Appendix 6

Treasury Management Strategy

Treasury Management Report

Annexes:

1. Background

1.1 Treasury management is the management of the Authority’s cash flows, borrowing and investments, and the associated risks. 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 financial risk are therefore central to the Authority’s prudent financial management. The Treasury Management Strategy for 2021/22 was approved at Council on 17 February 2021.

1.2 Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy’s *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority’s legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.

1.3 Investments held for service purposes or for commercial profit are considered in the Investment Report (**Appendix 7**).

2. External Context

1.4 **Economic background:** 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.

1.5 The Bank of England (BoE) Base 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.

1.6 UK Consumer Price Inflation (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.

1.7 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 March 2022 showed the unemployment rate at 3.7% while the employment rate rose to 75.7%. Headline 3-month average annual growth rate for wages were 7.0% for total pay and 4.2% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 1.4% while regular pay fell by 1.2%.

1.8 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 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 and took UK GDP to just 0.1% below where it was before the pandemic. In the first quarter of 2022 GDP was 0.8% but this was all in January with no contribution in February or March increasing the likelihood of a recession.

1.9 Having increased Bank Base Rate from 0.10% to 0.25% in December, the Bank of England increased 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.

1.10 In 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.

1.11 The US economy grew by 6.9% in quarter 4 2021, a sharp in 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.

1.12 In the Eurozone inflation remains high at 7.5% putting further pressure on its long-term stance of holding its main interest rate of 0%.

1.13 **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.

1.14 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. The 10-year UK gilt yield began the quarter at 0.97% rising to 1.61% and the 20-year yield rose from 1.20% to 1.82%.

1.15 **Credit Review:** In the first half of financial year 2021/22 credit default swap (CDS) spreads were flat over most of the 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.

1.16 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.

1.17 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.

3. Updated PWLB Lending Facility Guidance & Revised CIPFA Codes

1.18 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.

1.19 CIPFA published its revised Prudential Code for Capital Finance and Treasury Management Code on 20 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.

1.20 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 decision that will increase the Capital Financing Requirement (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.

1.21 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.

1.22 The Authority is not planning to borrow to invest primarily for commercial return and so is unaffected by the changes to the Prudential Code.

4. Local Context

1.23 As at 31 March 2022 the Authority has borrowings of £201m and investments of £54m. This is set out in further detail at **Annex A.** Forecast changes in these sums are shown in the balance sheet analysis in **Table 1** below.

Table 1: Balance Sheet Summary and Forecast

	31/03/21 Actual £m	31/03/22 Actual £m	31/03/23 Estimate £m	31/03/24 Estimate £m	31/03/25 Estimate £m
General Fund CFR	403	436	460	491	502
Less: Other long-term liabilities *	(22)	(20)	(19)	(18)	(17)
Loans CFR	**381**	**416**	**441**	**473**	**485**
Less: External borrowing **	(190)	(181)	(77)	(77)	(77)
Internal (over) borrowing	**191**	**235**	**364**	**396**	**408**
Less: Usable reserves	(101)	(140)	(114)	(106)	(101)
Less: Working capital	(80)	(80)	(75)	(75)	(73)
Investments (or New borrowing)	**(10)**	**(15)**	**(175)**	**(215)**	**(234)**

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

** shows only loans to which the Authority is committed and excludes optional refinancing.

1.24 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

1.25 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. **Table 1** shows that the Authority expects to comply with this recommendation.

