

REPORT

SUBJECT:	TREASURY OUTTURN REPORT 2021/22
MEETING:	Governance & Audit Committee
DATE:	14th July 2022
DIVISIONS/WARD AFFECTED:	All

1. **PURPOSE:**

- 1.1. During 2021/22, the Council's treasury management activity was underpinned by the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code for Capital Finance in Local Authorities (the Prudential Code), and complimented by the CIPFA guidance "Treasury Management in the Public Services" which sets out good practice in treasury management.
- 1.2. These place a requirement on local authorities to produce annually a Treasury Management Strategy Statement and Prudential Indicators on their likely financing and investment activity, and to ensure that the appropriate governance function that oversees the treasury management activities of the Authority is kept informed at least twice a year.
- 1.3. This report represents the second update of treasury management activity during 2021/22 following the [mid-year report](#) to Governance & Audit committee on the 3rd November 2021.

2. **RECOMMENDATIONS:**

- 2.1. That Governance & Audit committee review the results of treasury management activities and the performance achieved in 2021/22 as part of their delegated responsibility to provide scrutiny of treasury policy, strategy and activity on behalf of Council.

3. **SUMMARY OF KEY ISSUES:**

- 3.1. The continuing economic recovery from coronavirus pandemic, together with the war in Ukraine, higher inflation, and higher interest rates were major issues over the period.
- 3.2. The Bank of England (BoE) increased the bank rate across the year from 0.10% to 0.75% by March 2022. The MPC also voted unanimously to start reducing the stock of its asset purchase scheme by ceasing to reinvest the proceeds from maturing bonds as well as starting a programme of selling its corporate bonds.
- 3.3. Inflation has increased significantly over the course of the year from 0.7% in March 2021 to 7.0% in March 2022. Inflation was initially driven by a combination of rising global costs and strong demand which was exacerbated by supply shortages and transport dislocations. The MPC noted that the invasion of Ukraine had caused further large increases in energy and other commodity prices, with the expectation that the conflict will worsen supply chain disruptions around the world and push CPI inflation to around 8% later in 2022

- 3.4. In a local context the treasury strategy of the Authority continued with the approach of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce counterparty risk and keep interest costs low.
- 3.5. At the 31st March 2022 the Authority had a borrowing [Capital Financing Requirement](#) (CFR) of £187.0m and gross external borrowing of 178.5m. Total borrowing has reduced year-on-year by £4.3m which primarily related to the temporary high borrowing balance at the previous year end alongside the delay in expending budgeted capital expenditure during the year.
- 3.6. Borrowing rates increased during the year and further rises are expected in the near term. As a response to this, during the year the Authority looked to secure additional long-term borrowing at comparatively low rates. This has increased the proportion of long-term to short-term borrowing and provides an added element of balance and certainty over future interest payments. The movement in the overall maturity structure of borrowing is noted in table 11 of this report.
- 3.7. In year, the Authority's total treasury investments increased by £9.0m to £48m primarily due to higher temporary year end balances relating to the receipt of large amounts of unbudgeted grant towards the end of March 2022. This position was temporary in nature and since year-end investment balances have reduced considerably in line with expected cashflow.
- 3.8. 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).
- 3.9. £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. These funds generated an average total return 3.26%, comprising a 3.43% income return which is used to support services in year, and 0.17% of unrealised capital losses. It is important to note that unrealised capital movements on these funds do not impact the income and expenditure account of the Authority and will only materialise at the time that the investments are disposed of. At the 31st March 2022 net unrealised capital losses across all pooled funds totalled £38,509.
- 3.10. As shown in section 11 the Authority achieved a saving of £506,000 against net treasury budgets of £3.6m primarily due to lower overall borrowing costs than budgeted as rates remained at extremely low levels for the majority of the year.
- 3.11. As reported in sections 12 and 13, the Authority complied with the CIPFA code of practice on treasury management, and acted within the approved 2021/22 Treasury management strategy and indicators during the year.
- 3.12. **Impact of the Covid-19 pandemic on treasury activities**
- 3.13. Since the outbreak of the pandemic the Council has needed to monitor the impact on cash flow closely. Throughout 2021/22 the Council saw an increase in Covid-19 related expenditure, a reduction in income across some services, and pressures in the collection of Council Tax and Non-Domestic Rates (NDR) which resulted in additional support in the form of extraordinary settlement funding and the provision of resourcing to assist with taxation relief schemes such as NDR Relief Scheme for retail, leisure and hospitality businesses.
- 3.14. All of the above had a significant impact on cash flow, however Welsh Government mitigated a significant proportion of this impact by reimbursing increased expenditure and income losses through the funding support provided. The Council has therefore not been required to undertake additional borrowing to address cash flow considerations.

