Treasury Management

Borrowing and Investments

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

The Authority maintained its strategy of keeping borrowing and investments below their underlying levels in order to reduce risk and make a net saving.

2.

	31-Mar-22 Actual £M	31-Mar-22 Average Yield / Rate %	30-Jun-22 Actual £M	30-Jun-22 Average Yield / Rate %	31-Mar-23 Forecast £M	31-Mar-23 Forecast Average %
Long Term Borrowing						
Public Works Loan	246.30	2.88	256.29	2.75	340.29	2.84
LOBO Loans from Banks	9.00	4.89	9.00	4.86	9.00	4.87
	255.30	**2.95**	**265.29**	**2.88**	**349.29**	**2.82**
Short Term Borrowing						
Other Local Authorities	0.00	0.00	0.00	0.00	10.00	2.25
Other	0.36		0.36	1.26	0.36	1.26
Total External Borrowing	**255.66**	**0.00**	**265.65**	**2.85**	**359.65**	**2.78**
Other Long Term Liabilities						
PFI Schemes	47.52	9.01	45.95	10.20	44.37	10.20
Deferred Debt Charges (HCC)	13.10	2.66	12.92	2.56	12.73	2.56
Total Gross External Debt	**316.28**	**3.87**	**324.51**	**4.08**	**416.75**	**3.89**
Investments:						
Managed In-House						
Government & Local Authority	0.00	0.00	(10.52)	1.06		
Cash (Instant access)	(54.50)	0.51	(46.60)	1.12	(10.00)	2.25
Cash (Notice Account)	0.00	0.00	0.00	0.00	0.00	0.00
Long Term Bonds	(1.06)	5.27	(1.01)	5.27	(1.00)	5.27
Managed Externally						
Pooled Funds (CCLA) & Shares	(27.25)	3.81	(27.00)	4.04	(27.00)	3.00
Total Investments	**(107.22)**	**3.46**	**(85.13)**	**3.96**	**(38.00)**	**2.86**
Net Debt	**209.06**		**239.38**		**378.75**	

3. After taking into account maturing and new debt requirements in year and a forecast reduction in investment balances, net borrowing is expected to increase to £378.75M for the year.

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

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

As detailed below rates for new long term borrowing are higher than budgeted and are on an upward trend. However, the higher interest rates are having a positive impact on investment income, and this mitigates the impact on the revenue budget.

	Borrowing
5.	The forecast cost of financing the council's loan debt is £17.36M of which £5.38M relates to the HRA, however this will be subject to movement as the need for further borrowing for the remainder of the year becomes more certain.
6.	Short term interest rates have remained low and are likely to do so for the remainder of the year and offer good value, which we will utilise to fund any further borrowing needs in the year, unless an opportunity arises to secure a long term loan at advantageous rates or to provide certainty for the portfolio. Although we currently do not have any short term debt, we anticipate borrowing before year end to replace maturing long term debt, expected reduction in reserves and to fund the forecast capital programme for the year, until a decision is taken with regards to long term borrowing. Any increase in short term borrowing costs will be offset by a reduction in long term costs. This is later than previously reported as cash flows have remained higher than expected.
7.	The Authority has previously raised the majority of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Authority intends to avoid this activity in order to retain its access to PWLB loans.
8.	As outlined in the treasury strategy, the Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective. The Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. Over the April-June quarter, short-term rates rose between 0.5% and 0.9% and long-term rates rose between 0.6% and 0.8%.
9.	The Authority has an increasing CFR due to the capital programme and currently has a further estimated borrowing requirement of £91.10M for the year, as determined by the Liability Benchmark which takes into account capital spend, maturing debt, usable reserves and working capital. Having considered various options and in consultation with our advisors, it was decided to take a long-term maturity loan. This loan provides some longer-term certainty and stability to the debt portfolio and was in respect of the GF for unfinanced debt at the 31 March 2022. Rates are on an upward trajectory and are currently above the rate used for setting budget. Further borrowing will be required during the year and rates will be monitored to determine the appropriate time; current advice is to take small amounts over regular period due to interest volatility.