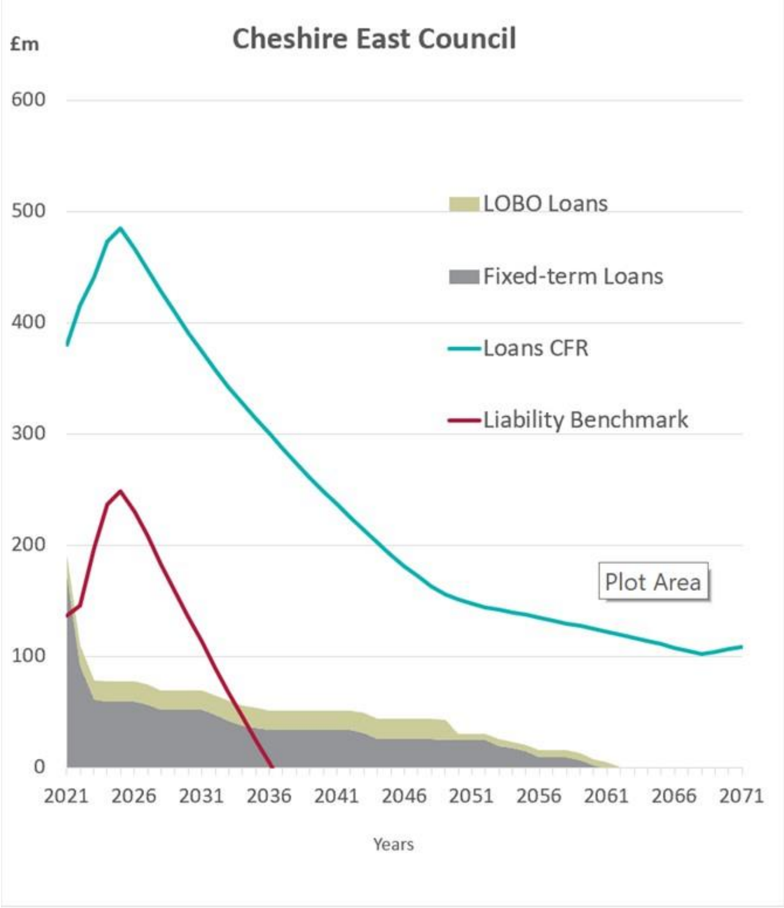
1.26 **Liability Benchmark:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as Table 1, but that cash and investment balances are kept to a minimum level of £20m at each year-end to maintain a core strategic investment.

Table 2: Liability Benchmark

	31/03/21 Actual £m	31/03/22 Actual £m	31/03/23 Estimate £m	31/03/24 Estimate £m	31/03/25 Estimate £m
Loans CFR	381	416	441	473	485
Less: Usable reserves	(101)	(140)	(114)	(106)	(101)
Less: Working capital	(80)	(80)	(75)	(75)	(73)
Plus: Minimum investments	20	20	20	20	20
Liability Benchmark	**220**	**216**	**272**	**312**	**331**

1.27 Following on from the medium-term forecasts in Table 2 above the long-term liability benchmark assumes minimum revenue provision on new capital expenditure based on a 25 year asset life and income, expenditure and reserves all increasing by inflation of 2.5% a year. This is shown in **Chart 1**.

Chart 1: Liability Benchmark Chart



5. Borrowing Strategy

1.28 The Authority currently holds loans of £181m, a decrease of £9m since 31 March 2021. Covid-19 grants received in advance of payment has kept the level of borrowing lower than expected over the last 2 years.

1.29 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.

1.30 Despite the recent increases in interest rates and forecasts for further increases, the high levels of liquidity in the markets still allow the Authority to consider it more cost effective to continue with short term borrowing. As the levels of borrowing increase and/or liquidity in the markets reduces then some longer term borrowing may be considered. The cost of short term borrowing in 2021/22 was 0.18%. A full list of temporary borrowings as at 31 March 2022 is shown below in **Table 3**.

Table 3 – Current Temporary Borrowing

Lender	Start	Maturity	Rate %	£m
Evergreen Fund (CW LEP)	Call Account		0.41	1.5
Renfrewshire	10/09/21	04/04/22	0.03	5.0
Hartlepool	11/10/21	11/04/22	0.04	5.0
Wealden	23/09/21	14/04/22	0.04	5.0
Western Isles	14/10/21	14/04/22	0.03	2.0
West Midlands CA	21/10/21	21/04/22	0.03	5.0
Greater Manchester CA	24/01/22	22/04/22	0.17	5.0
Renfrewshire	08/10/21	25/04/22	0.03	5.0
Bridgend	23/09/21	25/04/22	0.03	3.0
Merseyside Fire & Rescue	08/11/21	09/05/22	0.03	3.0
Western Isles	23/09/21	09/05/22	0.04	2.0
Northern Ireland Housing Executive	13/12/21	13/05/22	0.04	10.0
Wigan	14/02/22	16/05/22	0.15	5.0
Blaenau Gwent	21/02/22	23/05/22	0.16	5.0
Carmarthenshire	28/02/22	27/05/22	0.57	5.0
Bedford	28/02/22	31/05/22	0.48	3.0
Surrey Heath	21/03/22	15/06/22	0.52	2.0
Neath Port Talbot	21/03/22	21/06/22	0.50	5.0
Northern Ireland Housing Executive	25/02/22	27/06/22	0.55	5.0
PCC Warwickshire	28/03/22	28/06/22	0.57	2.0
Wandsworth	30/03/22	30/06/22	0.57	5.0
Middlesbrough	25/02/22	01/07/22	0.57	5.0
West Midlands CA	31/03/22	30/09/22	0.70	5.0
Torbay	31/03/22	30/09/22	0.90	5.0
TOTAL				**103.5**

1.31 **LOBO's:** The Authority holds £17m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOS have options during 2021/22, and although the Authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Authority will take the option to repay LOBO loans at no cost if it has the opportunity to do so.