4. **INTRODUCTION**

- 4.1. The Authority's treasury management strategy for 2021/22 was approved by Council on 11th March 2021. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Authority's treasury management strategy.
- 4.2. Treasury risk management at the Authority is conducted within the framework of the CIPFA Prudential code and Treasury Management in the Public Services which requires the Authority to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report.
- 4.3. This annual treasury outturn report presents the following information:
- An update on the [external market conditions](#) impacting treasury activity during the year;
 - An update of the [movement in treasury balances](#) and performance against budget during the year;
 - details of [borrowing strategy](#), [investment activity](#) and [non-treasury investment](#) performance;
 - [compliance](#) with treasury limits and indicators for the year.

5. **External market conditions**

- 5.1. Economic background (as at 31st March 2022): The continuing economic recovery from coronavirus pandemic, together with the war in Ukraine, higher inflation, and higher interest rates were major issues over the period.
- 5.2. [Bank Rate](#) was 0.1% at the beginning of the reporting period. April and May saw the economy gathering momentum as the shackles of the pandemic restrictions were eased. Despite the improving outlook, market expectations were that the Bank of England would delay rate rises until 2022. Rising, persistent inflation changed that.
- 5.3. UK CPI was 0.7% in March 2021 but thereafter began to steadily increase. Initially driven by energy price effects and by inflation in sectors such as retail and hospitality which were re-opening after the pandemic lockdowns, inflation then was believed to be temporary. Thereafter price rises slowly became more widespread, as a combination of rising global costs and strong demand was exacerbated by supply shortages and transport dislocations. The surge in wholesale gas and electricity prices led to elevated inflation expectations. CPI for February 2022 registered 6.2% year on year, up from 5.5% in the previous month and the highest reading in the National Statistic series. Core inflation, which excludes the more volatile components, rose to 5.2% y/y from 4.4%.
- 5.4. The government's jobs furlough scheme insulated the labour market from the worst effects of the pandemic. The labour market began to tighten and demand for workers grew strongly as employers found it increasingly difficult to find workers to fill vacant jobs. Having peaked at 5.2% in December 2020, unemployment continued to fall and the most recent labour market data for the three months to January 2022 showed the unemployment rate at 3.9% while the employment rate rose to 75.6%. Headline 3-month average annual growth rate for wages were 4.8% for total pay and 3.8% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 0.1% while regular pay fell by 1.0%.
- 5.5. With the fading of lockdown – and, briefly, the 'pingdemic' – restraints, activity in consumer-facing sectors improved substantially as did sectors such as oil and mining with the reopening of oil rigs but

materials shortages and the reduction in the real spending power of households and businesses dampened some of the growth momentum. Gross domestic product (GDP) grew by an upwardly revised 1.3% in the fourth calendar quarter of 2021 according to the final estimate (initial estimate 1.0%) and took UK GDP to just 0.1% below where it was before the pandemic. The annual growth rate was revised down slightly to 7.4% (from 7.5%) following a revised 9.3% fall in 2020.

