Appendix 1

Treasury Management Half Yearly Report – 2021/22

1. Background

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate security and liquidity initially before considering optimising investment return (yield).

Accordingly Treasury Management is defined as:

"The management of the local authority'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."

The second main function of a treasury management service is the funding of an authority's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasions any debt previously drawn may be restructured to meet Council risk or cost objectives.

2. Introduction

In February 2010 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Council to approve treasury management semi-annual and annual reports.

The Council's treasury management strategy for 2021/22 was approved at a meeting on 24 February 2021. The Council has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Council's treasury management strategy.

The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 24 February 2021.

This Half Yearly Report to members is intended to provide an update of the treasury management strategy and performance for the period April to September of this financial year.

3. Economic Update – as provided by the Council's Treasury Management Advisors, Arlingclose

The 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 (MPC) 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.

The latest labour market data showed that in the three months to July 2021 the unemployment rate fell to 4.6%. The employment rate increased, and economic activity rates decreased, suggesting an improving labour market picture. Latest data showed growth in average total pay (including bonuses) and regular pay (excluding bonuses) among employees was 8.3% and 6.3% respectively over the period. However, part of the robust growth figures is due to a base effect from a decline in average pay in the spring of last year associated with the furlough scheme.

Annual CPI inflation rose to 3.2% in August, exceeding expectations for 2.9%, with the largest upward contribution coming from restaurants and hotels. The Bank of England now expects inflation to exceed 4% by the end of the calendar year owing largely to developments in energy and goods prices. The Office of National Statistics' (ONS') preferred measure of CPIH which includes owner-occupied housing was 3.0% year/year, marginally higher than expectations for 2.7%.

The easing of restrictions boosted activity in the second quarter of the calendar year, helping push GDP up by 5.5% quarter on quarter (final estimate vs 4.8% quarter on quarter initial estimate). Household consumption was the largest contributor. Within the sector breakdown production contributed 1.0% q/q, construction 3.8% q/q and services 6.5% quarter on quarter, taking all of these close to their pre-pandemic levels.

The US economy grew by 6.3% in the first quarter of 2021 and then by an even stronger 6.6% in the second quarter as the recovery continued. The Federal Reserve maintained its main interest rate at between 0% and 0.25% over the period but in its most recent meeting made suggestion that monetary policy may start to be tightened soon.

The European Central Bank maintained its base rate at 0%, deposit rate at -0.5%, and asset purchase scheme at €1.85 trillion.

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.

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.

As ever, the institutions and durations on the Authority's counterparty list recommended by treasury management advisors Arlingclose remain under constant review.

4. Regulatory Updates – as provided by the Council's Treasury Management Advisors, Arlingclose

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.

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 (CFR), 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; and
    - Excluding investment income from the definition of financing costs;
- Incorporating ESG issues as a consideration within TMP 1 Risk Management; and

- Additional focus on the knowledge and skills of officers and elected members involved in decision making

DLUHC (previously MHCLG) Improvements to the Capital Finance Framework

DLUHC 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".

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 DLUHC regulations enforce guidance from CIPFA and the new PWLB lending arrangements.

A further consultation on these matters is expected soon.

5. Arlingclose's Economic Outlook for the remainder of 2021/22 (based on the October 2021 interest rate forecast)

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

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Official Bank Rate									
Upside Risk	0.00	0.15	0.00	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*
Downside Risk	0.00	0.00	0.15	0.15	0.15	0.40	0.40	0.40	0.40

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.

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.

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.

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. 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.

Government bond yields increased sharply following the September 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.

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.

6. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy for 2021/22 was approved by Full Council on 24 February 2021. The Council's annual Investment Strategy, which is incorporated in the Treasury Management Strategy, outlines the Council's investment priorities as follows:

- Security of Capital
- Liquidity

The Council will also aim to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term, and only invest with highly credit rated financial institutions using the Arlingclose suggested creditworthiness matrices. Currently investments are only being made with UK financial institutions.

