WEST OF ENGLAND Combined Authority

**ITEM 16**

**REPORT TO:** **WEST OF ENGLAND COMBINED AUTHORITY COMMITTEE**

**DATE:** **1st JULY 2022**

**REPORT TITLE:** **TREASURY MANAGEMENT OUTTURN REPORT 2021/22**

**DIRECTOR:** **RICHARD ENNIS, DIRECTOR OF INVESTMENT AND CORPORATE SERVICES**

**AUTHOR:** **STEVE FINNEGAN, FINANCIAL ACCOUNTANT**

**Purpose of Report**

1 The Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services: Code of Practice requires the Authority to approve a Treasury Management Strategy before the start of each financial year, review performance during the year, and approve an annual report after the end of each financial year. This report provides a review of performance to 31st March 2022.

**Recommendations**

The West of England Combined Authority Committee is required to:

a) Note the Treasury Management Outturn Report to 31st March 2022, prepared in accordance with the CIPFA Treasury Code of Practice.

b) Note the Treasury Management Indicators to 31st March 2022.

**Voting Arrangements:**

None required – Recommendations are for noting purposes.

## Background / Issues for Consideration

2 The CIPFA Code of Practice requires that the Combined Authority Committee considers the treasury management outturn report after the end of each financial year.

## Summary

2.1 The average rate of investment return for 2021/22 was 0.93%, which is 0.64% above the London interbank bid benchmark rate.

2.2 The Authority's Prudential Indicators for 2021/22 were agreed by the Authority at its meeting on 29th January 2021 and performance against the key indicators is shown in **Appendix 1**. All indicators are within target levels.

## Summary of Returns

2.3 The Authority's investment position as at 31st March 2022 is detailed in **Appendix 2**. This shows a change in Investment Balances to £280.89m at 31st March 2022 from £305m at 30th September 2021, which reflects a net decrease.

2.4 The Authority is the Accountable Body for the West of England Revolving Investment Fund, (RIF). The balance at 31st March 2022 was £10.5m and this sum, prior to distribution, is being invested in line with the Authority's Treasury Management Strategy, with the interest earmarked to the RIF.

2.5 The Authority also acts as Accountable Body for the West of England Local Enterprise Partnership, (LEP). In 2020/21 £34.2m of Local Growth Fund (LGF) grant was received from Central Government, along with the remaining sums and offset against spend, provided a balance at 31st March 2022 of £3.4m. This sum, prior to distribution, is being invested in line with the Authority's Treasury Management Strategy with interest being credited to the Local Enterprise Partnership revenue budget (as set out in the approved budget).

2.6 Gross interest earned on all investments for April 2021 to March 2022 was £2,510k. Interest earned for RIF and LGF is ringfenced to those funds, giving rise to an income outturn for the Combined Authority activities of £2,428k.

## Summary of Borrowings

2.7 The Authority does not currently have any underlying need to borrow long term to fund capital expenditure. As part of its approach to liquidity management, the Authority may borrow short term loans to cover any unplanned cash flow shortages as they arrive. As at 31st March 2022 the Authority has no external borrowing.

**Strategic & Tactical Decisions**

2.8 Both the CIPFA code and government guidance require the Authority 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 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. The approach, given these are public funds is minimising risk first with return as the second consideration.

2.9 As shown in the charts at **Appendix 2**, the investment portfolio has been diversified across UK Banks and Local Authorities, which totalled £209.4m. The Authority also uses AAA rated Money Market funds (MMF) to maintain very short-term liquidity with £24.5m invested in Money Market Funds as at 31st March 2022. Ultra-low short-dated cash rates, which were a feature since March 2020 when Bank Rate was cut to 0.1%, prevailed for much of the 12-month reporting period which resulted in the return on sterling low volatility net asset value (LVNAV) Money Market Funds being close to zero even after some managers have temporarily waived or lowered their fees. However, higher returns on cash instruments followed the increases in Bank Rate in December, February and March. At 31st March, the 1-day return on the Authority's MMFs ranged between 0.60% to 0.67% p.a.