- 5.6. Having increased Bank Rate from 0.10% to 0.25% in December, the Bank of England hiked it further to 0.50% in February and 0.75% in March. At the meeting in February, the Monetary Policy Committee (MPC) voted unanimously to start reducing the stock of its asset purchase scheme by ceasing to reinvest the proceeds from maturing bonds as well as starting a programme of selling its corporate bonds.
- 5.7. In its March interest rate announcement, the MPC noted that the invasion of Ukraine had caused further large increases in energy and other commodity prices, with the expectation that the conflict will worsen supply chain disruptions around the world and push CPI inflation to around 8% later in 2022, even higher than forecast only a month before in the February Monetary Policy Report. The Committee also noted that although GDP in January was stronger than expected with business confidence holding up and the labour market remaining robust, consumer confidence had fallen due to the squeeze in real household incomes.
- 5.8. GDP growth in the euro zone increased by 0.3% in calendar Q4 2021 following a gain of 2.3% in the third quarter and 2.2% in the second. Headline inflation remains high, with CPI registering a record 7.5% year-on-year in March, the ninth successive month of rising inflation. Core CPI inflation was 3.0% y/y in March, was well above the European Central Bank's target of 'below, but close to 2%', putting further pressure on its long-term stance of holding its main interest rate of 0%.
- 5.9. The US economy expanded at a downwardly revised annualised rate of 6.9% in Q4 2021, a sharp increase from a gain of 2.3% in the previous quarter. In its March 2022 interest rate announcement, the Federal Reserve raised the Fed Funds rate to between 0.25% and 0.50% and outlined further increases should be expected in the coming months. The Fed also repeated its plan to reduce its asset purchase programme which could start by May 2022.
- 5.10. Financial markets: The conflict in Ukraine added further volatility to the already uncertain inflation and interest rate outlook over the period. The Dow Jones started to decline in January but remained above its pre-pandemic level by the end of the period while the FTSE 250 and FTSE 100 also fell and ended the quarter below their pre-March 2020 levels.
- 5.11. Bond yields were similarly volatile as the tension between higher inflation and flight to quality from the war pushed and pulled yields, but with a general upward trend from higher interest rates dominating as yields generally climbed.
- 5.12. The 5-year UK benchmark [gilt yield](#) began the quarter at 0.82% before rising to 1.41%. Over the same period the 10 year gilt yield rose from 0.97% to 1.61% and the 20-year yield from 1.20% to 1.82%.
- 5.13. The Sterling Overnight Rate (SONIA) averaged 0.39% over the quarter.
- 5.14. Credit review: In the first half of FY 2021-22 [credit default swap \(CDS\)](#) spreads were flat over most of period and are broadly in line with their pre-pandemic levels. In September spreads rose by a few basis points due to concerns around Chinese property developer Evergrande defaulting but then fell back. Fitch and Moody's revised upward the outlook on a number of UK banks and building societies on the Authority's counterparty to 'stable', recognising their improved capital positions compared to 2020 and better economic growth prospects in the UK.

- 5.15. Fitch also revised the outlook for Nordea, Svenska Handelsbanken and Handelsbanken plc to stable. The agency considered the improved economic prospects in the Nordic region to have reduced the baseline downside risks it previously assigned to the lenders.
- 5.16. The successful vaccine rollout programme was credit positive for the financial services sector in general and the improved economic outlook meant some institutions were able to reduce provisions for bad loans. However, in 2022, the uncertainty engendered by Russia's invasion of Ukraine pushed CDS prices modestly higher over the first calendar quarter, but only to levels slightly above their 2021 averages, illustrating the general resilience of the banking sector.
- 5.17. Having completed its full review of its credit advice on unsecured deposits, in September Arlingclose extended the maximum duration limit for UK bank entities on its recommended lending list from 35 days to 100 days; a similar extension was advised in December for the non-UK banks on this list. As ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remains under constant review.

6. **Revised CIPFA Codes, Updated PWLB Lending Facility Guidance**

- 6.1. In August 2021 HM Treasury significantly revised guidance for the [PWLB](#) lending facility with more detail and 12 examples of permitted and prohibited use of PWLB loans. 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. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.
- 6.2. CIPFA published its revised Prudential Code for Capital Finance and Treasury Management Code on 20th 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.
- 6.3. The principles of the Prudential Code took immediate effect although local authorities could defer introducing the revised reporting requirements until the 2023/24 financial year if they wish. Monmouthshire have taken the decision to defer the requirement to report on treasury activity quarterly until the 2023/24 financial year.
- 6.4. To comply with the Prudential Code, authorities must not borrow to invest primarily for financial return. This Code also states that it is not prudent for local authorities to make investment or spending decisions that will increase the CFR unless directly and primarily related to the functions of the authority. Existing commercial investments are not required to be sold; however, authorities with existing commercial investments who expect to need to borrow should review the options for exiting these investments.
- 6.5. Borrowing is permitted for cashflow management, interest rate risk management, to refinance current borrowing and to adjust levels of internal borrowing. Borrowing to refinance capital expenditure primarily related to the delivery of a local authority's function but where a financial return is also expected is allowed, provided that financial return is not the primary reason for the expenditure. The changes align the CIPFA Prudential Code with the PWLB lending rules.
- 6.6. Unlike the Prudential Code, there is no mention of the date of initial application in the Treasury Management Code. The TM Code now includes extensive additional requirements for service and commercial investments, far beyond those in the 2017 version.

