

REPORT TITLE: TREASURY MANAGEMENT MID YEAR MONITORING REPORT
2021/22

16 DECEMBER 2021

REPORT OF CABINET MEMBER: Cllr Neil Cutler, Deputy Leader and Cabinet
Member for Finance and Risk

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WARD(S): ALL WARDS

PURPOSE

This report provides detail of the performance of the treasury management function. This includes the effects of the decisions taken in the past six months, and confirmation that there were no instances of non-compliance with the Council's Treasury Management Policy Statement and Treasury Management Practices, for 2021/22 to date.

RECOMMENDATIONS:

1. Note the Treasury Management Mid-Year Monitoring Report 2021/22.

IMPLICATIONS:

1 COUNCIL PLAN OUTCOME

- 1.1 Treasury management is an integral part of helping to deliver the Council Strategy and all of its outcomes. Of key importance is ensuring the security and sufficient liquidity of the council's cash and investment balances whilst, where possible, optimising the yield from those investments. The income from investments is available to be used by the council in achieving its objectives.

2 FINANCIAL IMPLICATIONS (to be reviewed by s151 officer)

- 2.1 Effective treasury management ensures both the financial security and liquidity of the council.

3 LEGAL AND PROCUREMENT IMPLICATIONS

- 3.1 The Council's Treasury Management Strategy Statement follows the latest codes of practice and the MHCLG (now known as the Department for Levelling Up, Housing and Communities) and CIPFA guidance.
- 3.2 With effect from September 2014 Hampshire County Council (HCC) and Winchester City Council (WCC) established arrangements for the joint discharge of functions under Section (101)(1) and (5) of the Local Government Act 1972 and Section 9EA and 9EB Local Government Act 2000. Under this arrangement, HCC's Investments and Borrowing Team provide a Treasury Service which includes the management of WCC's cash balances and investment of surplus cash or sourcing of short-term borrowing in accordance with the agreed Treasury Management Strategy Statement.

4 WORKFORCE IMPLICATIONS

- 4.1 HCC's Investments and Borrowing Team carry out the day to day management of the council's cash balances and investments. The council's in-house finance team undertake the accounting and retain responsibility for long-term borrowing decisions.

5 PROPERTY AND ASSET IMPLICATIONS

- 5.1 None

6 CONSULTATION AND COMMUNICATION

- 6.1 This report has been produced in consultation with HCC's Investments & Borrowing team.

7 ENVIRONMENTAL CONSIDERATIONS

- 7.1 Following the council's declaration of a Climate Emergency in June 2019 and in line with the ethical stances in its investment policy, the council has no

direct or indirect equity investments in companies directly involved in the fossil fuel industry.

8 EQUALITY IMPACT ASSESSEMENT

8.1 There are no actions which arise directly from this report.

9 DATA PROTECTION IMPACT ASSESSMENT

9.1 None required

10 RISK MANAGEMENT

Risk	Mitigation	Opportunities
<i>Returns from investments are too low</i>	A diversified strategy that attempts to manage the balance between liquidity risk, credit risk and yield within the council's risk appetite.	Returns above budgeted levels
<i>A counterparty fails</i>	A diversified strategy that has relatively low levels of counter-party risk	
<i>Cash is not available</i>	A balanced portfolio of liquid and long term funds are held to ensure cash is available to utilise. The council also mitigates this risk through cashflow forecasting	More accurate and immediate cashflow forecasting can help improve the return on investments through more active treasury management activity

11 SUPPORTING INFORMATION:

12 Introduction

12.1 The council has adopted the key recommendations of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code), last updated in 2017. The CIPFA Code requires the council to approve a treasury management strategy before the start of the year, a mid-year report, and annual treasury outturn report. The purpose of this report is therefore to meet this obligation by providing an update on the performance of the treasury management function at the mid-year point.

13 Summary

13.1 The report fulfils the council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code and provides an update on the performance of the treasury management function during 2021/22.

13.2 The council's treasury management strategy was most recently updated and approved at a meeting of Full Council in February 2021. The council has borrowed and invested 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 are therefore central to the council's treasury management strategy.