2.10 The Authority retains units invested in the CCLA Property Fund of £9.9m and we have added a further £13m to our pooled fund's portfolio, with a new investment of £10m with Royal London, and a further investment of £3m with Kames bringing the total invested to £10m. The Authority retains investments with Investec for £10m, £3.5m with M & G and £3.5m with Columbia Threadneedle. The Authority has a total of £47m invested across the funds. These investments seek to enhance yields, provide diversification and are intended to be held for higher returns over a long period of time.

2.11 In the nine months to December improved market sentiment was reflected in equity, property and multi-asset fund valuations and, in turn, in the capital values of the Authority's property, equity and multi-asset income funds in the Authority's portfolio. The prospect of higher inflation and rising bond yields did however result in muted bond fund performance. In the January- March quarter the two dominant themes were tighter UK and US monetary policy and higher interest rates, and the military invasion of Ukraine by Russia in February, the latter triggering significant volatility and uncertainty in financial markets. In light of Russia's invasion, Arlingclose contacted the fund managers of the Authority's MMF, cash plus and strategic funds and confirmed no direct exposure to Russian or Belarusian assets had been identified. Indirect exposures were immaterial. It should be noted that that any assets held by banks and financial institutions (e.g. from loans to companies with links to those countries) within MMFs and other pooled funds cannot be identified easily or with any certainty as that level of granular detail is unlikely to be available to the fund managers or Arlingclose in the short-term, if at all. These investments are made in the knowledge that capital values will move both up and down on months and quarters, but with the confidence that over a three to five-year period, total returns will exceed interest rates. They provide regular revenue income and in 2021-22 provided an average total return of 3.66%. In light of their performance over the medium-long term, investment in these funds has been maintained.

2.12 The Authority does not hold any direct investments with banks in countries within the Eurozone reflecting both on the underlying debt issues in some Eurozone countries and the low levels of interest rates.

2.13 Environmental, Social and Governance (ESG) and responsible investing has gained further momentum in 2021. Investors in physical and financial assets are increasingly being expected to be on the frontline of combating climate change and committing to sustainability goals. In its recent consultation on the Treasury Management Code of Practice, CIPFA has proposed a new Treasury Management Practice on ESG Risk Management. The Authority will continue to work with its treasury advisors Arlingclose for support and advice through its ESG, and responsible investment service.

**Future Strategic & Tactical Issues**

2.14 The Authority's treasury management advisors have provided an economic and market review for 2021/22 – attached at **Appendix 3**.

2.15 Following the increase in Bank rates in December, February, and March to 0.75%, the Authority will expect to receive higher income from its cash and short-dated money market investments, including money market funds in 2022/23. The Authority has moved £699k from its investment income surplus for 2021-22 to an earmarked Treasury Management reserve, to offset the risk of future capital losses or future rate drops.

**Other Options Considered**

3 None.

**Risk Management/Assessment**

4 The Authority's lending & borrowing list is regularly reviewed, and credit ratings are monitored throughout the year. All lending/borrowing transactions are within approved limits, with approved institutions. Investment and Borrowing advice is provided by our Treasury Management consultants Arlingclose.

The CIPFA Treasury Management in the Public Services: Code of Practice requires the Authority nominate a committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies. The West of England Combined Authority Audit Committee carries out this role.

**Public Sector Equality Duties**

5 The public sector equality duty created under the Equality Act 2010 means that public authorities must have due regard to the need to:

- Eliminate unlawful discrimination, harassment and victimization and other conduct prohibited by the Act.
- Advance equality of opportunity between people who share a protected characteristic and those who do not.
- Foster good relations between people who share a protected characteristic and those who do not.

5.1 The Act explains that having due regard for advancing equality involves:

- Removing or minimising disadvantages suffered by people due to their protected characteristics.

- Taking steps to meet the needs of people from protected groups where these are different from the needs of other people.
- Encouraging people from protected groups to participate in public life or in other activities where their participation is disproportionately low.

5.2 The general equality duty therefore requires organisations to consider how they could positively contribute to the advancement of equality and good relations. It requires equality considerations to be reflected in the design of policies and the delivery of services, including policies, and for these issues to be kept under review.

