

**SUBJECT: MID-YEAR TREASURY REPORT 2021/22**

**MEETING: Governance & Audit Committee**

**DATE: 3<sup>rd</sup> November 2021**

**DIVISION/WARDS AFFECTED: Whole Authority**

## **1 PURPOSE**

- 1.1 To provide an interim update on treasury management activity for the first 6 months of 2021/22 in accordance with best practice and the requirements of the Authority's Treasury Management Strategy Statement for 2021/22.

## **2 RECOMMENDATIONS**

- 2.1 That Governance & Audit Committee review the treasury management activities in the first half of 2021/22 using this report and discuss with officers any changes to the process that should be considered for incorporation into the 2022/23 Treasury Management Strategy Statement which will be considered at the January G&AC meeting.

## **3 KEY ISSUES**

- 3.1 In March 2005 the Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Authority to approve 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 2021/22 was approved at Council on the 11th March 2021. 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 The Treasury Management Code which was revised in 2017/18 now covers non-treasury investments as well as treasury investments requiring Authorities to show how they provide due diligence on these investments in the same way as it does for treasury investments (see Section 8). Given the current economic uncertainty the Authority has not increased its holding of non-treasury investments in the first half of 2021/22.
- 3.4 With short-term interest rates continuing to remain much lower than long-term rates and temporary investments earning Bank Rate or even zero return, the Authority considers it to be more cost effective in the near term to use internal resources or borrowed rolling temporary / short-term loans instead.
- 3.5 The current economic environment is unprecedented and continues to very much represent the bottom of the treasury cost curve for an Authority like Monmouthshire who is a net borrower. Despite this, it remains very difficult to currently justify locking into longer term borrowing to provide additional

certainty to long term treasury costs and budgets. The continued margin between PWLB and market borrowing in particular is a significant barrier to this in an environment where the cost of carry is so substantial.

- 3.6 At the 31<sup>st</sup> March 2021 the Authority had a borrowing Capital Financing Requirement (CFR) of £186.8m and gross external borrowing of £182.8m. As detailed in table 2, gross borrowing reduced considerably by £26.6m to £156.2m in the six months to the 30<sup>th</sup> September 2021 but net borrowing only fell by £8.8m due to an overall reduction in investments. This can be explained by 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 2021. This has resulted in the temporary borrowing requirement reducing until such time that the grant funding is expended. Alongside this reduced activity in the Authorities capital programme during the first six months of the year has reduced the overall temporary borrowing requirement.
- 3.7 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).
- 3.8 £3m 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<sup>th</sup> September 2021 it is pleasing to note that these funds continue to generate an average annualised income return of 5.57% which is used to support services in year, and -0.25% of unrealised capital losses.
- 3.9 As shown in section 9, the Authority is forecasting a saving against budget of £219,000 for 2021/22 in the areas of interest payable and interest receivable against a total net budget of £3.5m.
- 3.10 As reported in section 10, the Authority complied with the Cipfa code of practice on treasury management and the 2021/22 Treasury management strategy, during the year.
- 3.11 The ongoing coronavirus pandemic will continue to have a significant financial impact on the Authority and consequently its treasury management activity for the remainder of the 2021/22 financial year. At the time of writing it is felt that the existing Treasury Strategy approved for the 2021/22 financial year provides the required flexibility both in terms of investment and borrowing approach to respond the challenges faced.

## 4 EXTERNAL CONTEXT

- 4.1 **Economic background (as at 30<sup>th</sup> September 2021):** The economic recovery from coronavirus pandemic continued to dominate the first half of the financial year. By the end of the period over 48 million people in the UK had received their first dose of a COVID-19 vaccine and almost 45 million their second dose.
- 4.2 The Bank of England (BoE) held Bank Rate at 0.1% throughout the period and maintained its Quantitative Easing programme at £895 billion, unchanged since the November 2020 meeting. In its September 2021 policy announcement, the BoE noted it now expected the UK economy to grow at a slower pace than was predicted in August, as the pace of the global recovery had shown signs of slowing and there were concerns inflationary pressures may be more persistent. Within the announcement, Bank expectations for GDP growth for the third (calendar) quarter were revised down to 2.1% (from 2.9%), in part reflecting tighter supply conditions. The path of CPI inflation is now expected to rise slightly above 4% in the last three months of 2021, due to higher energy prices and core goods inflation. While the Monetary Policy Committee meeting ended with policy rates unchanged, the tone was more hawkish.