7. **Movement in Treasury balances**

- 7.1. 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 to offset the CFR or for investment.
- 7.2. On 31st March 2022, the Authority had net investments of £48.0m arising from its revenue and capital income and expenditure activity. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.21 Actual £m	Movement Actual £m	31.3.22 Actual £m
General Fund CFR	189.2	0.2	189.4
Less: *Other debt liabilities	(2.4)	(0.0)	(2.4)
Borrowing CFR	186.8	0.2	187.0
External borrowing	(182.8)	7.3	(175.5)
Internal borrowing	4.1	7.4	11.5
Less: Usable reserves	(28.5)	(10.1)	(42.7)
Less: Working capital	(14.6)	(2.2)	(16.8)
(Net Investments) at 31st March 2021	(39.0)	(9.0)	(48.0)

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

- 7.3. 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 therefore pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce overall risk and keep interest costs low.
- 7.4. The treasury management position at 31st March 2022 and the change during the year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.21 Balance £m	31.3.21 Rate %	Movement £m	31.3.22 Balance £m	31.3.22 Rate %
Long-term borrowing	85.5	3.6	18.8	104.3	3.1
Short-term borrowing	97.2	0.3	(26.0)	71.2	0.2
Total borrowing	182.8	1.9	(7.3)	175.5	2.0
Long-term investments	0.0	N/A	0.0	0.0	N/A
Short-term investments	(20.0)	0.5	6.0	(14.0)	0.12
Pooled Funds	(3.0)	4.6	(1.0)	(4.0)	3.40
Cash and cash equivalents	(16.0)	Included in ST above	(14.0)	(30.0)	Included in ST above
Total investments	(39.0)	0.5	(9.0)	(48.0)	0.40
Net Borrowing	143.8		(16.3)	127.5	

- 7.5. Interest rates increased during the year and are expected to increase further in the near term. As such, during the year the Authority looked to secure additional long-term borrowing at comparatively low rates. This has increased the proportion of long-term to short-term borrowing and provides an added

element of certainty over future interest payments.

- 7.6. The balance of cash and cash equivalents at the 31st March 2022 was significantly higher than the previous year end reflective of the receipt of significant temporary external grant funding that was expected to be expended in the near term, and consequently was held in extremely liquid instruments.
- 7.7. 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 3 below.

Table 3: Performance

Interest Payable	Actual £'000	Budget £'000	Over/ (under)
PWLB	2,620	2,597	23
Market loans	652	697	(45)
Short term loans	127	443	(315)
Total Interest payable on borrowing	3,399	3,737	(337)
Interest Receivable	Actual £'000	Budget £'000	Over/ (under)
Invested cash short term	(30)	(134)	104
Pooled Funds	(140)	Included above	(140)
Finance lease income	(58)	Included above	(58)
Other Interest	(75)	Included above	(75)
Total income from Investments	(303)	(134)	(169)
Net Over/(Under)spend	3,096	3,603	(506)

8. Borrowing strategy during the year

- 8.1. At 31st March 2022 the Authority held £175.5m of loans, a decrease of £7.3m to 31st March 2021, as part of its strategy for funding previous and current years' capital programmes.

