authorities & other government entities	£0	£4m	Yes
Secured investments	£0	£4m	Yes
Banks (unsecured)	£3m	£2m (£3m total for the Authority's operational bank)	Yes
Building societies (unsecured)	£0	£2m	Yes
Registered providers (e.g. Housing Associations (unsecured)	£0	£2m	Yes
Money market funds (individually)	£4m	£4m	Yes
Strategic pooled funds	£3m	£5m	Yes
Real estate investment trusts	£0	£5m	Yes
Other Investments	£0	£2m	Yes

9.5 **Treasury Management Indicators**

9.6 The Authority measures and manages its exposures to treasury management risks using the following indicators.

9.7 **Security:** The Authority 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.

Table 9: Security

	30.09.22 Actual	2021/22 Target	Complied?
Portfolio average credit	A+/4.38	A-/5.0	Yes

9.8 **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:

Table 10: Maturity structure of borrowing

	30.03.22 Actual	30.09.22 Actual	Lower Limit	Upper Limit	Complied?
Under 12 months	41%	20%	0%	60%	Yes
12 months and within 24 months	2%	2%	0%	30%	Yes
24 months and within 5 years	6%	5%	0%	30%	Yes
5 years and within 10 years	6%	17%	0%	30%	Yes
10 years and within 20 years	12%	13%	0%	30%	Yes

20 years and within 30 years	15%	19%	0%	30%	Yes
30 years and within 40 years	7%	13%	0%	30%	Yes
40 years and within 50 years	11%	12%	0%	30%	Yes
50 years and above	0%	0%	0%	30%	Yes

9.9 **Principal Sums Invested for Periods Longer than a year:** 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 limits on the long-term principal sum invested to final maturities beyond the period end were:

Table 11: Invested beyond 1 Year

	2022/23	2023/24	2024/25
Actual principal invested for 365 days & beyond year end	£0	£0	£0
Limit on principal invested for 365 days & beyond year end	£6m	£6m	£6m
Complied?	Yes	Yes	Yes

10 REASONS

10.1 The Treasury Management Strategy for the Authority is underpinned by its adherence to the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management, which includes the requirement that members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing best practice in accordance with CIPFA's recommendations.

11 CONSULTEES

Deputy Chief Executive, Chief Officer - Resources (Section 151 officer)

Arlingclose – Treasury Management Advisors to Monmouthshire CC

12 BACKGROUND PAPERS

Glossary of treasury terms

13 AUTHORS

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Background paper: Glossary of Treasury Terms

Authorised Limit	The affordable borrowing limit determined in compliance with the Local Government Act 2003 (English and Welsh authorities) and the Local Government in Scotland Act 2003. This Prudential Indicator is a statutory limit for total external debt. It is set by the Authority and needs to be consistent with the Authority's plans for capital expenditure financing and funding. The Authorised Limit provides headroom over and above the *Operational Boundary* to accommodate expected cash movements. Affordability and prudence are matters which must be taken into account when setting this limit. (see **also** *Operational Boundary*, below)
Balances and Reserves	Accumulated sums that are maintained either earmarked for specific future costs or commitments or generally held to meet unforeseen or emergency expenditure.
Bail-in	Refers to the process which the banking regulatory authorities will use to restructure a financial institution which is failing or likely to fail. Unsecured creditors of and investors in that financial institution will participate in its restructure who will, as a consequence, incur a non-recoverable loss (commonly referred to as a 'haircut') on their obligation/investment. Local authority investments with banks and building societies such as term deposits, certificates of deposit, call accounts and non-collateralised bonds are unsecured investments and are therefore vulnerable to bail-in.
Bank Rate	The official interest rate set by the Bank of England's Monetary Policy Committee and what is generally termed at the "base rate". This rate is also referred to as the 'repo rate'.
Bond	A certificate of debt issued by a company, government, or other institution. The bond holder receives interest at a rate stated at the time of issue of the bond. The price of a bond may vary during its life.
Capital Expenditure	Expenditure on the acquisition, creation or enhancement of capital assets
Capital Financing Requirement (CFR)	The Authority's underlying need to borrow for capital purposes representing the cumulative capital expenditure of the local authority that has not been financed.
Capital growth	Increase in the value of the asset (in the context of a collective investment scheme, it will be the increase in the unit price of the fund)
Capital receipts	Money obtained on the sale of a capital asset.
CIPFA	Chartered Institute of Public Finance and Accountancy
Constant Net Asset Value (CNAV)	Also referred to as Stable Net Asset Value. A term used in relation to the valuation of 1 share in a fund. This means that at all times the value of 1 share is £1/€1/US$1 (depending on the currency of the fund). The Constant NAV is maintained since dividend income (or interest) is either added to the shareholders' account by creating shares equal to the value of interest earned or paid to the shareholder's bank account, depending on which option is selected by the shareholder.
Collective Investment Schemes	Funds in which several investors collectively hold units or shares. The assets in the fund are not held directly by each investor, but as part of a pool (hence these funds are also referred to as 'Pooled Funds'). Unit Trusts and Open-Ended Investment Companies are types of collective investment schemes / pooled funds.