**Finance Implications, including economic impact assessment where appropriate:**

6 A breakdown of the revenue budget that was set for interest income and the year-end outturn position is included in **Appendix 4**.

Advice given by: Richard Ennis, Director of Investment & Corporate Services

**Legal Implications:**

7 The Prudential Code and CIPFA's Code of Practice on Treasury Management requires regular monitoring and reporting of Treasury Management activities.

Advice given by: Stephen Gerrard, Director of Legal Services

**Appendices & Background papers:**

**Appendix 1** – Performance Against Prudential Indicators
**Appendix 2** – The Authority's Investment Position at 31 March 2022
**Appendix 3** – Arlingclose's Economic & Market Review for 2021/22
**Appendix 4** – Interest & Capital Financing Budget Monitoring 2021/22
**Appendix 5** – Summary Guide to Credit Ratings

**Background Papers: Treasury Management Strategy Statement & Investment Strategy 2021/22 – As reported to West of England Combined Authority Committee on 29th January 2021.**


| Report Author | Contact Details |
| --- | --- |
| Richard Ennis | Richard.Ennis@westofengland-ca.gov.uk |

**APPENDIX 1**

## Performance against Treasury Management Indicators (as approved in the Treasury Management Strategy Statement)

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

**1. Security**
The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

| Credit risk indicator | Target | Actual |
|---|---|---|
| Minimum portfolio average credit rating | A- | A+ |

**2. Liquidity**
The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount it can borrow each quarter without giving prior notice.

| Liquidity risk indicator | Target | Actual |
|---|---|---|
| Total sum borrowed in past 3 months without prior notice | £30m | £0m |

**3. Interest Rate Exposure**
This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

| Interest rate risk indicator | Limit | Actual |
|---|---|---|
| Upper limit on one-year revenue impact of a 1% fall in interest rates | £900k | £888k |

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

**4. Principal sums invested for periods longer than a year:**
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 long-term principal sum invested to final maturities beyond the period end will be:

| Price risk indicator | 2021/22 Target | 2021/22 Actual | 2022/23 Target | 2022/23 Actual | 2023/24 Target | 2023/24 Actual | +3 Years Target | +3 Years Actual |
|---|---|---|---|---|---|---|---|---|
| Limit on principal invested beyond 364 days as % of total cash balance | 50% | 30% | 30% | 28% | 20% | 20% | 20% | 16% |

**APPENDIX 2**

## The Authority's Investment position at 31st March 2022

The term of investments are as follows:

| | **Balance at 31st March 2022 £000s** |
|---|---|
| Notice (instant access funds) | **33,750** |
| Up to 1 month | **15,000** |
| 1 month to 3 months | **60,185** |
| 4 to 6 months | **60,000** |
| 6 to 12 months | **35,000** |
| More than 12 months | **30,000** |
| Pooled Funds * | **46,957** |
| **Total** | **280,892** |

The Authority had a total average net positive balance of £296.3m during the period April 2021 to March 2022