Investments during the first six months of the 2021/22 financial year have been in line with the strategy, and there have been no deviations from the strategy.

As outlined in Section 3 above, there is considerable uncertainty in the financial and banking market, both globally and in the UK. In this context, it is considered that the strategy approved on 24 February 2021 is still fit for purpose in the current economic climate.

7. Investment Portfolio 2021/22

In accordance with the CIPFA Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in section 3, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the current 0.10% Bank Rate. Given this environment, investment returns are likely to remain low.

The Council held investments of £15.5m as at 30 September 2021; £12.5m was placed in the Debt Management Account Deposit Facility (DMADF) with the DMO, £2m was held in the Public Sector Deposit Fund, and £1m was held in the Council's Lloyds Current Account for liquidity. In comparison only £4.3m was held as at 31 March 2021, entirely within the Council's Lloyds Current Account. Investments held have been with institutes with a credit rating of A+ or above. This is greater than the average portfolio credit rating target of A or above set in the Council's Treasury Management Strategy 2021/22.

Funds available for investment purposes during 2021/22 to date have varied throughout the year, with up to £22m being available for investment, mainly due to the central government funding received to support small and medium businesses during the coronavirus pandemic. There are fluctuations due to cash inflows and outflows during each month. Large cash inflows include council tax and business rate direct debits and the Housing Benefit subsidy from the Department for Work and Pensions. Large cash outflows include payment of the precepts to Staffordshire County Council, the Fire Authority and the Police, payment of salaries and payment of business rates to Central Government and the Staffordshire Business Rate pool.

The investment portfolio yield for the first six months of the year is 0.01%, at 30 September 2021 this yield was 0.13%. The Council's budgeted investment return for 2020/21 is nil. As at the end of the first 2 quarters of 2021/22 less than £1k of interest has been earned.

Both the CIPFA Code and government guidance 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 to strike an appropriate balance between risk and return, minimising the risk of incurring losses.

Throughout 2021/22 to date, there has been zero interest on the Lloyds Current Account, and only up to 0.02% from the DMADF. The return on Money Market Funds net of fees also fell over the six months and specifically for the Public Sector Deposit Fund that the Council holds, returns have ranged between 0.01% and 0.03%.

8. Borrowing Position 2021/22

The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low. During the first six months of 2021/22 no borrowing has taken place, however it is envisaged that borrowing will be required to cover short-term cash flow deficits together with the capital programme.

With short-term interest rates remaining much lower than long-term rates, the Council consider it to be more cost effective in the near term to use internal resources or borrow on a short-term basis. This is also in line with advice provided by Arlingclose Ltd.

However, a need to borrow in order to fund the Council's capital programme was included within the Revenue and Capital Budgets and Strategies 2021/22 reports presented to Council on 24 February 2021. The impact of borrowing is included in the Medium Term Financial Strategy pressures for 2021/22 and future years.

Borrowing Update

Local authorities can borrow from the Public Works Loan Board (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. 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.

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. Further changes to the CIPFA Prudential Code expected in December 2021 are likely to prohibit borrowing for the primary purpose of commercial return even where the source of borrowing is not the PWLB.

The Authority is not planning to purchase any investment assets primarily for yield within the next three years and so is able fully access the PWLB.

Revised PWLB Guidance

HM Treasury published further guidance on PWLB borrowing in August 2021 providing additional detail and clarifications predominantly around the definition of an 'investment asset primarily for yield'. The principal aspects of the new guidance are:

- Capital expenditure incurred or committed to before 26th November 2020 is allowable even for an 'investment asset primarily for yield'.
- Capital plans should be submitted by local authorities via a DELTA return. These open for the new financial year on 1st March and remain open all year. Returns must be updated if there is a change of more than 10%.
- An asset held primarily to generate yield that serves no direct policy purpose should not be categorised as service delivery.
- Further detail on how local authorities purchasing investment assets primarily for yield can access the PWLB for the purposes of refinancing existing loans or externalising internal borrowing.
- Additional detail on the sanctions which can be imposed for inappropriate use of the PWLB loan. These can include a request to cancel projects, restrictions to accessing the PLWB and requests for information on further plans.