Corporate Bonds	Corporate bonds are bonds issued by companies. The term is often used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.
Corporate Bond Funds	Collective Investment Schemes investing predominantly in bonds issued by companies and supranational organisations.
CPI ***Also see RPI***	Consumer Price Index. (This measure is used as the Bank of England's inflation target.)
Credit Default Swap (CDS)	A Credit Default Swap is similar to an insurance policy against a credit default. Both the buyer and seller of a CDS are exposed to credit risk. Naked CDS, i.e. one which is not linked to an underlying security, can lead to speculative trading.
Credit Rating	Formal opinion by a registered rating agency of a counterparty's future ability to meet its financial liabilities; these are opinions only and not guarantees.
Cost of carry	When a loan is borrowed in advance of requirement, this is the difference between the interest rate and (other associated costs) on the loan and the income earned from investing the cash in the interim.
Credit default swaps	Financial instrument for swapping the risk of debt default; the buyer effectively pays a premium against the risk of default.
Diversification / diversified exposure	The spreading of investments among different types of assets or between markets in order to reduce risk.
Derivatives	Financial instruments whose value, and price, are dependent on one or more underlying assets. Derivatives can be used to gain exposure to, or to help protect against, expected changes in the value of the underlying investments. Derivatives may be traded on a regulated exchange or traded 'over the counter'.
ECB	European Central Bank
Federal Reserve	The US central bank. (Often referred to as "the Fed")
Floating Rate Notes	A bond issued by a company where the interest rate paid on the bond changes at set intervals (generally every 3 months). The rate of interest is linked to LIBOR and may therefore increase or decrease at each rate setting
GDP	Gross domestic product – also termed as "growth" in the economy. The value of the national aggregate production of goods and services in the economy.
General Fund	This includes most of the day-to-day spending and income. (All spending and income related to the management and maintenance of the housing stock is kept separately in the HRA).
Gilts (UK Govt)	Gilts are bonds issued by the UK Government. They take their name from 'gilt-edged': being issued by the UK government, they are deemed to be very secure as the investor expects to receive the full face value of the bond to be repaid on maturity.
Housing Revenue Account (HRA)	A ring-fenced account of all housing income and expenditure, required by statute

IFRS	International Financial Reporting Standards
Income Distribution	The payment made to investors from the income generated by a fund; such a payment can also be referred to as a ‘dividend’
Investments - **Secured** - **unsecured**	Secured investments which have underlying collateral in the form of assets which can be called upon in the event of default Unsecured investments do not have underlying collateral. Such investments made by local authorities with banks and building societies are at risk of bail-in should the regulator determine that the bank is failing or likely to fail.
Liability Benchmark	Term in CIPFA’s Risk Management Toolkit which refers to the minimum amount of borrowing required to keep investments at a minimum liquidity level (which may be zero).
LOBOs	LOBO stands for ‘Lender’s Option Borrower’s Option’. The underlying loan facility is typically long term and the interest rate is fixed. However, in the LOBO facility the lender has the option to call on the facilities at predetermined future dates. On these call dates, the lender can propose or impose a new fixed rate for the remaining term of the facility and the borrower has the ‘option’ to either accept the new imposed fixed rate or repay the loan facility.
LVNAV (Low Volatility Net Asset Value)	From 2019 Money Market Funds will have to operate under a variable Net Value Structure with minimal volatility (fluctuations around £1 limited to between 99.8p to 100.2p)
Maturity	The date when an investment or borrowing is repaid.
Maturity profile	A table or graph showing the amount (or percentage) of debt or investments maturing over a time period. The amount or percent maturing could be shown on a year-by-year or quarter-by-quarter or month-by-month basis.
MiFID II	MiFID II replaced the Markets in Financial Instruments Directive (MiFID I) from 3 January 2018. It is a legislative framework instituted by the European Union to regulate financial markets in the bloc and improve protections for investors.
Money Market Funds (MMF)	Pooled funds which invest in a range of short term assets providing high credit quality and high liquidity.
Minimum Revenue Provision	An annual provision that the Authority is statutorily required to set aside and charge to the Revenue Account for the repayment of debt associated with expenditure incurred on capital assets
Non-Specified Investments	Term used in the Communities and Local Government Guidance and Welsh Assembly Guidance for Local Authority Investments. It includes any investment for periods greater than one year or those with bodies that do not have a high credit rating, use of which must be justified.
Net Asset Value (NAV)	A fund’s net asset value is calculated by taking the current value of the fund’s assets and subtracting its liabilities.
Operational Boundary	This is the limit set by the Authority as its most likely, i.e. prudent, estimate level of external debt, but not the worst case scenario. This limit links directly to the Authority’s plans for capital expenditure, the estimates of the Capital Financing Requirement (CFR) and the estimate of cashflow requirements for the year.