- 13.3 Treasury management in the context of this report is defined as: "the management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."
- 13.4 This report sets out the performance of the treasury management function from the beginning of April to the end of September 2021, to include the effects of the decisions taken and the transactions executed in the past year.
- 13.5 Hampshire County Council's Investments & Borrowing Team has been contracted to manage the council's treasury management balances since September 2014 but overall responsibility for treasury management remains with Winchester City Council. No treasury management activity is without risk and as such the effective identification and management of risk are integral to the council's treasury management objectives.
- 13.6 All treasury activity has complied with the council's Treasury Management Strategy and Investment Strategy for 2021/22, and all relevant statute, guidance and accounting standards. In addition, support in undertaking treasury management activities has been provided by the council's treasury advisers, Arlingclose.
- 13.7 The 2017 Prudential Code includes a requirement for local authorities to produce a Capital Strategy, a summary document approved by Full Council covering capital expenditure and financing, treasury management and non-treasury investments. The latest iteration of the council's Capital and Investment Strategy, complying with CIPFA's requirement, was approved by Full Council in February 2021 (CAB3283).

14 External Context

- 14.1 The following sections outline the key economic themes in the UK against which investment and borrowing decisions have been made so far in 2021/22.

Economic commentary

- 14.2 The coronavirus pandemic continued to dominate the news during the period, with economic resurgence following the rapid vaccination programme.
- 14.3 The Bank of England (BoE) has held Bank Rate at 0.1% since March 2020 and has maintained its Quantitative Easing programme at £895bn since November 2020. 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. 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.

Financial markets

- 14.4 Ongoing monetary and fiscal stimulus together with improving economic growth prospects and successful vaccine rollout programmes continued to boost equity markets over the period. In the UK, the FTSE 250 index continued making gains over pre-pandemic levels and the more internationally focused FTSE 100 saw more modest gains over the period and remains below its pre-crisis peak.
- 14.5 Inflation worries continued during the period but declines in bond yields between April and June suggest bond markets may be expecting any general price increases to be less severe, or more transitory, than was previously thought. However, an increase in gas prices in the UK and European Union, 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 instances, lead to higher prices. UK government bonds remained positive over the period.

Credit review

- 14.6 Credit default swap spreads were flat over the period and are broadly in line with their pre-pandemic levels. Credit default swaps are used as an indicator of credit risk, where higher premiums indicate higher perceived risks.
- 14.7 Over the period credit ratings agencies, Fitch and Moody's, upwardly revised to stable the outlook on a number of UK banks and building societies on Arlingclose's counterparty list, recognising their improved capital positions compared to last year and better economic growth prospects in the UK.
- 14.8 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.
- 14.9 On 24 September 2021 Arlingclose published its review of its credit advice on unsecured deposits, judging that the UK has seen six months of positive GDP growth, and while forward-looking indicators suggest that economic growth has entered a slower phase as the UK heads into autumn, and the risks around both the continuing pandemic and a period of economic adjustment post government support remain, the likelihood of further significant economic fallout from the pandemic impacting on the financial viability of certain banks has diminished. As a result Arlingclose has updated its treasury management

advice, allowing maximum durations of 100 days for unsecured investments with some UK banks on their list of recommended counterparties.

15 Local Context

- 15.1 At 31 March 2021 the council's underlying need to borrow for capital purposes was £246.3m as measured by the Capital Financing Requirement (CFR). The Council held £23.9m of investments (principal invested plus gains on investments with a variable net asset value) and £166.7m of external borrowing. These factors are summarised in Table 1.

Table 1: Balance sheet summary	31/03/21 Balance £m
General Fund CFR	(68.1)
Housing Revenue Account CFR	(178.2)
Borrowing CFR	(246.3)
External borrowing	(166.7)
Internal borrowing	(79.6)
Total funding of the CFR	(246.3)
Total investments	23.9

- 15.2 The council's strategy is to maintain borrowing and investments below their underlying levels, referred to as internal borrowing, to reduce risk and keep interest costs low. The treasury management position as at 30 September 2021 and the movement since 31 March 2021 are shown in Table 2.