6. Investment Strategy

1.32 The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. Due to the overriding need for short term borrowing, other than £20m invested strategically in managed funds, the investments are generally short term for liquidity purposes. However, receipt of Government funding due to Covid-19 measures and other schemes in advance of expenditure has, at times, led to higher balances than expected.

1.33 The CIPFA Code requires the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest 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.

1.34 The maximum amount that can be invested with any one organisation is set in the Treasury Management Strategy Report. The maximum amount and duration of investments with any institution depends on the organisations credit rating, the type of investment and for banks and building societies, the security of the investment. Generally credit rated banks and building societies have been set at a maximum value of £6m for unsecured investments and £12m for secured investments. Any limits also apply to the banking group that each bank belongs to. Limits for each Money Market fund have been set at a maximum value of £12m per fund. All potential counterparties are kept under continual review by our treasury advisors and and advisory lower limits than those contained in the strategy are applied.

1.35 Treasury Management income for 2021/22 is £987,000 which is higher than the budgeted £840,000. Borrowing costs are also lower than budgeted at £172,000 compared to budget of £400,000.

- The average daily investment balance including managed funds during 2021/22 is £44.1m

- The average annualized interest rate received on in-house investments during 2021/22 is 0.09%

- The average annualized interest rate received on the externally managed funds during 2021/22 is 4.59%

1.36 The Authority's total average interest rate on all investments in 2021/22 is 2.13%. The returns continue to exceed our own performance target of 1.25% (Base Rate at 31/03/22 + 0.50%). Previous comparator rates using LIBID are no longer produced. These have been replaced by the Sterling OverNight Index Average (SONIA).

Table 4 – Interest Rate Comparison

Comparator	Average Rate 2021/22
Cheshire East	2.13%
SONIA 7 Day	0.19%
Base Rate	0.19%
Target Rate	0.69%

1.37 As the Authority holds a large amount of reserves and working capital, £20m of this has been placed in strategic investments in order to benefit from higher income returns whilst spreading risk across different asset classes.

1.38 The investments are in five different funds which are all designed to give an annual income return between 4% and 5% but which have different underlying levels of volatility. By spreading investments across different types of fund, the intention is to dampen any large fluctuations in the underlying value of the investments.

Table 5 –Strategic Investments

Fund Manager	Asset Class	Invested £m	31/03/22 Value £m
CCLA	Property	7.5	9.0
Aegon	Multi Asset	5.0	5.0
Fidelity	Equity - Global	4.0	4.1
Schroders	Equity - UK	2.5	2.4
M & G	Bonds	1.0	0.9
TOTAL		20.0	21.4

1.39 The value of these investments does vary. During 2021/22 the valuation of all funds recovered from the previous years fall in value due to Covid-19. The value of most funds are around the amount originally invested with more significant gains being made by the property fund. This reflects the careful consideration of the classes of property and quality of tenants which have been less susceptible to economic shocks. All funds continue to deliver high levels of income return.