Changes to PWLB Terms and Conditions from 8th September 2021

The settlement time for a PWLB loan has been extended from two workings days to five working days. 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%.

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.

UK Infrastructure Bank

£4bn has been earmarked for lending to local authorities by the UK Infrastructure Bank which is wholly owned and backed by HM Treasury. The availability of this lending to local authorities, for which there will be a bidding process, is yet to commence. Loans will be available for qualifying projects at gilt yields plus 0.6%, which is 0.2% lower than the PWLB certainty rate.

8. Prudential Indicators 2021/22

Treasury management activity during the first half year has been carried out within the parameters set by the prudential indicators contained in the approved 2021/22 Treasury Management Strategy. Consequently, there is no intention to revise any of the indicators for the remainder of the year.

9. Compliance

The Head of Finance (S151 Officer) reports that all treasury management activities undertaken during the year to date have complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

Compliance with debt limits:

	Q1 & Q2 2021/22 Maximum	30.09.21 Actual	2021/22 Operational Boundary	2021/22 Authorised Limit	Complied?
Borrowing	£0m	£0m	£75m	£85m	Yes

Compliance with investment limits:

	Q1 & Q2 2021/22 Maximum	30.09.21 Actual	2021/22 Limit	Complied?
The UK Government	£16m	£12.5m	Unlimited	Yes
Local authorities & other government entities	£0m	£0m	£7m	Yes
Secured investments	£0m	£0m	£7m	Yes
Banks (unsecured)	£6.5m	£1m	£7m	Yes
Building societies (unsecured)	£0m	£0m	£7m	Yes
Registered providers (unsecured)	£0m	£0m	£10m	Yes
Money market funds	£2m	£2m	£7m	Yes
Other Investments	£0m	£0m	£7m	Yes

Annex A

Treasury Management – Glossary of Terms

- **CFR** – the Capital Financing Requirement measures the Council's underlining need to borrow for capital purpose, i.e. its borrowing requirement.
- **CIPFA** – the Chartered Institute of Public Finance and Accountancy, is the professional body for accountants working in Local Government and other public sector organisations.
- **CPI** – a measure that examines the weighted average of prices of a basket of consumer goods and services. The Consumer Price Index is calculated by taking price changes for each item in the predetermined basket of goods/services and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.
- **DMADF** –is provided by the DMO as part of its cash management operations and in the context of a wider series of measures designed to support local authorities' cash management.
- **DLUHC** – the Department for Levelling Up, Housing and Communities formerly the Ministry for Housing, Communities and Local Government (MHCLG), is the UK Government department for housing, communities, local government in England and the levelling up policy.
- **DMO** – The Debt Management Office is an Executive Agency of Her Majesty's Treasury responsible for debt and cash management for the UK Government, lending to local authorities and managing certain public sector funds.
- **GDP** – Gross Domestic Product is the market value of all officially recognised final goods and services produced within a country in a given period of time.
- **Liquidity** – relates to the amount of readily available or short term investment money which can be used for either day to day or unforeseen expenses. For example Call Accounts allow instant daily access to invested funds.
- **MPC** – the Monetary Policy Committee (MPC) is a committee of the Bank of England, which meets for three and a half days, eight times a year, to decide the official interest rate in the United Kingdom (the Bank Rate).
- **PWLB** – is a statutory body operating within the United Kingdom Debt Management Office. PWLB's function is to lend money from the National Loans Fund to local authorities, and to collect the repayments.
- **Quantitative Easing** – a form of unconventional monetary policy in which a central bank purchases longer-term securities from the open market in order to increase the money supply and encourage lending and investment. Buying these securities adds new money to the economy, and also serves to lower interest rates by bidding up fixed-income securities. It also expands the central bank's balance sheet.