Table 2: Treasury management summary	31/03/21 Balance £m	Movement £m	30/09/21 Balance £m	30/09/21 Rate %
Long-term borrowing	(166.7)	0.0	(166.7)	3.2
Total borrowing	(166.7)	0.0	(166.7)	3.2
Long-term investments	7.6	(0.6)	7.0	3.3
Short-term investments	9.2	5.4	14.6	0.1
Cash and cash equivalents	7.1	12.6	19.7	0.0
Total investments	23.9	17.4	41.3	0.6
Net borrowing	(142.8)	17.4	(125.4)	

Note: the figures in Table 2 at 31 March 2021 are from the balance sheet in the council's statement of accounts

15.3 The reduction in net borrowing of £17.4m shown in Table 2 reflects an increase in total investments of £17.4m and there has been no change to the borrowing position. Further details are provided in the Borrowing Activity and Treasury Investments Activity sections of this report.

16 Borrowing Update

- 16.1 Local authorities can borrow from the Public Works Loan Board (PWLB) provided they have not purchased an investment asset primarily for yield since 26 November 2020 and can confirm they are not planning to do so 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.
- 16.2 Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.
- 16.3 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.
- 16.4 The council is not planning to purchase any investment assets primarily for yield within the next three years and so is able to fully access the PWLB if required.
- 16.5 CIPFA has recently released a further consultation on its Prudential Code (more information provided at paragraph 22.1 of this report) ahead of the new Code being released in December 2021. The consultation documents include the guidance that authorities ‘must not borrow to invest for the primary purpose of financial return’, and the sector was concerned that the documentation also seemed to read that those authorities who were invested in pooled funds would not be able to access borrowing from the PWLB. However CIPFA have subsequently published early guidance on not borrowing to invest which covers existing commercial investments:
- 16.6 “The Code’s statement that authorities ‘must not borrow to invest for the primary purpose of financial return’ is not intended to require the forced sale of existing commercial investments, whether commercial properties or financial investments. Selling these investments and using the proceeds to net down debt does, however, reduce treasury risks on both sides of the balance sheet and is therefore an option which should be kept under review, especially if new long term borrowing is being considered.”
- 16.7 Responses to this consultation are expected by 16 November 2021 before the final Code is released in December 2021, and the council, as well as its adviser, Arlingclose, intends to respond to this consultation.

17 Borrowing Activity

- 17.1 At 30 September 2021 the council held £166.7m of loans, the vast majority of which (£156.7m) relates to the financing settlement of the HRA in 2012. The mid-year treasury management borrowing position at 30 September 2021 and the movement since 31 March 2021 are summarised in Table 3. During 2021/22 to date there have been no maturing PWLB debt, and the council has not taken out any additional borrowing.

Table 3: Borrowing position	31/03/21 Balance	Net movement	30/09/21 Balance	30/09/21 Weighted average rate	30/09/21 Weighted average maturity (years)
	£m	£m	£m	%	
Public Works Loan Board	(166.7)	0.0	(166.7)	3.2	21
Total borrowing	(166.7)	0.0	(166.7)	3.2	21

Note: The figures in Table 3 at 31 March 2021 are from the balance sheet in the Council's statement of accounts but adjusted to exclude accrued interest.

- 17.2 The council'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 council's long-term plans change being a secondary objective.
- 17.3 In keeping with these objectives no new borrowing has been undertaken within the first half of the financial year, which has enabled the council to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.
- 17.4 The council has an increasing CFR due to the capital programme and an estimated borrowing requirement as determined by the Liability Benchmark, which also takes into account usable reserves and working capital. Therefore there may be the requirement over the second half of the financial year for the council to consider taking further borrowing, but this decision will be taken with the assistance of Arlingclose. A new loan would ensure that the council can meet its cashflow obligations and provide some certainty in the cost of borrowing.
- 17.5 This borrowing strategy has been monitored with the assistance of Arlingclose and has enabled the council to keep long-term borrowing costs low and mitigates against future interest rate increases.