Table 4: Borrowing Position

	31.3.21 Balance	31.3.21 Weighted Average	31.3.21 Weighted Average	Balance movement	31.3.22 Balance	31.3.22 Weighted Average	31.3.22 Weighted Average
	£m	Rate %	Maturity (years)	£m	£m	Rate %	Maturity (years)
Public Works Loan Board	74.2	3.5	17.4	12.6	86.8	3.1	24.8
Banks (LOBO)	13.6	4.8	20.8	0.0	13.6	4.8	19.8
Welsh Gov Interest Free	5.1	0.0	3.4	1.0	6.0	0.0	3.3
Local authorities/Other	89.9	0.1	0.2	(20.9)	69.0	0.1	0.3
Total borrowing	182.8	1.9	8.8	(7.3)	175.5	2.0	14.0

- 8.2. Whilst the Council has significant long-term borrowing requirements, the Council has continued its strategy of internal borrowing, where the Council seeks to use its existing cash balances and reserves to afford its capital expenditure prior to the necessity to take out external borrowing.
- 8.3. However the Authority's chief objective when borrowing has always 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. To that end, during the year some short-term borrowing was replaced with long term PWLB borrowing at competitive rates of interest.
- 8.4. Having considered the appropriate duration and structure of the borrowing need based on realistic projections, the Authority borrowed £20m of longer-term fixed rate loans during the year, details of which are below. These loans provide some longer-term certainty and stability to the debt portfolio.

Table 5: Long-dated Loans borrowed

Long-dated Loans borrowed	Amount £m	Rate %	Period (Years)
PWLB Maturity Loan	5.0	1.43	45
PWLB Maturity Loan	5.0	1.37	50
PWLB Maturity Loan	2.5	1.31	46
PWLB Maturity Loan	2.5	1.30	47
PWLB Maturity Loan	2.5	1.29	48
PWLB Maturity Loan	2.5	1.27	49
Total	20.0		

- 8.5. The requirement for short-term borrowing during the year was further reduced with the receipt of significant amounts of unbudgeted grants in the final quarter of the year.
- 8.6. It is important to note that the Authority's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short and longer-term borrowing has been maintained.
- 8.7. PWLB funding margins continued to lurch quite substantially during the year and there remains a strong argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields + 0.80%. The Authority will evaluate and pursue these lower cost solutions and opportunities with its advisor Arlingclose.
- 8.8. **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 year.
- 8.9. The Authority currently holds commercial investments that were purchased prior to the change in the CIPFA Prudential Code. The Authority is not planning to purchase any investment assets primarily for yield within the next three years and so is able to access PWLB borrowing if considered cost effective.

9. **Investment activity during the year**

- 9.1. CIPFA published a revised Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes on 20th December 2021. These define treasury management investments as investments that arise from the organisation's cash flows or treasury risk management activity that

ultimately represents balances that need to be invested until the cash is required for use in the course of business.

- 9.2. The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged from between £18m and £62m due to timing differences between income and expenditure. The investment position at year end is shown in table 6 below.

Table 6: Treasury Investment Position

	31.3.21	Net	31.3.22	31.3.22	31.3.22
	Balance	Movement	Balance	Income	Weighted
	£m	£m	£m	Return	Average
				%	Maturity
					days
Banks & building societies (unsecured)	(2.0)	0.0	(2.0)	Average 0.03%	Up to 180 days
Government (incl. local authorities)	(20.0)	6.0	(14.0)		
Money Market Funds (MMFs)	(14.0)	(14.0)	(28.0)		
Multi asset income, Pooled funds	(3.0)	(1.0)	(4.0)	3.43%	N/A
Total investments	(39.0)	(9.0)	(48.0)		

- 9.3. Receipt of unbudgeted grant in the last quarter of the year along with significant capital slippage at year end increased temporary investment balances compared to 31st March 2021. These short-term balances were invested in highly liquid Money Market Funds and Government Deposits to ensure they could be called upon once required.
- 9.4. Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.
- 9.5. Ultra low short-dated cash rates, which were a feature since March 2020 when Bank Rate was cut to 0.1%, prevailed for much of the 12-month reporting period which resulted in the return on sterling low volatility net asset value (LVNAV) Money Market Funds being close to zero even after some managers have temporarily waived or lowered their fees. However, higher returns on cash instruments followed the increases in Bank Rate in December, February and March. At 31st March 2022, the 1-day return on the Authority's [MMFs](#) ranged between 0.48% - 0.58% p.a.
- 9.6. Similarly, deposit rates with the Debt Management Account Deposit Facility (DMADF) initially remained very low with rates ranging from 0% to 0.1%, but following the hikes to base rates these increased to between 0.55% and 0.85% depending on the deposit maturity. The average return on the Authority's DMADF deposits was 0.1%.
- 9.7. Given the risk and low returns from short-term unsecured bank investments, the Authority increased its diversification in higher yielding asset classes as shown in table 6 above by £1m and that is available for longer-term investment and invested in multi-asset funds.
- 9.8. The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 7 below.