- 4.3 Government initiatives continued to support the economy over the quarter but came to an end on 30th September 2021, with businesses required to either take back the 1.6 million workers on the furlough scheme or make them redundant.
- 4.4 The latest labour market data showed that in the three months to July 2021 the unemployment rate fell to 4.6%. The employment rate increased, and economic activity rates decreased, suggesting an improving labour market picture. Latest data showed growth in average total pay (including bonuses) and regular pay (excluding bonuses) among employees was 8.3% and 6.3% respectively over the period. However, part of the robust growth figures is due to a base effect from a decline in average pay in the spring of last year associated with the furlough scheme.
- 4.5 Annual CPI inflation rose to 3.2% in August, exceeding expectations for 2.9%, with the largest upward contribution coming from restaurants and hotels. The Bank of England now expects inflation to exceed 4% by the end of the calendar year owing largely to developments in energy and goods prices. The Office of National Statistics' (ONS') preferred measure of CPIH which includes owner-occupied housing was 3.0% year/year, marginally higher than expectations for 2.7%.
- 4.6 The easing of restrictions boosted activity in the second quarter of calendar year, helping push GDP up by 5.5% q/q (final estimate vs 4.8% q/q initial estimate). Household consumption was the largest contributor. Within the sector breakdown production contributed 1.0% q/q, construction 3.8% q/q and services 6.5% q/q, taking all of these close to their pre-pandemic levels.
- 4.7 The US economy grew by 6.3% in Q1 2021 (Jan-Mar) and then by an even stronger 6.6% in Q2 as the recovery continued. The Federal Reserve maintained its main interest rate at between 0% and 0.25% over the period but in its most recent meeting made suggestion that monetary policy may start to be tightened soon.
- 4.8 The European Central Bank maintained its base rate at 0%, deposit rate at -0.5%, and asset purchase scheme at €1.85 trillion.
- 4.9 Financial markets: Monetary and fiscal stimulus together with rising economic growth and the ongoing vaccine rollout programmes continued to support equity markets over most of the period, albeit with a bumpy ride towards the end. The Dow Jones hit another record high while the UK-focused FTSE 250 index continued making gains over pre-pandemic levels. The more internationally focused FTSE 100 saw more modest gains over the period and remains below its pre-crisis peak.
- 4.10 Inflation worries continued during the period. Declines in bond yields in the first quarter of the financial year suggested bond markets were expecting any general price increases to be less severe, or more transitory, that was previously thought. However, an increase in gas prices in the UK and EU, supply shortages and a dearth of HGV and lorry drivers with companies willing to pay more to secure their services, has caused problems for a range of industries and, in some instance, lead to higher prices.
- 4.11 The 5-year UK benchmark gilt yield began the financial year at 0.36% before declining to 0.33% by the end of June 2021 and then climbing to 0.64% on 30th September. Over the same period the 10 year gilt yield fell from 0.80% to 0.71% before rising to 1.03% and the 20-year yield declined from 1.31% to 1.21% and then increased to 1.37%.
- 4.12 The Sterling Overnight Rate (SONIA) averaged 0.05% over the quarter.
- 4.13 **Credit review:** Credit default swap spreads were flat over most of period and are broadly in line with their pre-pandemic levels. In late September spreads rose by a few basis points due to concerns around Chinese property developer Evergrande defaulting but are now falling back. The gap in spreads between UK ringfenced and non-ringfenced entities continued to narrow, but Santander UK remained an outlier compared to the other ringfenced/retail banks. At the end of the period

Santander UK was trading the highest at 53bps and Lloyds Banks Plc the lowest at 32bps. The other ringfenced banks were trading between 37-39bps and Nationwide Building Society was 39bps.