Long Term Loans	Date	Amount £M	Rate %	Period (Years)
PWLB Maturity Loan	12/05/2022	10,000	2.94%	25
Total Borrowing		**10,000.00**		

	Investment
10.	The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves. During the year investment balances have ranged between £109.37M and £73.27M during the year and are currently £85.13M but are expected to reduce to £38M by year end. The 0.25% increases in Bank Rate at the MPC's meetings in May and June and with the prospect of more increases to come, short-dated cash rates, which had ranged between 0.7% - 1.5% at the end of March, rose on average by 0.65% over the quarter. At the end of June, the rates on DMADF average 1.06% and the return on sterling low volatility net asset value (LVNAV) Money Market Funds averaged 1.12%. Forecast income is now £1.4M, £0.38M higher than originally budgeted.
	External Managed investments
11.	The council has invested £27M in property funds as an alternative to buying property directly. As previously reported these funds offer the potential for enhanced returns over the longer term but may be more volatile in the shorter term and are managed by professional fund managers which allows the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments.
12.	Because these funds have no defined maturity date but are usually available for withdrawal after a notice period (90 days), their performance and continued suitability in meeting the Authority's investment objectives is regularly reviewed.
13.	Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three to five-year period total returns will exceed cash interest rates. In light of their performance over the long-term and the Authority's latest cash flow forecasts, investment in these funds has been maintained.
14.	The market has continued to improve since year end when the value was last reported as £30.89M and at £32.51M has increased by a further £1.62M and is now £5.51M above the initial investment of £27M. The dividend for April to June has been estimated at £0.27M, 4.04% against the original investment, this is similar to 2021/22. If rates remain at this level the total forecast dividend for the year is £1.09M.
	Financial Review and Outlook
15.	A summary of the external factors, which sets the background for Treasury, as provided by the council's treasury advisors, Arlingclose Ltd, is summarised below. **Arlingclose's Economic Outlook for the remainder of 2022/23 (based on the June 2022 interest rate forecast)**
16.	The economic interest rate outlook provided by the Council's treasury advisor, Arlingclose Ltd, for June 2022 is detailed below and is based on the following Underlying Assumptions:

	Current	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25
Official Bank Rate													
Upside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Arlingclose Central Case	1.25	1.75	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.00	2.00	1.75	1.75
Downside risk	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.50	-0.50	-0.75	-0.75	-0.75

- The MPC will raise Bank Rate further to dampen aggregate demand and reduce the risk of sustained higher inflation.
- Arlingclose expects Bank Rate to rise to 2.25% by December, in 25bp steps at each of the next four meetings. We now also expect a reduction in Bank Rate during the forecast period.
- Risks remain weighted to the upside in the short term following the MPC's more hawkish stance.
- Gilt yields will remain under upward pressure in the short term on inflation and central bank policy expectations, and investor uncertainty. Yields will decline over the medium time as weak growth places pressure on central banks to ease policy.
- The risks around the gilt yield forecasts remain tilted to the upside over the short term, primarily due to US policy uncertainty. Over the medium term, the balance of risks shifts to the downside as growth softens.

17. Following Russia's Invasion of Ukraine in February, global inflationary pressures have intensified sharply, leading to a sizeable deterioration in the outlook for world and UK growth.

The economic backdrop in the April-June quarter was characterised by higher oil, gas and commodity prices, fears of rising and persistent inflation and its damaging impact on consumers' cost of living, little indication of an imminent end to Russia-Ukraine hostilities and supply chain bottlenecks exacerbated by war in Ukraine and lockdowns in China.

Added to this was tough rhetoric and action by central bankers globally on fighting inflation through higher interest rates and quantitative tightening even as financial conditions became increasingly difficult for consumers, more so for those whose wages have not kept pace with inflation.
In the UK inflation remained elevated. Ofgem, the energy regulator, increased the energy price cap by 54% in April, equivalent to around £700 for a household with average energy consumption (the cap had already increased 12% back in October 2021). May data showed CPI edging higher to 9.1% while the core CPI rate, which removes energy, fuel and food was 5.9%. RPI rose to 11.7%.

The labour market continued to show signs of tightness as employers struggled to fill vacancies with workers with skill sets matching their requirements. The unemployment rate 3m/year for April fell to 3.8% and is now below pre-pandemic levels. Pay growth was 6.8% for total pay (including bonuses) and 4.2% for regular pay; however, adjusted for inflation, growth in total pay was just 0.4%, whilst regular pay fell 2.2%.

Unsurprisingly, with disposable income squeezed and another energy cap increase due in October, consumer confidence plummeted to the level last seen during the 2008/09 financial crisis. Quarterly GDP growth was 0.8% in the January-March quarter and the Bank of England now expects a decline of 0.3% in Q2 2022.