* Notice period 4 days except property fund which is 90 days

**Chart 1 : WECA Investments by Funding Source (£280.89m) at 31st March 2022**

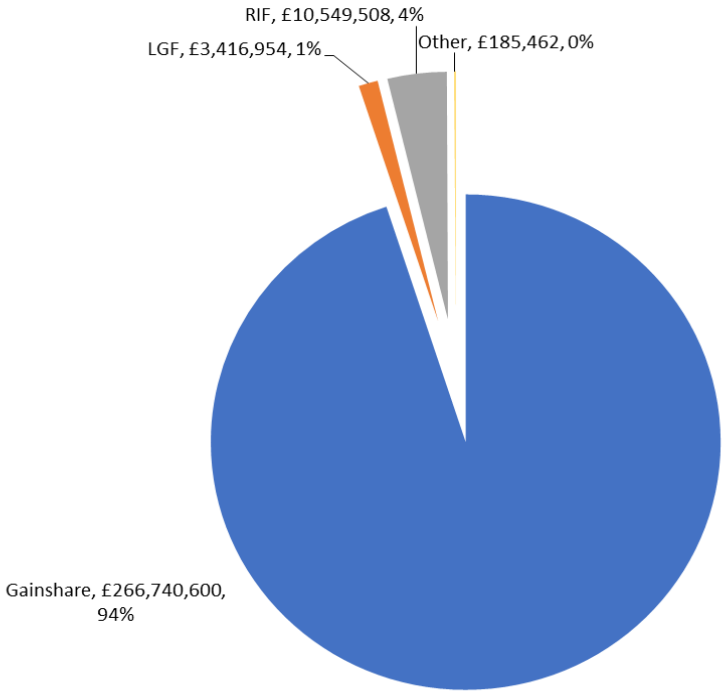



**Chart 2 : WECA Investments by Funding Source (£305.39m) at 30th Sept 2021**

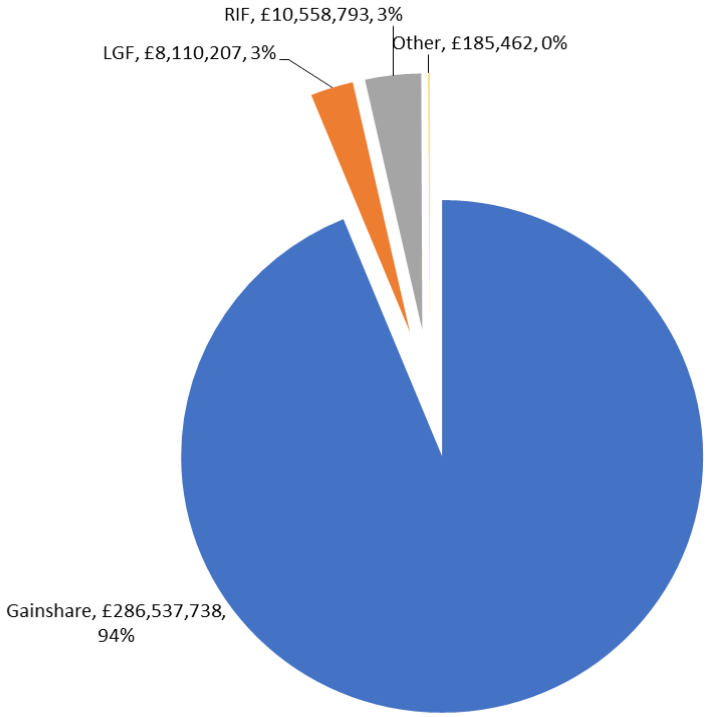


**Chart 3: WECA Investments by Type (280.89m) as at 31st March 2022**

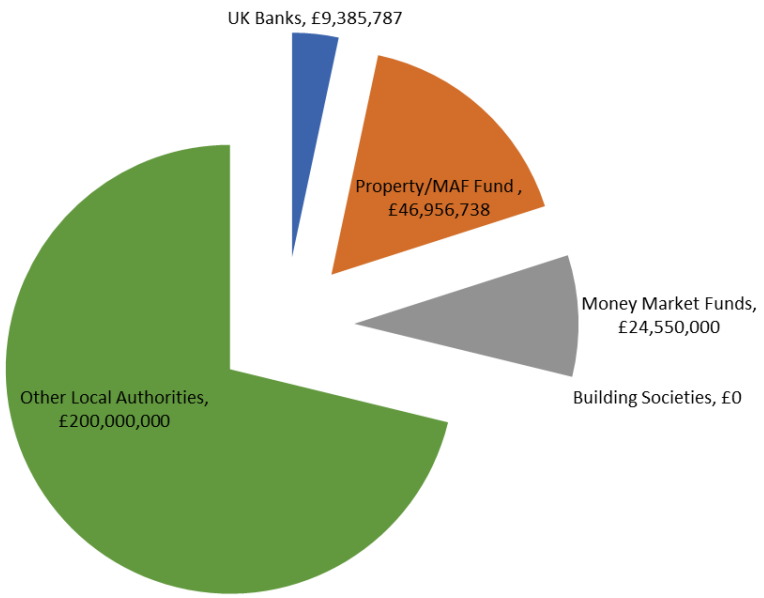



**Chart 4: WECA Investments by Type (305.39m) as at 30th Sept 2021**

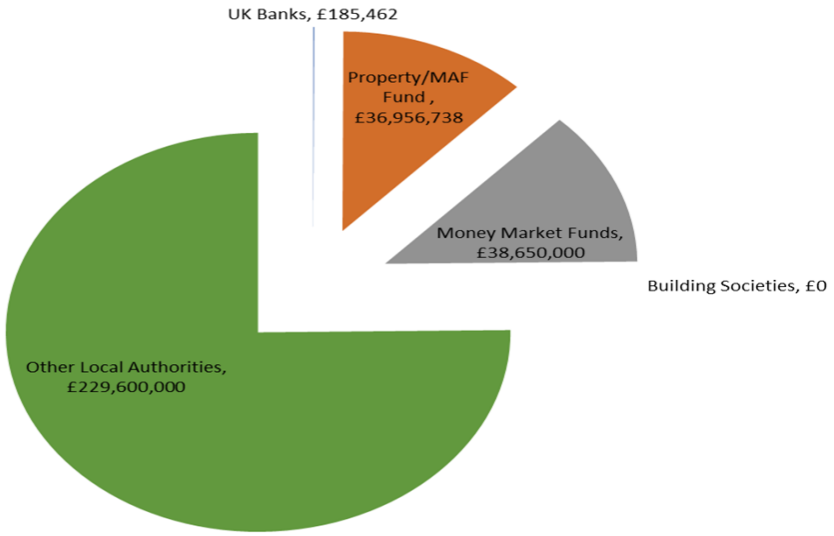