- 4.14 Over the period Fitch and Moody's upwardly revised to stable the outlook on a number of UK banks and building societies on our counterparty list, recognising their improved capital positions compared to last year and better economic growth prospects in the UK.
- 4.15 Fitch also revised the outlooks for Nordea, Svenska Handelsbanken and Handelsbanken plc to stable from negative. The rating agency considered the improved economic prospects in the Nordic region to have reduced the baseline downside risks it previously assigned to the lenders.
- 4.16 The successful vaccine rollout programme is credit positive for the financial services sector in general and the improved economic outlook has meant some institutions have been able to reduce provisions for bad loans. While there is still uncertainty around the full extent of the losses banks and building societies will suffer due to the pandemic-related economic slowdown, the sector is in a generally better position now compared to earlier this year and 2020.
- 4.17 At the end of the period Arlingclose had completed its full review of its credit advice on unsecured deposits. The outcome of this review included the addition of NatWest Markets plc to the counterparty list together with the removal of the suspension of Handelsbanken plc. In addition, the maximum duration for all recommended counterparties was extended to 100 days.
- 4.18 As ever, the institutions and durations on the Authority's counterparty list recommended by treasury management advisors Arlingclose remain under constant review.

## 5 LOCAL CONTEXT

- 5.1 On 31<sup>st</sup> March 2021, the Authority had net investments of £39m 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 (Start of year)**

	<b>31.3.21 Actual £m</b>
General Fund capital financing requirement	189.2
Less: *Other debt liabilities	(2.4)
<b>Borrowing capital financing requirement</b>	<b>186.8</b>
External borrowing	(182.8)
<b>Internal borrowing</b>	<b>4.1</b>
Less: Usable reserves	(28.5)
Less: Working capital	(14.6)
<b>Investments at 31<sup>st</sup> March 2021</b>	<b>(39.0)</b>

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

- 5.2 Lower official interest rates have lowered the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing. The Authority pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal

borrowing, in order to reduce counterparty risk.

- 5.3 The treasury management position on 30<sup>th</sup> September 2021 and the change over the six months is shown in Table 2 below.

**Table 2: Treasury Management Summary**

	<b>31.3.21</b>	<b>31.3.21</b>		<b>30.09.21</b>	<b>30.09.21</b>
	<b>Balance</b>	<b>Rate</b>	<b>Net</b>	<b>Balance</b>	<b>Rate</b>
	<b>£m</b>	<b>%</b>	<b>Movement</b>	<b>£m</b>	<b>%</b>
			<b>£m</b>		
Long-term borrowing	85.5	3.6	(0.5)	85.0	3.6
Short-term borrowing	97.2	0.3	(26.0)	71.2	0.1
<b>Total borrowing</b>	<b>182.8</b>	<b>1.9</b>	<b>(26.6)</b>	<b>156.2</b>	<b>2.0</b>
Long-term investments	0.0	N/A	0.0	0.0	N/A
Short-term investments	(20.0)	0.03	17.0	(3.0)	0.01
Strategic Pooled Funds	(3.0)	4.59	0.0	(3.0)	5.57
Cash and cash equivalents	(16.0)	0.1	0.8	(15.3)	0.01
<b>Total investments</b>	<b>(39.0)</b>	<b>0.4</b>	<b>17.7</b>	<b>(21.2)</b>	<b>0.4</b>
<b>Net Borrowing</b>	<b>143.8</b>		<b>(8.8)</b>	<b>135.0</b>	

\*\* Annualised return

## 6 BORROWING UPDATE

- 6.1 Local authorities can borrow from the PWLB provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 officer. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing.
- 6.2 Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.
- 6.3 Competitive market alternatives may be available for authorities with or without access to the PWLB. However, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders. Further changes to the CIPFA Prudential Code expected in December 2021 are likely to prohibit borrowing for the primary purpose of commercial return even where the source of borrowing is not the PWLB.
- 6.4 The Authority is not planning to purchase any investment assets primarily for yield within the next three years and so is able fully access the PWLB.
- 6.5 Revised PWLB Guidance
- 6.6 HM Treasury published further guidance on PWLB borrowing in August 2021 providing additional detail and clarifications predominantly around the definition of an 'investment asset primarily for yield'. The principal aspects of the new guidance are:
- 6.7 Capital expenditure incurred or committed to before 26th November 2020 is allowable even for an 'investment asset primarily for yield'.
- 6.8 Capital plans should be submitted by local authorities via a DELTA return. These open for the new financial year on 1st March and remain open all year. Returns must be updated if there is a change of more than 10%.

