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 month 6 capital monitoring and will be subject to review during the year.

   Lower official interest rates have continued to lower the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing. 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-21 Actual £M	31-Mar-21 Average %	30-Sep-21 Actual £M	30-Sep-21 Average %	31-Mar-22 Forecast £M	31-Mar-22 Forecast %
Long Term Borrowing						
Public Works Loan	222.59	2.72	238.84	2.77	350.80	2.70
LOBO Loans from Banks	9.00	4.86	9.00	4.86	9.00	4.86
	231.59	**2.75**	**247.84**	**2.91**	**359.80**	**2.82**
Short Term Borrowing						
Other Local Authorities	10.00	0.28	0.00	0.00	10.00	0.04
Other	0.36	0.28	0.36	0.23	0.36	0.23
Total External Borrowing	**241.95**	**2.75**	**248.20**	**2.85**	**370.16**	**2.78**
Other Long Term Liabilities						
PFI Schemes	50.97	9.16	49.25	8.82	47.52	9.65
Deferred Debt Charges (HCC)	13.47	2.13	13.29	2.61	13.10	2.10
Total Gross External Debt	**306.39**	**3.78**	**310.73**	**4.08**	**430.78**	**3.63**
Investments:						
Managed In-House						
Government & Local Authority	0.00	0.00	(22.25)	0.01		
Cash (Instant access)	(30.13)	0.01	(49.23)	0.01	(10.00)	0.01
Cash (Notice Account)	0.00	0.00	0.00	0.00	0.00	0.00
Long Term Bonds	(3.17)	5.30	(1.06)	5.27	(1.10)	5.27
Managed Externally						
Pooled Funds (CCLA) & Shares	(26.57)	4.16	(27.02)	3.70	(27.02)	3.00
Total Investments	**(59.87)**	**4.26**	**(99.57)**	**3.49**	**(38.12)**	**2.28**
Net Debt	**246.52**		**211.16**		**392.66**	

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 by £188.14M 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.

	Borrowing
5.	The forecast cost of financing the council's loan debt is £16.54M of which £5.06M 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.	**PWLB:** Local authorities can borrow from the PWLB provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 Officer. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management. From 8th September 2021 the settlement time for a PWLB loan was extended from two workings days (T+2) to five working days (T+5). In a move to protect the PWLB against negative interest rates, the minimum interest rate for PWLB loans has also been set at 0.01% and the interest charged on late repayments will be the higher of Bank of England Base Rate or 0.1%. Competitive market alternatives may be available however, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders.
8.	**Municipal Bonds Agency (MBA):** The MBA is working to deliver a new short-term loan solution, available in the first instance to principal local authorities in England, allowing them access to short-dated, low rate, flexible debt. The minimum loan size is expected to be £25 million. Importantly, local authorities will borrow in their own name and will not cross guarantee any other authorities. If the Authority intends future borrowing through the MBA, it will first ensure that it has thoroughly scrutinised the legal terms and conditions of the arrangement and is satisfied with them.
9.	**UK Infrastructure Bank:** £4bn has been earmarked for lending to local authorities by the UK Infrastructure Bank. The availability of this lending to local authorities is due to commence in summer 2021 for which there is expected to be a bidding process. Loans will be available for qualifying projects at gilt yields plus 0.6%, which is 0.2% lower than the PWLB certainty rate.
	Investment
10.	The Authority received central government funding to support small and medium businesses during the coronavirus pandemic through grant schemes which was temporarily invested in short-dated, liquid instruments such as call accounts and Money Market Funds and led to higher than expected cash flow whilst the cash was being disbursed. Investment balances have ranged between £116.90M and £43.02M during the year and are currently £99.57M.

	Continued downward pressure on short-dated cash means net returns on money market funds are low between 0.02% and zero even after some managers have temporarily lowered their fees. This supports our decision to only borrow for cash flow purposes at this stage as savings on borrowing costs more than offset the loss on short term investments. The impact of COVID-19 will continue during the year and will be reported at each quarter and as part of Treasury Reports to Governance Committee.
	<u>External Managed investments</u>
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. 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.
12.	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.
13.	The market has continued to improve since year end when the value was reported at £26.28M, and at September 2021 has a value of £28.11M (June 2021,£27.18M) an increase of £1.83M since March and is now £1.11M above the initial investment of £27M. The dividend for April to September has been estimated at £0.26M, 3.86% against the original investment. This is lower than 2020/21 which was boosted by a significant level of one-off receipts. If rates remain at this level the total forecast dividend for the year is £1.02M.
	<u>Financial Review and Outlook</u>
14.	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. The low for longer interest rate outlook theme that has been at the core of the recommended strategic advice for over a decade remains. **<u>Arlingclose's Economic Outlook for the remainder of 2021/22 (based on the October 2021 interest rate forecast)</u>**

	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

15.	Arlingclose expects Bank Rate to rise in Q2 2022, which they believe is driven as much by the Bank of England's desire to move from emergency levels as by fears of inflationary pressure. 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.