Permitted Investments	Term used by Scottish Authorities as those the Authority has formally approved for use.
Pooled funds	See Collective Investment Schemes (above)
Premiums and Discounts	In the context of local authority borrowing, (a) the premium is the penalty arising when a loan is redeemed prior to its maturity date and (b) the discount is the gain arising when a loan is redeemed prior to its maturity date. If on a £1 million loan, it is calculated* that a £100,000 premium is payable on premature redemption, then the amount paid by the borrower to redeem the loan is £1,100,000 plus accrued interest. If on a £1 million loan, it is calculated that a £100,000 discount receivable on premature redemption, then the amount paid by the borrower to redeem the loan is £900,000 plus accrued interest. PWLB premium/discount rates are calculated according to the length of time to maturity, current market rates (plus a margin), and the existing loan rate which then produces a premium/discount dependent on whether the discount rate is lower/higher than the coupon rate. *The calculation of the total amount payable to redeem a loan borrowed from the Public Works Loans Board (PWLB) is the present value of the remaining payments of principal and interest due in respect of the loan being repaid prematurely, calculated on normal actuarial principles. More details are contained in the PWLB's lending arrangements circular.
Private Finance Initiative (PFI)	Private Finance Initiative (PFI) provides a way of funding major capital investments, without immediate recourse to the public purse. Private consortia, usually involving large construction firms, are contracted to design, build, and in some cases manage new projects. Contracts can typically last for 30 years, during which time the asset is leased by a public authority.
Prudential Code	Developed by CIPFA and introduced on 01/4/2004 as a professional code of practice to support local authority capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice.
Prudential Indicators	Indicators determined by the local authority to define its capital expenditure and asset management framework. They are designed to support and record local decision making in a manner that is publicly accountable; they are not intended to be comparative performance indicators between authorities.
PWLB	Public Works Loans Board. It is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. The PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments.
Quantitative Easing	In relation to the UK, it is the process used by the Bank of England to directly increase the quantity of money in the economy. It "does not involve printing more banknotes. Instead, the Bank buys assets from private sector institutions – that could be insurance companies, pension funds, banks or non-financial firms – and credits the seller's bank account. So the seller has more money in their bank account, while their bank holds a corresponding claim against the Bank of England (known as reserves). The end result is more money out in the wider economy". Source: Bank of England
Registered Provider of Social Housing	Formerly known as Housing Association
Revenue Expenditure	Expenditure to meet the continuing cost of delivery of services including salaries and wages, the purchase of materials and capital financing charges

RPI	Retail Prices Index. A monthly index demonstrating the movement in the cost of living as it tracks the prices of goods and services including mortgage interest and rent. Pensions and index-linked gilts are uprated using the CPI index.
SORP	Statement of Recommended Practice for Accounting (Code of Practice on Local Authority Accounting in the United Kingdom).
Specified Investments	Term used in the CLG Guidance and Welsh Assembly Guidance for Local Authority Investments. Investments that offer high security and high liquidity, in sterling and for no more than 1 year. UK government, local authorities and bodies that have a high credit rating.
Supported Borrowing	Borrowing for which the costs are supported by the government or third party.
Supranational Bonds	Instruments issued by supranational organisations created by governments through international treaties (often called multilateral development banks). The bonds carry an AAA rating in their own right. Examples of supranational organisations are those issued by the European Investment Bank, the International Bank for Reconstruction and Development.
Treasury Management Code	CIPFA's Code of Practice for Treasury Management in the Public Services. The current Code is the edition released in autumn 2011.
Temporary Borrowing	Borrowing to cover peaks and troughs of cash flow, not to fund spending.
Term Deposits	Deposits of cash with terms attached relating to maturity and rate of return (interest)
Unsupported Borrowing	Borrowing which is self-financed by the local authority. This is also sometimes referred to as Prudential Borrowing.
Usable Reserves	Resources available to finance future revenue and capital expenditure
Variable Net Asset Value (VNAV)	A term used in relation to the valuation of 1 share in a fund. This means that the net asset value (NAV) of these funds is calculated daily based on market prices.
Working Capital	Timing differences between income/expenditure and receipts/payments
Yield	The measure of the return on an investment instrument