- 6.9 An asset held primarily to generate yield that serves no direct policy purpose should not be categorised as service delivery.
- 6.10 Further detail on how local authorities purchasing investment assets primarily for yield can access the PWLB for the purposes of refinancing existing loans or externalising internal borrowing.
- 6.11 Additional detail on the sanctions which can be imposed for inappropriate use of the PWLB loan. These can include a request to cancel projects, restrictions to accessing the PLWB and requests for information on further plans.
- 6.12 Changes to PWLB Terms and Conditions from 8th September 2021
- 6.13 The settlement time for a PWLB loan has been extended from two working days (T+2) to five working days (T+5). In a move to protect the PWLB against negative interest rates, the minimum interest rate for PWLB loans has also been set at 0.01% and the interest charged on late repayments will be the higher of Bank of England Base Rate or 0.1%.
- 6.14 Municipal Bonds Agency (MBA): The MBA is working to deliver a new short-term loan solution, available in the first instance to principal local authorities in England, allowing them access to short-dated, low rate, flexible debt. The minimum loan size is expected to be £25 million. Importantly, local authorities will borrow in their own name and will not cross guarantee any other authorities.
- 6.15 If the Authority intends future borrowing through the MBA, it will first ensure that it has thoroughly scrutinised the legal terms and conditions of the arrangement and is satisfied with them.
- 6.16 UK Infrastructure Bank: £4bn has been earmarked for of lending to local authorities by the UK Infrastructure Bank which is wholly owned and backed by HM Treasury. The availability of this lending to local authorities, for which there will be a bidding process, is yet to commence. Loans will be available for qualifying projects at gilt yields plus 0.6%, which is 0.2% lower than the PWLB certainty rate.
- 6.17 **Borrowing Strategy during the period**
- 6.18 At 30<sup>th</sup> September 2021 the Authority held £156.2m of loans, (a decrease of £26.6m from 31<sup>st</sup> March 2021), as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30<sup>th</sup> September are summarised in Table 3 below.

**Table 3: Borrowing Position**

	31.3.21 Balance £m	31.3.21 Weighted Average Rate %	31.3.21 Weighted Average Maturity (years)	Net Movement £m	30.09.21 Balance £m	30.09.21 Weighted Average Rate %	30.09.21 Weighted Average Maturity (years)
Public Works Loan Board	74.2	3.5	17.4	(4.4)	69.7	3.5	17.9
Banks (LOBO)	13.6	4.8	20.8	0.0	13.6	4.8	20.3
Welsh Gov Interest Free	5.1	0.0	3.4	(0.1)	4.9	0.0	3.0
Local authorities/Other	89.9	0.1	0.2	(22.0)	67.9	0.1	0.4
<b>Total borrowing</b>	<b>182.8</b>	<b>1.9</b>	<b>8.8</b>	<b>(26.6)</b>	<b>156.2</b>	<b>2.0</b>	<b>10.1</b>

- 6.19 Gross borrowing reduced considerably by £26.6m to £156.2m in the six months to the 30<sup>th</sup> September 2021 but net borrowing (as shown in table 2) only fell by £8.8m due to an overall reduction in investments. This can be explained by 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 2021. This has resulted in the temporary borrowing requirement reducing until such time that the grant funding is expended. Alongside this reduced activity in the Authorities capital programme during the first six months of the year has reduced the overall borrowing requirement.

- 6.20 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.
- 6.21 In keeping with these objectives, no new long term borrowing was undertaken, while existing loans maturing were replaced with rolling temporary / short terms loans, or internal resources. With short-term interest rates remaining much lower than long-term rates and temporary investments earning Bank Rate or lower, the Authority considers it to be more cost effective in the near term to use internal resources or borrowed rolling temporary / short-term loans.
- 6.22 PWLB funding margins have lurched quite substantially and 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.
- 6.23 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 quarter.