18 Treasury Investment Activity

- 18.1 The council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the six-month period from 1 April to 30 September 2021, the council's investment balances have

ranged between £26.3m and £50.2m due to timing differences between income and expenditure.

- 18.2 Table 4 shows investment activity for the council as at 30 September 2021 in comparison to the reported activity as at 31 March 2021. The increase in total investments since 31 March 2021 reflects the fact that the balance at 31 March is typically the lowest of the year.

Table 4: Treasury investment position	31/03/21 Balance	Net movement	30/09/21 Balance	30/09/21 Income return	30/09/21 Weighted average maturity (years)
	£m	£m	£m	%	
Short term investments:					
Banks and building societies:					
- Unsecured	4.25	2.85	7.10	0.07	0.06
- Secured	3.50	(0.30)	3.20	0.08	0.34
Government:					
- Local authorities	1.50	(1.50)	0.00	N/A	N/A
- DMADF	0.00	4.40	4.40	0.01	0.06
Money market funds	10.48	8.10	18.58	0.02	0.00
Cash plus funds	1.00	0.00	1.00	0.75	0.00
	20.73	13.55	34.28	0.05	0.05
Long term investments:					
Banks and building societies:					
- Secured	2.04	0.00	2.04	0.42	1.28
	2.04	0.00	2.04	0.42	1.28
High yield investments					
Pooled property fund*	5.00	0.00	5.00	4.46	N/A
	5.00	0.00	5.00	4.46	N/A
Total investments	27.77	13.55	41.32	0.61	0.12

* The rate provided for the pooled property fund investment is reflective of annualised income returns over the year to 30 September 2021 based on the market value of investments 12 months earlier.

Note: the figures in Table 4 at 31 March 2021 are from the balance sheet in the council's statement of accounts but adjusted to exclude operational cash, accrued interest and other accounting adjustments.

- 18.3 Investment balances have increased since 31 March 2021 in line with previous years due to 31 March typically holding the lowest balances, and the mid-year position reflects the higher balances typically seen at this time of year, due to the difference in timing between income and expenditure. A large proportion of investment balances continue to be held as short-term investments to enable the funding of the capital programme, as well as to meet the council's business as usual working capital requirements.

- 18.4 The CIPFA Code and government guidance both require the council 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 council's objective when investing money is therefore to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults against the risk of receiving unsuitably low investment income. The council's Treasury Management Strategy Statement (TMSS) sets out how it will manage and mitigate these risks.
- 18.5 The security of investments has been maintained by following the counterparty policy and investment limits within the TMSS, taking advice from Arlingclose on changes in counterparty credit worthiness, and making use of secured investment products that provide collateral. The council invests in liquid investments to ensure money is available when required to meet its financial obligations, spreading these investments across a number of counterparties to mitigate operational risk.
- 18.6 In delivering investment returns, the council has operated against a backdrop in which the UK Bank Rate was cut to 0.10% in March 2020 in response to the coronavirus pandemic. It has remained at this rate throughout the year, having an impact on rates across the market. Returns had been at or around +0.01% for liquid investment options such as Money Market Funds (MMFs), bank call accounts and the UK Government's Debt Management Account Deposit Facility (DMADF) and have not been significantly higher for other short-term options like fixed duration loans to other local authorities and bank notice accounts. Investment income has therefore largely come from investments arranged at fixed rates of interest prior to the pandemic and through the council's investment in a property pooled fund.
- 18.7 The council benchmarks the performance of its internally managed investments against that of other Arlingclose clients. Internally managed investments include all investments except externally managed pooled funds but do include MMFs. The performance of these investments against relevant measures of security, liquidity and yield are shown in Table 5, providing data as at 30 June 2021 and at 31 March 2021 for comparison. The council's data at 30 September 2021 is available and is shown in Table 5; however, unfortunately the comparative benchmarking data was not available at the publishing date.