**Chart 5: WECA Investments per lowest equivalent Long Term credit rating (£280.89m) at 31st March 2022**

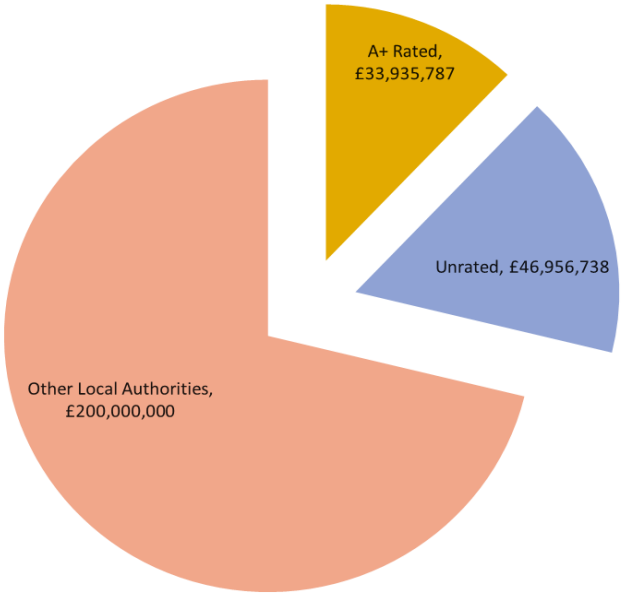
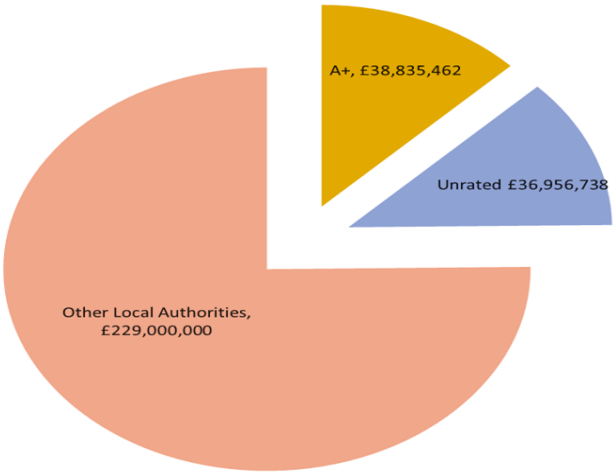



**Chart 6: WECA Investments per lowest equivalent Long Term credit rating (£305.39m) at 30th Sept 2021**




Unrated investments are the Pooled Funds

**APPENDIX 3**

## Economic and Market Review for 2021/22

**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.

Bank 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.