## 7 INVESTMENT UPDATE

- 7.1 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 ranged between £10.0m and £51.7m due to timing differences between income and expenditure. The investment position is shown in table 4 below.

**Table 4: Treasury Investments**

	<b>31.3.21 Balance</b>	<b>Net Movement</b>	<b>30.09.21 Balance</b>	<b>30.09.21 Capital Return</b>	<b>30.09.21 Income Return</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>%</b>	<b>%</b>
Banks & building societies (unsecured)	(2.0)	0.0	(2.0)	n/a	0.00%
Government (incl. local authorities)	(20.0)	17.0	(3.0)	n/a	0.01%
Money Market Funds	(14.0)	0.8	(13.3)	n/a	0.01%
Strategic Pooled funds	(3.0)	0.0	(3.0)	-0.25%	5.57%
<b>Total investments</b>	<b>(39.0)</b>	<b>17.9</b>	<b>(21.3)</b>		

\*\* Annualised return

- 7.2 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.
- 7.3 Ultra low short-dated cash rates which have been a feature since March 2020 when Bank Rate was

cut to 0.1% have resulted in the return on sterling low volatility net asset value money market funds (LVNAV MMFs) being close to zero even after some managers have temporarily waived or lowered their fees. At this stage net negative returns are not the central case of most MMF managers over the short-term, and fee cuts or waivers should result in MMF net yields having a floor of zero, but the possibility cannot be ruled out.

- 7.4 Deposit rates with the Debt Management Account Deposit Facility (DMADF) are also largely around zero.
- 7.5 Given the continuing risk and low returns from short-term unsecured bank investments, the Authority has continued to diversify into more secure and/or higher yielding asset classes as shown in table 4 above.
- 7.6 The progression of risk and return metrics are shown in the quarterly investment benchmarking in Table 5 below.

**Table 5: Investment benchmarking - Treasury investments managed in-house**

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
31.03.2021	AA-	4.26	44%	11	0.00
30.09.2021	A+	4.95	84%	17	0.02
<b>Similar LAs</b>	A+	4.73	58%	48	0.07
<b>All LAs</b>	A+	4.69	69%	10	0.08

- 7.7 **Externally Managed Pooled Funds:** £3m 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<sup>th</sup> September 2021 these funds had generated an average annualised income return of 5.57% which is used to support services in year, and -0.25% of unrealised capital losses.
- 7.8 The improved market sentiment in the first six months of the year is reflected in equity, property and multi-asset fund valuations and, in turn, maintained comparably stable capital values to the Authority's multi-asset income funds in the Authority's portfolio, when compared to prior periods. The prospect of higher inflation and rising bond yields resulted in muted bond fund performance.
- 7.9 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.

## **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 primarily for 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 book value of £30.6m of such non-financial asset investments at the 31<sup>st</sup> March 2021 (£31.0m as at 31<sup>st</sup> March 2020) made up of:

- Oak Grove Solar Farm £5.1m NBV
- Castlegate Business Park & service loan £7.5m NBV
- Newport Leisure Park & service loan £18.0m NBV

8.3 The rest of the Authority's Investment Properties have been held for over a decade and are retained purely for income or capital gain:

- Agricultural Properties £29.8m NBV
- Industrial Properties and Retail Units £3.2m NBV

8.4 These investments are budgeted to generate approximately £1.7m of investment income for the Authority in 2021/22 after taking account of direct costs and contributes to supporting the Authority's ongoing revenue budget.

8.5 Returns on the Newport leisure park investment were severely impacted by the COVID-19 restrictions in place and consequently the Authority has looked to legitimately recover the income losses it suffered from the Welsh Government Local Government hardship fund. The remaining investments were largely unaffected by the restrictions in place and continued to generate investment income for the Authority.