Table 7: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	<u>Bail-in Exposure</u>	Weighted Average Maturity (days)	Rate of Return %
MCC 31.03.2021	AA-	4.26	44%	11	0.00
MCC 31.03.2022	AA-	3.81	59%	4	0.64
Similar LAs	AA-	3.86	28%	75	0.59
All LAs	AA-	4.47	60%	14	0.97

9.9. £4m of the Authority’s investments are invested 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. These funds generated an average total return of £130k (3.26%), comprising a £136k (3.43%) income return which is used to support services in year, and -£6k (-0.17%) of capital loss.

9.10. In the nine months to December 2021, improved market sentiment was reflected in equity, property and multi-asset fund valuations and, in turn, in the capital values of the Authority’s property and multi-asset income funds in the Authority’s portfolio. The prospect of higher inflation and rising bond yields did however result in muted bond fund performance. In the January-March quarter the two dominant themes were tighter UK and US monetary policy and higher interest rates, and the military invasion of Ukraine by Russia in February, the latter triggering significant volatility and uncertainty in financial markets.

9.11. In light of Russia’s invasion, Arlingclose contacted the fund managers of our MMF and strategic funds and confirmed no direct exposure to Russian or Belarusian assets had been identified. It should be noted that any assets held by banks and financial institutions (e.g. from loans to companies with links to those countries) within MMFs and other pooled funds cannot be identified easily or with any certainty as that level of granular detail is unlikely to be available to the fund managers or Arlingclose in the short-term, if at all.

9.12. 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.

9.13. Investments in Pooled Funds have been increased by £1m during the year in order to provide stability to investment income returns over a more medium term outlook and reflective of the fact that the authority is required to hold a minimum of £10m in investments under MiFiD II requirements.

10. Non-Treasury Investments

10.1. The definition of investments in CIPFA’s revised 2021 Treasury Management Code covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and/or for commercial purposes (made primarily for financial return).

- 10.2. Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) and Welsh Government also broadens the definition of investments to include all such assets held partially or wholly for financial return.
- 10.3. The Authority held a net book value of £30.4m of such non-financial asset investments at the 31st March 2022 (£30.6m as at 31st March 2021) made up of:
- Oak Grove Solar Farm: £5.4m NBV
 - Castlegate Business Park & service loan: £6.1m NBV
 - Newport Leisure Park & service loan: £18.9m NBV
- 10.4. The rest of the Authority's Investment Properties have been held for over a decade and are retained for income generation, capital gain or to support wider economic development or broader policy objectives:
- Agricultural Properties: £33.6m NBV
 - Industrial Properties and Retail units: £3.4m NBV
- 10.5. Returns on the Newport leisure park investment continued to be impacted by the underlying impact of the pandemic during the year and consequently the Authority looked to legitimately recover the income losses it suffered from the Welsh Government Local Government hardship fund. As the year progressed and the impact of the pandemic subsided somewhat, reliance on the hardship fund reduced considerably.
- 10.6. The remaining investments were largely unaffected during the year by the impact of the pandemic, however the Council will need to consider the longer lasting and more indirect impacts of the pandemic that may take some time to develop, and in particular the wider challenging economic picture.
- 10.7. Overall, non-treasury investments continued to generate approximately £2.7m of investment income for the Authority net of direct costs and this continues to support the Authority's ongoing revenue budget.

11. **Compliance with treasury limits and indicators**

- 11.1. The Section 151 officer reports that all treasury management activities undertaken during the year complied fully with the CIPFA code and the limits and indicators as set out in the Authority's approved Treasury Management Strategy.
- 11.2. **Borrowing limits:** Compliance with the [authorised limit](#) and [operational boundary](#) for external debt is demonstrated in table 8 below.

Table 8: Borrowing Limits

	2021/22 Maximum during year £m	31.3.22 Actual £m	2021/22 Operational Boundary £m	2021/22 Authorised Limit £m	Complied? Yes/No
Borrowing	191.8	175.5	216.3	246.5	Yes
PFI, Finance Leases & Other LT liabs	2.4	2.4	2.9	4.4	Yes
Total debt	194.2	177.9	219.2	250.9	Yes

11.3. **Note:** 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.