Table 5: Investment benchmarking (excluding pooled funds)	Credit rating	Bail-in exposure	Weighted average maturity (days)	Rate of return
		%		%
31.03.2021	AA-	67	72	0.39
30.06.2021	AA-	88	63	0.07
Similar LAs	AA-	68	41	0.12
All LAs	AA-	67	12	0.11
30.09.2021	AA-	73	46	0.10

- 18.8 Table 5 shows the average credit rating of the portfolio has remained consistent over the first half of the financial year. Bail-in exposure rose and then fell again (as a function of the total balances for investment), reflecting a greater investment balance in money market funds which, although exposed to bail in risk, are considered good investments due to their diversification and AAA credit rating. The council keeps a large proportion of its cash balance either short term or liquid to meet capital payments during the year which has led to a steadily reducing weighted average maturity measure. As a result, the average rate of return has reduced over the period, but the council has benefited from higher rates for investments made prior to the pandemic helping to offset returns at or close to 0% for many investments across the market.
- 18.9 The council compared favourably with the other local authorities included in the benchmarking exercise at 30 June 2021 across most metrics. Although it is difficult to know the exact reason why the rate of return was lower than the average of the other local authorities as at 30 June 2021, it is most likely due to the large liquid and short term investment balance that was held at that point and continues to be held to meet capital payments.

Externally managed pooled property fund

- 18.10 In order to minimise the risk of receiving unsuitably low investment income, the council has continued to invest a proportion of steady core balances in an externally managed pooled property fund as part of its higher yielding strategy.
- 18.11 The CIPFA Code requires the council to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking the highest yield. As a result, the council's investments targeting higher yields have been made from its most stable balances and with the intention that they will be held for at least the medium term. This means that the initial costs of any investment and any periods of falling capital values can be overcome and mitigates the risk of having to sell an asset for liquidity purposes, helping to ensure the long-term security of the council's investments.

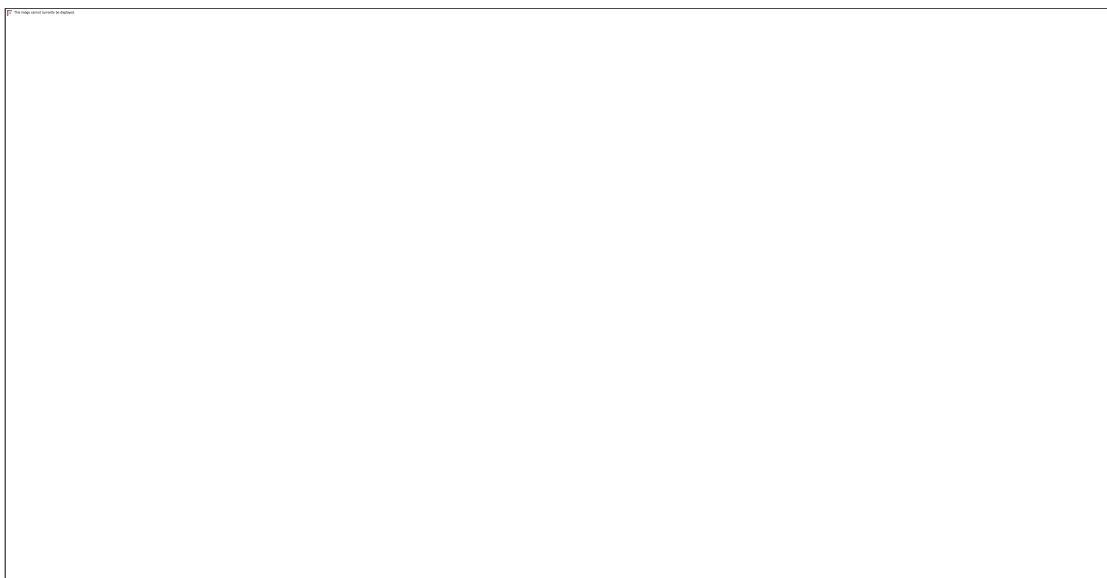
18.12 The council's investment in the pooled property fund fell considerably in value when the coronavirus pandemic hit world markets but in the last year the capital value has stabilised, with the UK commercial property sector turning the corner from recession in the last quarter of 2020/21 and conditions continuing to improve over recent months. This recovery means this investment is now worth more than the capital market value as at 30 September 2020, and due to the council's long-term holding in this fund the capital market value continues to remain significantly above the amount invested, as shown in Table 6. This demonstrates the importance of taking a longer term approach and being able to ride out periods of market volatility, ensuring the council is not a forced seller at the bottom of the market.