## 9 TREASURY PERFORMANCE

9.1 The Authority measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 6 below.

**Table 6: Performance**

	<b>Forecast 2021/22 £'000</b>	<b>Budget 2021/22 £'000</b>	<b>Over/(under) Spend</b>
PWLB	2,597	2,597	0
Market loans	697	697	0
Short term loans	171	401	(230)
<b>Total Interest payable on borrowing</b>	<b>3,465</b>	<b>3,695</b>	<b>(230)</b>
Invested cash	(5)	0	(5)
Pooled Funds	(118)	(134)	16
Finance lease income	(62)	(62)	0
<b>Total interest from Investments</b>	<b>(185)</b>	<b>(196)</b>	<b>11</b>
<b>Net Over/(Under)spend</b>	<b>3,280</b>	<b>3,499</b>	<b>(219)</b>

## 10 COMPLIANCE

10.1 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.

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

**Table 7: Debt limits**

	<b>2021/22 Maximum during year £m</b>	<b>30.09.21 Actual £m</b>	<b>2021/22 Operational Boundary £m</b>	<b>2021/22 Authorised Limit £m</b>	<b>Complied? Yes/No</b>
Borrowing	182.8	161.2	216.3	246.5	Yes
PFI, Finance Leases & Other LT liabilities	2.4	2.4	2.9	4.4	Yes
<b>Total debt</b>	<b>185.2</b>	<b>163.6</b>	<b>219.2</b>	<b>250.9</b>	

10.3 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.

10.4 Compliance with agreed Investment limits is shown below:

**Table 8: Investment limits**

	<b>2021/22 Maximum</b>	<b>2021/22 Limit</b>	<b>Complied? Yes</b>
The UK Government	£19.2m	Unlimited	Yes
Local authorities & other government entities	£0	£4m	Yes
Secured investments	£0	£4m	Yes
Banks (unsecured)	£2m	£2m	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

#### 10.5 Treasury Management Indicators

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

10.7 **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**

	<b>30.09.21 Actual</b>	<b>2020/21 Target</b>	<b>Complied?</b>
Portfolio average credit	A+/4.95	A-/5.0	Yes

10.8 **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**

	<b>30.09.21 Actual</b>	<b>Lower Limit</b>	<b>Upper Limit</b>	<b>Complied?</b>
Under 12 months	46%	0%	60%	Yes
12 months and within 24 months	3%	0%	30%	Yes
24 months and within 5 years	5%	0%	30%	Yes
5 years and within 10 years	8%	0%	30%	Yes
10 years and within 20 years	13%	0%	30%	Yes
20 years and within 30 years	14%	0%	30%	Yes
30 years and within 40 years	11%	0%	30%	Yes
40 years and within 50 years	0%	0%	30%	Yes
50 years and above	0%	0%	30%	Yes

10.9 **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**

	<b>2021/22</b>	<b>2022/23</b>	<b>2023/24</b>
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

10.10 **Other issues**

10.11 Revisions to CIPFA Codes

10.12 In February 2021 CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These followed the Public Accounts Committee's recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes. In June, CIPFA provided feedback from this consultation.

10.13 In September CIPFA issued the revised Codes and Guidance Notes in draft form and opened the latest consultation process on their proposed changes. The changes include:

- Clarification that (a) local authorities must not borrow to invest primarily for financial return (b) it is not prudent for 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.
- Categorising investments as those (a) for treasury management purposes, (b) for service purposes and (c) for commercial purposes.
- Defining acceptable reasons to borrow money: (i) financing capital expenditure primarily related to delivering a local authority's functions, (ii) temporary management of cash flow within the context of a balanced budget, (iii) securing affordability by removing exposure to future interest rate rises and (iv) refinancing current borrowing, including replacing internal borrowing.