Table 9: Investment Limits

	31.3.22	2021/22	Complied?
	Maximum in year	Limit	Yes/No
The UK Government	£33.4m	Unlimited	Yes
Local Authorities per counterparty	£0m	£4m	Yes
Secured Investments	£0m	£4m	Yes
Banks per counterparty, rating A- or above	£2m	£2m	Yes
Building societies (unsecured)	£0m	£2m	Yes
Registered providers (e.g. Housing Associations (unsecured)	£0m	£2m	Yes
Money Market Funds	£4m	£4m	Yes
Any group of pooled funds under the same management	£2m	£5m	Yes
Real estate investment trusts	£0m	£5m	Yes
Limit per non-UK country	£0m	£4m	Yes
Other Investments	£0m	£2m	Yes

11.4. **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 10: Credit Risk

	31.3.22 Actual	2021/22 Target	Complied?
Portfolio average credit	AA-/3.81	A-/5.0	Yes

11.5. **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 11: Maturity Structure of borrowing

Maturity	31.3.22 Actual	Lower Limit	Upper Limit	Complied?	31.3.21 Actual (For info)
Under 12 months	41%	0%	60%	Yes	53%
12 months and within 24 months	2%	0%	30%	Yes	1%
24 months and within 5 years	6%	0%	30%	Yes	6%
5 years and within 10 years	6%	0%	30%	Yes	7%
10 years and within 20 years	12%	0%	30%	Yes	5%
20 years and within 30 years	15%	0%	30%	Yes	18%
30 years and within 40 years	7%	0%	30%	Yes	10%
40 years and within 50 years	11%	0%	30%	Yes	0%
50 years and above	0%	0%	30%	Yes	0%

11.6. **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 12: Principal invested for period longer than a year

	During 2021/22
Actual principal invested for 365 days & beyond year end	£0m
Limit	£6m
Complied?	Yes

12. **Other Issues**

12.1. **IFRS 16:** The implementation of the new IFRS 16 Leases accounting standard was due to come into force for local authorities from 1st April 2022. Following a consultation CIPFA/LASAAC announced an optional two year delay to the implementation of this standard, a decision which was confirmed by the Financial Reporting Advisory Board in early April 2022. Authorities can now choose to adopt the new standard on 1st April 2022, 1st April 2023 or 1st April 2024. The Authority intends to adopt the new standard on 1st April 2024.

13. **REASONS**

13.1. The Authority's Treasury Management Strategy for 2021/22 was underpinned by the adoption of the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code), and complimented by the CIPFA guidance "Treasury Management in the Public Services" which sets out good practice in treasury management.

13.2. The code requires the Authority to set a treasury strategy each financial year for financing and investment activities and recommends 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.

14. **RESOURCE IMPLICATIONS**

14.1. The outturn position is explained in the report, there are no other resource implications arising directly from this report.

15. **CONSULTEES**

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

Arlingclose – External Treasury management advisors to Monmouthshire CC

16. **BACKGROUND PAPERS**

Glossary of treasury terms

17. **AUTHORS:**

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Background paper: Glossary of Treasury Terms

Authorised Limit	<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>
Balances and Reserves	<p>Accumulated sums that are maintained either earmarked for specific future costs or commitments or generally held to meet unforeseen or emergency expenditure.</p>
Bail-in	<p>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.</p>
Bank Rate	<p>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'.</p>
Bond	<p>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.</p>
Capital Expenditure	<p>Expenditure on the acquisition, creation or enhancement of capital assets</p>
Capital Financing Requirement (CFR)	<p>The Council's underlying need to borrow for capital purposes representing the cumulative capital expenditure of the local authority that has not been financed.</p>
Capital growth	<p>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)</p>
Capital receipts	<p>Money obtained on the sale of a capital asset.</p>
CIPFA	<p>Chartered Institute of Public Finance and Accountancy</p>
Constant Net Asset Value (CNAV)	<p>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.</p>
Collective Investment Schemes	<p>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.</p>

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 <i>Also see RPI</i>	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	<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>
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.
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