UK 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. Core inflation, which excludes the more volatile components, rose to 5.2% y/y from 4.4%.

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 January 2022 showed the unemployment rate at 3.9% while the employment rate rose to 75.6%. Headline 3-month average annual growth rate for wages were 4.8% for total pay and 3.8% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 0.1% while regular pay fell by 1.0%.

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 with the reopening of oil rigs 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 according to the final estimate (initial estimate 1.0%) and took UK GDP to just 0.1% below where it was before the pandemic. The annual growth rate was revised down slightly to 7.4% (from 7.5%) following a revised 9.3% fall in 2020.

Having increased Bank 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.

In its 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.

GDP growth in the euro zone increased by 0.3% in calendar Q4 2021 following a gain of 2.3% in the third quarter and 2.2% in the second. Headline inflation remains high, with CPI registering a record 7.5% year-on-year in March, the ninth successive month of rising inflation. Core CPI inflation was 3.0% y/y in March, was well above the European Central Bank's target of 'below, but close to 2%', putting further pressure on its long-term stance of holding its main interest rate of 0%.

The US economy expanded at a downwardly revised annualised rate of 6.9% in Q4 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 it plan to reduce its asset purchase programme which could start by May 2022.

**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.

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 5-year UK benchmark gilt yield began the quarter at 0.82% before rising to 1.41%. Over the same period the 10-year gilt yield rose from 0.97% to 1.61% and the 20-year yield from 1.20% to 1.82%.

The Sterling Overnight Rate (SONIA) averaged 0.39% over the quarter.

**Credit review:** In the first half of FY 2021-22 credit default swap (CDS) spreads were flat over most of 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.

Fitch also revised the outlook for Nordea, Svenska Handelsbanken and Handelsbanken plc to stable. The agency considered the improved economic prospects in the Nordic region to have reduced the baseline downside risks it previously assigned to the lenders.

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.

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.

**APPENDIX 4**

## Interest & Capital Financing Costs – Outturn Position for 2021/22

| April 2021 to March 2022 | Year End Position<br>Budgeted Income<br>£'000 | Outturn Income<br>£'000 | Outturn over or under spend<br>£'000 | Adv/Fav |
|---|---|---|---|---|
| **Interest & Capital Financing** | | | | |
| - Debit Costs (Borrowing) | 0 | 0 | 0 | - |
| - Interest on Balances | | | | |
| WECA | 1,030 | 2,428 | 1,398 | Fav |
| RIF | 0 | 38 | 38 | Fav |
| LEP | 50 | 44 | -6 | Adv |
| **Total - Interest & Capital Financing** | **1,080** | **2,510** | **1,430** | **Fav** |

Lower level of interest received on the LEP balance due to longer term investment of LEP funds being limited, as the remaining LGF balance was due to be fully spent by March 2022.

**APPENDIX 5**

## Summary Guide to Credit Ratings

| Rating | Details |
|---|---|
| AAA | Highest credit quality – lowest expectation of default, which is unlikely to be adversely affected by foreseeable events. |
| AA | Very high credit quality - expectation of very low default risk, which is not likely to be significantly vulnerable to foreseeable events. |
| A | High credit quality - expectations of low default risk which may be more vulnerable to adverse business or economic conditions than is the case for higher ratings. |
| BBB | Good credit quality - expectations of default risk are currently low but adverse business or economic conditions are more likely to impair this capacity. |
| BB | Speculative - indicates an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time. |
| B | Highly speculative - indicates that material default risk is present, but a limited margin of safety remains. Capacity for continued payment is vulnerable to deterioration in the business and economic environment. |
| CCC | Substantial credit risk - default is a real possibility. |
| CC | Very high levels of credit risk - default of some kind appears probable. |
| C | Exceptionally high levels of credit risk - default is imminent or inevitable. |
| RD | Restricted default - indicates an issuer that has experienced payment default on a bond, loan or other material financial obligation but which has not entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, and which has not otherwise ceased operating. |
| D | Default - indicate san issuer that has entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, or which has otherwise ceased business. |