- 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).
- Prudential Indicators
  - New indicator for net income from commercial and service investments to the budgeted net revenue stream.
  - Inclusion of the liability benchmark as a mandatory 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.
- Incorporating ESG issues as a consideration within TMP 1 Risk Management.
- Additional focus on the knowledge and skills of officers and elected members involved in decision making

**10.14 Arlingclose’s Economic Outlook for the remainder of 2021/22 (based on the October 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
<b>Official Bank Rate</b>													
Upside risk	0.00	0.15	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
<b>Arlingclose Central Case</b>	<b>0.10</b>	<b>0.10</b>	<b>0.25</b>	<b>0.25</b>	<b>0.25</b>	<b>0.50</b>							
Downside risk	0.00	0.00	0.15	0.15	0.15	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40

- 10.15 Arlingclose expects Bank Rate to rise in Q2 2022. We believe this is driven as much by the Bank of England’s desire to move from emergency levels as by fears of inflationary pressure.
- 10.16 Investors have priced in multiple rises in Bank Rate to 1% by 2024. While Arlingclose believes Bank Rate will rise, it is by a lesser extent than expected by markets.
- 10.17 The global economy continues to recover from the pandemic but has entered a more challenging phase. The resurgence of 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. This is particularly apparent in the UK due to the impact of Brexit.
- 10.18 While Q2 UK GDP expanded more quickly than initially thought, the ‘pingdemic’ and more latterly supply disruption will leave Q3 GDP broadly stagnant. The outlook also appears weaker. Household spending, the driver of the recovery to date, is under pressure from a combination of retail energy price rises, the end of government support programmes and soon, tax rises. Government spending, the other driver of recovery, will slow considerably as the economy is taken off life support.
- 10.19 Inflation rose to 3.2% in August. A combination of factors will drive this to over 4% in the near term. While the transitory factors affecting inflation, including the low base effect of 2020, are expected to unwind over time, the MPC has recently communicated fears that these transitory factors will feed longer-term inflation expectations that require tighter monetary policy to control. This has driven interest rate expectations substantially higher.
- 10.20 The supply imbalances are apparent in the labour market. While wage growth is currently elevated

due to compositional and base factors, stories abound of higher wages for certain sectors, driving inflation expectations. It is uncertain whether a broad-based increase in wages is possible given the pressures on businesses.

- 10.21 Government bond yields increased sharply following the September FOMC and MPC minutes, in which both central banks communicated a lower tolerance for higher inflation than previously thought. The MPC in particular has doubled down on these signals in spite of softer economic data. Bond investors expect higher near-term interest rates but are also clearly uncertain about central bank policy.
- 10.22 The MPC appears to be playing both sides, but has made clear its intentions to tighten policy, possibly driven by a desire to move away from emergency levels. While the economic outlook will be challenging, the signals from policymakers suggest Bank Rate will rise unless data indicates a more severe slowdown.

## **11 REASONS**

- 11.1 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.

## **12 RESOURCE IMPLICATIONS**

- 12.1 There are no resource implications arising directly from this report.

## **13 CONSULTEES**

Deputy Chief Executive, Chief Officer - Resources (Section 151 officer)  
Arlingclose – Treasury Management Advisors to Monmouthshire CC

## **14 BACKGROUND PAPERS**

Glossary of treasury terms

## **15 AUTHOR**

Jonathan Davies  
Acting Assistant Head of Finance (Deputy Section 151 officer)  
email: [jonathandavies2@monmouthshire.gov.uk](mailto:jonathandavies2@monmouthshire.gov.uk)  
phone: (01633) 644114

## Background paper: Glossary of Treasury Terms

<b>Authorised Limit</b>	<p>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 <i>Operational Boundary</i> to accommodate expected cash movements. Affordability and prudence are matters which must be taken into account when setting this limit.</p> <p>(see also <i>Operational Boundary</i>, below)</p>
<b>Balances and Reserves</b>	Accumulated sums that are maintained either earmarked for specific future costs or commitments or generally held to meet unforeseen or emergency expenditure.
<b>Bail-in</b>	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.
<b>Bank Rate</b>	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'.
<b>Bond</b>	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.
<b>Capital Expenditure</b>	Expenditure on the acquisition, creation or enhancement of capital assets
<b>Capital Financing Requirement (CFR)</b>	The Council's underlying need to borrow for capital purposes representing the cumulative capital expenditure of the local authority that has not been financed.
<b>Capital growth</b>	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)
<b>Capital receipts</b>	Money obtained on the sale of a capital asset.
<b>CIPFA</b>	Chartered Institute of Public Finance and Accountancy
<b>Constant Net Asset Value (CNAV)</b>	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.
<b>Collective Investment Schemes</b>	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.