Table 6 – Higher yielding investments – market value performance	Amount invested*	Market value at 30/09/21	Gain/(fall) in capital value	
			Since purchase	One year
	£m	£m	£m	£m
Pooled property fund	5.00	5.66	0.66	0.50
Total	5.00	5.66	0.66	0.50

18.13 The council's investment in the pooled property fund targets long-term price stability and regular revenue income and bring significant benefits to the revenue budget. As shown in Table 7 the annualised income returns have averaged 3.30% pa (per annum) since purchase, contributing to a total return of 54.72% over its life.

Table 7 – Higher yielding investments – income and total returns since purchase	Annualised income return	Total return
	%	%
Pooled property fund	3.30	54.72
Total pooled funds	3.30	54.72

18.14 The council's pooled property fund investment continues to deliver income returns far in excess of what could be generated from cash investments. The cumulative total return from the council's investment in pooled property, as well as the previously owned investments in pooled equity funds since purchase is shown in the following graph. This highlights that the council has benefited from strong and steady income returns over time.



18.15 The IFRS 9 accounting standard that was introduced in 2018/19 means that annual movements in the capital values of investments need to be reflected in the revenue account on an annual basis, although a five year statutory override was put in place for local authorities that exempts them from complying with this requirement.

18.16 Pooled fund investments have no defined maturity date but are available for withdrawal after a notice period and their performance and continued suitability in meeting the council's investment objectives is monitored regularly and discussed with Arlingclose.

19 Other Non-Treasury Holdings and Activity

19.1 The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the council as well as other non-financial assets which the council holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held primarily for yield and those related to regeneration activities.

19.2 This includes service investments for operational and/or regeneration as well as commercial investments which are made mainly for financial reasons.

19.3 Further information on the council's non-Treasury investments is included in CAB3309 General Fund Outturn 2020/21 presented to Cabinet on 21 July 2021.

20 Compliance Report

20.1 The council confirms compliance of all treasury management activities undertaken during the period covered by this report with the CIPFA Code of Practice and the council's Treasury Management Strategy.

20.2 Compliance with the authorised limit and operational boundary for external debt is demonstrated in Table 8.

Table 8: Debt limits	2021/22 Maximum £m	30/09/21 Actual £m	2021/22 Operational Boundary £m	2021/22 Authorised Limit £m	Complied?
Borrowing	168.7	168.7	303.9	320.8	✓
Other long term liabilities	0.0	0.0	0.0	0.0	✓
Total debt	168.7	168.7	303.9	320.8	✓

20.3 The total actual debt as measured by the debt limits was £168.7m on 30 September 2021 which represents the use of £1.96m of the council's overdraft facility in addition to the £166.7m PWLB debt. On 30 September 2021 £2m principal was due to be returned to the council on maturity of a secured bond; however, it was not released due to counterparty error and so the council was forced to use its overdraft facility with NatWest for one day as the principal was returned to the council the following day. This issue is currently being looked into by the custodian to understand why this event occurred and the possibility of the council being reimbursed for the overdraft charge of £804.70.

20.4 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.