16.	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.
17.	While Q2 UK GDP expanded more quickly than initially thought, the 'pingdemic' and more latterly supply disruption will leave Q3 GDP broadly stagnant. The outlook also appears weaker. Household spending, the driver of the recovery to date, is under pressure from a combination of retail energy price rises, the end of government support programmes and soon, tax rises. Government spending, the other driver of recovery, will slow considerably as the economy is taken off life support.
18.	Inflation rose to 3.2% in August. A combination of factors will drive this to over 4% in the near term. While the transitory factors affecting inflation, including the low base effect of 2020, are expected to unwind over time, the MPC has recently communicated fears that these transitory factors will feed longer-term inflation expectations that require tighter monetary policy to control. This has driven interest rate expectations substantially higher.
19.	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 increased in wages is possible given the pressures on businesses.
20.	Government bond yields increased sharply following the September FOMC and MPC minutes, in which both central banks communicated a lower tolerance for higher inflation than previously thought. The MPC in particular has doubled down on these signals in spite of softer economic data. Bond investors expect higher near-term interest rates but are also clearly uncertain about central bank policy
21.	The MPC appears to be playing both sides, but has made clear its intentions to tighten policy, possibly driven by a desire to move away from emergency levels. While the economic outlook will be challenging, the signals from policymakers suggest Bank Rate will rise unless data indicates a more severe slowdown.
	Credit background
22.	Economic recovery from coronavirus pandemic continued to dominate the first half of the financial year. By the end of the period over 48 million people in the UK had received their first dose of a COVID-19 vaccine and almost 45 million their second dose. The Bank of England (BoE) held Bank Rate at 0.1% throughout the period and maintained its Quantitative Easing programme at £895 billion, unchanged since the November 2020 meeting. In its September 2021 policy announcement, the BoE noted it now expected the UK economy to grow at a slower pace than was predicted in August, as the pace of the global recovery had shown signs of slowing and there were concerns inflationary pressures may be more persistent. Within the announcement, Bank expectations for GDP growth for the third (calendar) quarter were revised down to 2.1% (from 2.9%), in part reflecting tighter supply conditions. The path of CPI inflation is now expected to rise slightly above 4% in the last three months of 2021, due to higher energy prices and core goods inflation. While the Monetary Policy Committee meeting ended with policy rates unchanged, the tone was more hawkish.

	Government initiatives continued to support the economy over the quarter but came to an end on 30th September 2021, with businesses required to either take back the 1.6 million workers on the furlough scheme or make them redundant.
23.	Monetary and fiscal stimulus together with rising economic growth and the ongoing vaccine rollout programmes continued to support equity markets over most of the period, albeit with a bumpy ride towards the end. The Dow Jones hit another record high while the UK-focused FTSE 250 index continued making gains over pre-pandemic levels. The more internationally focused FTSE 100 saw more modest gains over the period and remains below its pre-crisis peak. Inflation worries continued during the period. Declines in bond yields in the first quarter of the financial year suggested bond markets were expecting any general price increases to be less severe, or more transitory, that was previously thought. However, an increase in gas prices in the UK and EU, supply shortages and a dearth of HGV and lorry drivers with companies willing to pay more to secure their services, has caused problems for a range of industries and, in some instance, lead to higher prices. The 5-year UK benchmark gilt yield began the financial year at 0.36% before declining to 0.33% by the end of June 2021 and then climbing to 0.64% on 30th September. Over the same period the 10-year gilt yield fell from 0.80% to 0.71% before rising to 1.03% and the 20-year yield declined from 1.31% to 1.21% and then increased to 1.37%. The Sterling Overnight Rate (SONIA) averaged 0.05% over the quarter
24.	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.
25.	At the end of the period Arlingclose had completed its full review of its credit advice on unsecured deposits. The outcome of this review included the addition of NatWest Markets plc to the counterparty list together with the removal of the suspension of Handelsbanken plc. In addition, the maximum duration for all recommended counterparties was extended to 100 days. As ever, the institutions and durations on the Authority's counterparty list recommended by treasury management advisors Arlingclose remain under constant review.
	Investment Performance
26.	The council's advisors undertake quarterly investment benchmarking across its client base. As reported previously our portfolio was more diversified 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 will see a fall in suitable instruments. With this in mind, and following discussions with our advisors, it was decided to move more into property funds, which are a longer term investment, and to short term investments for cash flow purposes.
27.	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 paragraph 2.

28.	As detailed in paragraph 11 our cash balances have continued to be higher than forecast. As a result, we had £72.55M 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.
29.	Investments managed internally are currently averaging a return of 0.08% which is slightly higher than the average unitary authority at 0.06% whilst maintaining a higher average credit rating at AA-. Total income returns at 1.31% is also higher than the average for both unitary (0.85%) and LA's (0.78%), 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 28% 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 +10.82% our total investment return at 4.33% is significantly higher than the average LA's at 2.82% and the average unitary at 2.35% across Arlingclose's client base, but as previously reported it is the income return that is the driver to invest plus, they are deemed less risky than buying individual properties and do not constitute capital spend.
	Revision to CIPFA Codes
30.	In February 2021 CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These followed the Public Accounts Committee's recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes. In June, CIPFA provided feedback from this consultation and in September CIPFA issued the revised Codes and Guidance Notes in draft form and opened further consultation process on their proposed changes.
31.	We are currently reviewing the impact of the proposed changes, which includes the introduction of the liability benchmark and borrowing at net position which could have an impact on us holding long term investments such as CCLA. Early indications are that future long term investments will be prohibited but we will not need to unwind existing investments. A further update will be included in the Strategy report.