<b>Corporate Bonds</b>	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.
<b>Corporate Bond Funds</b>	Collective Investment Schemes investing predominantly in bonds issued by companies and supranational organisations.
<b>CPI</b> <i>Also see RPI</i>	Consumer Price Index. (This measure is used as the Bank of England's inflation target.)
<b>Credit Default Swap (CDS)</b>	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.
<b>Credit Rating</b>	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.
<b>Cost of carry</b>	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.
<b>Credit default swaps</b>	Financial instrument for swapping the risk of debt default; the buyer effectively pays a premium against the risk of default.
<b>Diversification / diversified exposure</b>	The spreading of investments among different types of assets or between markets in order to reduce risk.
<b>Derivatives</b>	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'.
<b>ECB</b>	European Central Bank
<b>Federal Reserve</b>	The US central bank. (Often referred to as "the Fed")
<b>Floating Rate Notes</b>	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
<b>GDP</b>	Gross domestic product - also termed as "growth" in the economy. The value of the national aggregate production of goods and services in the economy.
<b>General Fund</b>	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).
<b>Gilts (UK Govt)</b>	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.
<b>Housing Revenue Account (HRA)</b>	A ring-fenced account of all housing income and expenditure, required by statute

<b>IFRS</b>	International Financial Reporting Standards
<b>Income Distribution</b>	The payment made to investors from the income generated by a fund; such a payment can also be referred to as a 'dividend'
<b>Investments</b> - <b>Secured</b> - <b>unsecured</b>	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.
<b>Liability Benchmark</b>	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).
<b>LOBOs</b>	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.
<b>LVNAV (Low Volatility Net Asset Value)</b>	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)
<b>Maturity</b>	The date when an investment or borrowing is repaid.
<b>Maturity profile</b>	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.
<b>MiFID II</b>	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.
<b>Money Market Funds (MMF)</b>	Pooled funds which invest in a range of short term assets providing high credit quality and high liquidity.
<b>Minimum Revenue Provision</b>	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
<b>Non-Specified Investments</b>	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.
<b>Net Asset Value (NAV)</b>	A fund's net asset value is calculated by taking the current value of the fund's assets and subtracting its liabilities.
<b>Operational Boundary</b>	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.

<b>Permitted Investments</b>	Term used by Scottish Authorities as those the Authority has formally approved for use.
<b>Pooled funds</b>	See Collective Investment Schemes (above)
<b>Premiums and Discounts</b>	<p>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.</p> <p>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.</p> <p>*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.</p>
<b>Private Finance Initiative (PFI)</b>	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.
<b>Prudential Code</b>	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.
<b>Prudential Indicators</b>	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.
<b>PWLB</b>	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.
<b>Quantitative Easing</b>	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
<b>Registered Provider of Social Housing</b>	Formerly known as Housing Association
<b>Revenue Expenditure</b>	Expenditure to meet the continuing cost of delivery of services including salaries and wages, the purchase of materials and capital financing charges

<b>RPI</b>	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.
<b>SORP</b>	Statement of Recommended Practice for Accounting (Code of Practice on Local Authority Accounting in the United Kingdom).
<b>Specified Investments</b>	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.
<b>Supported Borrowing</b>	Borrowing for which the costs are supported by the government or third party.
<b>Supranational Bonds</b>	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.
<b>Treasury Management Code</b>	CIPFA's Code of Practice for Treasury Management in the Public Services. The current Code is the edition released in autumn 2011.
<b>Temporary Borrowing</b>	Borrowing to cover peaks and troughs of cash flow, not to fund spending.
<b>Term Deposits</b>	Deposits of cash with terms attached relating to maturity and rate of return (interest)
<b>Unsupported Borrowing</b>	Borrowing which is self-financed by the local authority. This is also sometimes referred to as Prudential Borrowing.
<b>Usable Reserves</b>	Resources available to finance future revenue and capital expenditure
<b>Variable Net Asset Value (VNAV)</b>	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.
<b>Working Capital</b>	Timing differences between income/expenditure and receipts/payments
<b>Yield</b>	The measure of the return on an investment instrument