Having increased interest rates by 0.25% in April, the Bank of England's Monetary Policy Committee on the 15th of June 2022 voted 6-3 to increase the official Bank Rate by 0.25% to 1.25%. Those members in the minority preferred to increase Bank Rate by 0.5%. Rises in the

	input and output producer price measures suggest further inflationary pressure is in the pipeline. The Bank of England is therefore unlikely to become complacent, so further rate rises look likely in the near term. Annual inflation in the US rose to 8.6% in May, the highest in nearly 40 years. The Federal Reserve also stepped up its fight against inflation with a 0.5% hike in rates in May followed by a further increase of 0.75% in June, the latter its most aggressive hike since 1994 and higher than markets expected, taking policy rates to a range of 1.5% - 1.75%. Inflation in the Eurozone also pushed higher to 8.1%, with energy price pressures a major contributor. Europe is heavily impacted by the energy crisis following the Russian invasion of Ukraine, but concerns about the Eurozone's peripheral members and highly indebted members states complicates the European Central Bank's response as it seeks to normalise monetary policy. The ECB stated it would end quantitative easing at the beginning of July and then increase interest rates by 0.25% later in the month, the first hike since 2011. The central bank's Governing Council also convened an emergency meeting in June to address 'fragmentation' risks.
	<u>Credit background</u>
18.	In May Moody's affirmed the long-term rating of Guildford Borough Council at Aa3, a reflection of the Council's solid track record of budgetary performance and high level of usable reserves, but changed the 'outlook' (the longer-term direction of travel) to negative. The agency downgraded the long-term rating of Warrington Borough Council from A2 to A3 and that of Transport for London (TfL) from A3 to Baa1. Having completed its full review of its credit advice on unsecured deposits at UK and non-UK banks, in May Arlingclose extended the maximum duration limit for five UK banks, four Canadian banks and four German banks to six months. The maximum duration for unsecured deposits with other UK and non-UK banks on Arlingclose's recommended list is 100 days. Arlingclose continued to monitor and assess credit default swap levels for signs of credit stress but made no changes to the counterparty list or recommended durations. Nevertheless, increased market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remains under constant review.
	<u>Investment Performance</u>
19.	The council's advisors undertake quarterly investment benchmarking across its client base. We previously had a more diversified portfolio and at higher interest rates than the average as a result of moving into the bond programme earlier than most clients, but there is now more competition for bonds from both government bodies and other local authorities, so opportunities to replace maturing bonds are limited and we have seen a fall in suitable instruments. With this in mind, and the changes to Prudential code to only borrow when cash flows dictate, our investments primarily now consist of a previous long term investment in property funds and short term investments for cash flow purposes.
20.	Our current investments in bonds has reduced from £3M to £1M following maturities in 2021/22 and we maintained the property funds at £27M, with all other cash being placed in short term deposits as shown in table in paragraph 2.
21.	As detailed in paragraph 11 our cash balances have continued to be higher than forecast. As a result, we had £57.12M in short term investment which is above our normal working balances.

	Our target is to reduce this to a £10M working balance to reduce borrowing and therefore net interest costs but this will be dependent on actual capital spend and movement in balances.
22.	Investments managed internally are currently averaging a return of 1.16% which is slightly higher than the average unitary authority at 0.96% whilst maintaining a higher average credit rating at AAA. Total income returns at 2.08% is also higher than the average for both unitary (1.52%) and LA's (1.39%), this is primarily due to historic investment in EIB bonds which return 5.27%, although on a small balance of £1M, since maturities cannot be replaced at the same level. We hold 36% of our investments in strategic funds which offer higher return over the long term as detailed in paragraphs 11 to 14 above. This is higher than the average but in line with our strategy. In addition, due to the increase in the capital value of our external funds of +19.6% our total investment return at 9.11% is significantly higher than the average LA's at 3.10% and the average unitary at 1.78% across Arlingclose's client base, but as previously reported it is the income return that is the driver to invest plus.
	Revision to CIPFA Codes
23.	CIPFA published revised Prudential and Treasury Management Codes in December 2021. The Prudential Code took immediate effect although detailed reporting requirements could be deferred until the 2023/24 financial year and have not been included in this report whilst we are reviewing the impact of the proposed changes.
24.	The main changes or expected changes from previous codes include: • Additional reporting requirements for the Capital Strategy. • For service and commercial investments, in addition to assessments of affordability and prudence, an assessment of proportionality in respect of the Authority's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services). • Forward looking prudential code indicators must be monitored and reported to members at least quarterly. • A new indicator for net income from commercial and service investments to net revenue stream. • Inclusion of the liability benchmark as a treasury management prudential indicator. CIPFA recommends this is presented as a chart of four balances – existing loan debt outstanding; loans CFR, net loans requirement, liability benchmark – over at least 10 years and ideally cover the authority's full debt maturity profile. • Excluding investment income from the definition of financing costs. • Credit and counterparty policies should set out the Authority's policy and practices relating to Environmental, Social and Governance (ESG) investment considerations. • Additional focus on the knowledge and skills of officers and elected members involved in decision making
25.	Early indications are that future long term investments, such as CCLA will be prohibited but we will not need to unwind existing investments.