Chart 2 – Current Investments by Counterparty Type

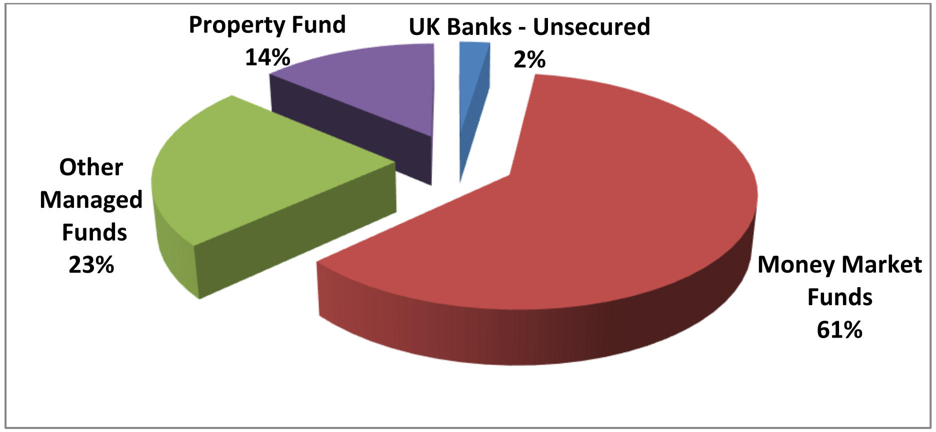


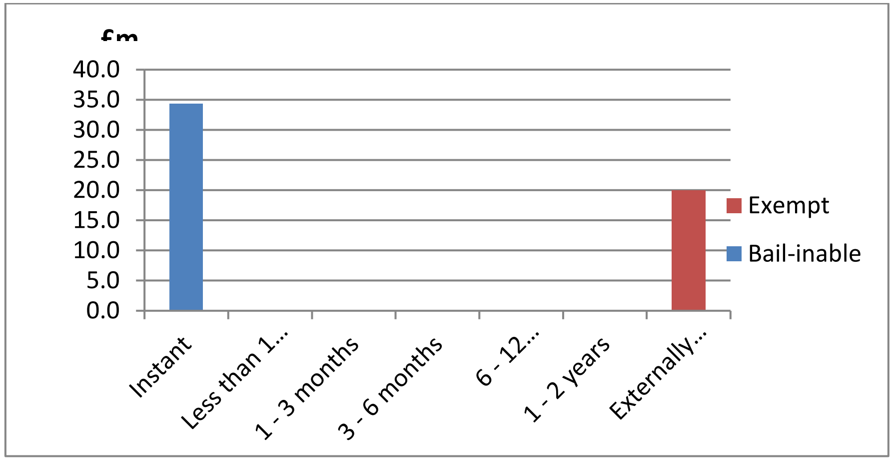
Table 6 – Types of Investments and Interest Rates at 31 March 2022

Instant Access Accounts	Average Rate %	£m
Money Market Funds	0.53	33.0
Barclays Bank	0.20	1.3

Externally Managed Funds	£m
Total – see table 5	20.0

Summary of Current Investments	£m
TOTAL	**54.3**

Chart 3 – Maturity Profile of Investments



Note: Bail-inable means that in the event of default the counterparty may be required to use part of the investments as their own capital in which case the Council would not get back as much as they invested. This would apply with most bank and Building Society investments.

7. Treasury Management Indicators

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

1.41 **Interest Rate Exposures**: This indicator is set to control the Authority's exposure to interest rate risk. The upper limit on the one-year revenue impact of a 1% rise in interest rates is:

Interest Rate Risk Indicator	Limit
Upper limit on one-year revenue impact of a 1% **rise** in interest rates	£582,500
Actual impact in 2021/22 of changes in interest rates	(£83,760)

1.42 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates. Prior to rates increasing near the end of the year, rates were generally lower in 2021/22 than the previous year and budget expectations.

1.43 **Maturity Structure of Borrowing:** This indicator is set to control the Authority's exposure to refinancing risk. Lower limits have been set at 0%. The upper limits on the maturity structure of borrowing and the actual maturity profiles as at 31 March 2022 are:

Refinancing rate risk indicator	Upper Limit	Actual
Under 12 months	70%	67%
12 months and within 24 months	35%	0%
24 months and within 5 years	35%	0%
5 years and within 10 years	75%	9%
10 years and within 20 years	100%	9%
20 years and above	100%	15%

1.44 Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment. The upper limit for loans maturing in under 12 months is relatively high as short term funding is currently considerably cheaper than alternatives.

1.45 **Principal Sums Invested for Periods Longer than 364 days:** 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 total principal sum invested to final maturities beyond the period end will be:

Price Risk Indicator	2022/23	2023/24	2024/25
Limit on principal invested beyond year end	£25m	£15m	£10m
Actual amounts committed beyond year end	£0m	£0m	£0m

Annex A: Existing Investment & Debt Portfolio Position

	31/03/22 **Actual Portfolio** **£m**	**31/03/22** **Average Rate for the year** **%**
External Borrowing:		
PWLB – Fixed Rate	60	4.50%
Local Authorities	102	0.11%
LOBO Loans	17	4.63%
Other	2	0.04%
Total External Borrowing	**181**	**2.35%**
Other Long Term Liabilities:		
PFI	20	-
Total Gross External Debt	**201**	-
Investments:		
Managed in-house		
Short-term investments:		
Instant Access	34	0.51%
Managed externally		
Property Fund	7.5	3.96%
Multi Asset Fund	5	5.04%
Equity - Global	4	4.86%
Equity - UK	2.5	6.01%
Bonds	1	2.44%
Total Investments	**54**	**2.02%**
Net Debt	**147**	-