21 Treasury Management Indicators

21.1 The council measures and manages its exposures to treasury management risks using the following indicators.

Interest rate exposures

21.2 The following indicator shows the sensitivity of the council's current investments and borrowing to a change in interest rates:

Table 9 – Interest rate risk indicator	30/09/21 Actual	Impact of +/-1% interest rate change
Sums subject to variable interest rates:		
Investments	£36.3m	+/- £0.3m
Borrowing	£0.0m	N/A

21.3 Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

Maturity structure of borrowing

- 21.4 This indicator is set to control the council's exposure to refinancing risk. The upper and lower limits show the maximum and minimum maturity exposure to fixed rate borrowing as agreed in the TMSS:

Table 10: Refinancing rate risk indicator	30/09/21 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	0%	25%	0%	✓
12 months and within 24 months	3%	25%	0%	✓
24 months and within 5 years	9%	25%	0%	✓
5 years and within 10 years	18%	30%	0%	✓
10 years and within 20 years	24%	50%	0%	✓
20 years and within 30 years	12%	50%	0%	✓
30 years and within 40 years	12%	75%	0%	✓
40 years and within 50 years	22%	200%	0%	✓

Principal sums invested for periods longer than a year

- 21.5 The purpose of this indicator is to control the council'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: Price risk indicator	2021/22	2022/23	2023/24
Actual principal invested beyond year end	£7m	£5m	£5m
Limit on principal invested beyond year end	£10m	£10m	£10m
Complied	✓	✓	✓

- 21.6 The table includes investments in strategic pooled funds of £5m as although these can usually be redeemed at short notice, the council intends to hold these investments for at least the medium term.

22 OtherRevisions to CIPFA Codes

- 22.1 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 for investment purposes by some authorities. In June, CIPFA provided feedback from this consultation.

22.2 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

MHCLG Improvements to the Capital Finance Framework

22.3 Ministry of Housing, Communities & Local Government (MHCLG – now known as Department for Levelling Up, Housing and Communities) published

a brief policy paper in July outlining the ways it feels that the current framework is failing and potential changes that could be made. The paper found that “while many authorities are compliant with the framework, there remain some authorities that continue to engage in practices that push the bounds of compliance and expose themselves to excessive risk”.

- 22.4 The actions announced include greater scrutiny of local authorities and particularly those engaged in commercial practices; an assessment of governance and training; a consideration of statutory caps on borrowing; further regulations around Minimum Revenue Provision (MRP) and ensuring that MHCLG regulations enforce guidance from CIPFA and the new PWLB lending arrangements.
- 22.5 A further consultation on these matters is expected soon.

Arlingclose’s outlook for the remainder of 2021/22

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Official Bank Rate													
Upside risk	0.00	0.15	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.10	0.10	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
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

- 22.6 Arlingclose expects Bank Rate to rise in Quarter 2 2022 and believe this is driven as much by the Bank of England’s desire to move from emergency levels as by fears of inflationary pressure.
- 22.7 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.
- 22.8 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.
- 22.9 While Quarter 2 UK GDP expanded more quickly than initially thought, the ‘pingdemic’ and more latterly supply disruption will leave Quarter 3 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.
- 22.10 Inflation rose to 3.2% in August 2021. A combination of factors is expected to 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.

- 22.11 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.
- 22.12 Government bond yields increased sharply following the September Federal Open Market Committee (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.
- 22.13 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 levers. While the economic outlook will be challenging, the signals from policymakers suggest Bank Rate will rise unless data indicates a more severe slowdown.

23 OTHER OPTIONS CONSIDERED AND REJECTED

- 23.1 The council could elect to bring all treasury management activity back in-house. This option has been rejected as the arrangement with Hampshire County Council's Investments and Borrowing team provides significant resilience and economies of scale.
- 23.2 The council could make more risky investments than those proposed in the Strategy to increase its yield. This has been rejected as priority is given to ensuring security and liquidity in line with the key principles of the CIPFA Treasury Management Code.

BACKGROUND DOCUMENTS:-

Previous Committee Reports:-

AUD119: Treasury Management Practices, 22 June 2015

AG034: Treasury Management Mid-Year Monitoring Report 2020/21, 12 November 2020

CAB3282: Treasury Management Strategy 2021/22, 11 February 2021

AG0057: Treasury Management Outturn 2020/21, 22 July 2021

Other Background Documents:-

None

APPENDICES:

None