APPENDIX 2

West of England Combined Authority

Treasury Management Strategy Statement 2023/24

1. Introduction

1.1 Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority has substantial sums of money invested 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.

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 2017 Edition* (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.

2. External Context

2.1 **Economic background:** The ongoing impact on the UK from the war in Ukraine, together with higher inflation, higher interest rates, recent changing government policy responses, and a deteriorating economic outlook, will be major influences on the Authority's treasury management strategy for 2023/24.

2.2 The Bank of England (BoE) increased Bank Rate by 0.75% to 3.0% in November 2022, the largest single rate hike since 1989 and the eighth successive rise since December 2021. The decision was voted for by a 7 v 2 majority of the Monetary Policy Committee (MPC), with one of the two dissenters voting for a 0.50% rise and the other for just a 0.25% rise.

2.3 The November quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with Consumer Price Index (CPI) inflation remaining elevated at over 10% in the near-term. While the projected peak of inflation is lower than in the August report, due in part to the government's support package for household energy costs, inflation is expected to remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising in spite of a labour shortage in the markets as a whole.

2.4 The UK economy grew by 0.2% between April and June 2022, but the BoE forecasts Gross Domestic Product (GDP) will decline 0.75% in the second half of the calendar year due to the squeeze on household income from higher energy costs and goods prices. Growth is then expected to continue to fall throughout 2023 and the first half of 2024.

2.5 CPI inflation is expected to peak at around 11% in the last calendar quarter of 2022 and then fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if Bank Rate follows the path implied by financial markets with a peak of 5.25%. However, the Bank of England has stated it considers this path to be too high, suggesting that the peak in interest rates will be lower, reducing the risk of inflation falling too far below target.

2.6 The labour market remains tight for now, with the most recent statistics showing the unemployment rate fell to 3.5%, driven mostly by a shrinking labour force. Earnings were up strongly in nominal terms by 6% for total pay and 5.4% for regular pay but factoring in inflation means real total pay was -2.4% and regular pay -2.9%. Looking forward, the Monetary Policy Report shows the labour market weakening in response to the deteriorating outlook for growth, leading to the unemployment rate rising to around 6.5% in 2025

2.7 Interest rates have also been rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.75% in November 2022 to 3.75%-4.0%. This was the fourth successive 0.75% rise in a pace of tightening that has seen rates increase from 0.25%-0.50% in March 2022. Annual inflation has been slowing in the US but remains above 8%. GDP grew at an annualised rate of 2.6% between July and September 2022, a better-than-expected rise, but with official interest rates expected to rise even further in the coming months, a recession in the region is widely expected at some point during 2023

2.8 Inflation has been rising consistently in the Euro Zone since the start of the year, hitting an annual rate of 10.7% in October 2022. Economic growth has been weakening with an expansion of just 0.2% in the three months to September 2022. As with the UK and US, the European Central Bank has been on an interest rate tightening cycle, pushing up its three key interest rates by 0.75% in October, the third major increase in a row, taking its main refinancing rate to 2% and deposit facility rate to 1.5%.

2.9 **Credit outlook:** Credit default swap (CDS) prices have followed an upward trend throughout the year, indicating higher credit risk. They have been increased by the war in Ukraine, increasing economic and political uncertainty and a weaker global and UK outlook, but remain well below the levels seen at the beginning of the Covid-19 pandemic. CDS price volatility has been higher in 2022 compared to 2021 and this year has seen a divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities once again.

2.10 The weakening economic picture during 2022 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several local authorities and financial institutions, revising them to negative from stable. There are competing tensions in the banking sector which could impact bank balance sheet strength going forward. The weakening economic outlook and likely recessions in many regions increase the possibility of a deterioration in the quality of banks' assets, while higher interest rates provide a boost to net income and profitability. However, the institutions on our adviser Arlingclose's counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

2.11 **Interest rate forecast:** The Authority's treasury management adviser Arlingclose forecasts that Bank Rate will continue to rise in 2022 and 2023 as the Bank of England attempts to subdue inflation which is significantly above its 2% target. While interest rate growth expectations reduced during October and November 2022, multiple interest rate rises are still expected over the horizon despite looming recession. Arlingclose expects Bank Rate to rise to 4.25% by June 2023 under its central case, with the risks in the near- and medium-term to the upside should inflation not evolve as the Bank forecasts and remains persistently higher. A more detailed economic and interest rate forecast provided by Arlingclose is in **Appendix A**

2.12 Yields are expected to remain broadly at current levels over the medium-term, with 5-, 10- and 20-year gilt yields expected to average around 3.6%, 3.7%, and 3.9% respectively over the 3-year period to September 2025. The risks for short, medium and longer-term yields are judged to be broadly balanced over the forecast horizon. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.

2.13 For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 2% for the West of England

Combined Authority balances, and 1.8% for Revolving Infrastructure Fund (RIF) balances. Lower levels of interest received on RIF balances due to longer term investments of funds being limited. Higher rates can only be achieved through retaining a proportion of our portfolio as long terms investments such as property, equities and mixed asset funds.

3. Local Context

3.1 On 31st October 2022, the Authority held £401m of investments, and £40m in short term borrowing. This is set out in further detail at **Appendix B**.

3.2 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.

3.3 The Authority's capital expenditure plans do not currently imply any need to borrow over the forecast period. Investments are forecast to fall to £230m by the end of 2023/24 as capital grants are used to finance capital expenditure and earmarked reserves are spent on their intended purpose.

4. Investment Strategy

4.1 The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. Since 1 April 2022, the Authority's investment balance has ranged between £280m and £401m, and similar levels are expected to be maintained in the forthcoming year.

4.2 As well as holding investments in its own right, the Authority also acts as Accountable Body for the West of England Revolving Investment Fund (RIF) holding Government Grants until they are ready to be distributed to Local Authorities and other organisations for approved project spend over the coming years.

4.3 The funds are invested primarily to protect the capital and, to achieve a high level of capital security, investments are made predominantly with Central Government, Local Authorities and Banks with high credit ratings. See **Appendix C** for Treasury Monitoring.

4.4 Interest earned on Revolving Infrastructure Fund investments is re-invested into the Fund.

4.5 **Objectives:** The Chartered Institute of Public Finance and Accountancy 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. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. Given the current level of CPI at 11% this will be impossible to achieve with fixed term deposits alone. However, we will continue to consider further longer-term investments within our overall investment portfolio, such as pooled funds, which will achieve a higher rate of return. Any temporary liquidity issues that may arise throughout the year will be dealt with by short term borrowing.

4.6 **Strategy:** The Authority expects to be a long-term investor and treasury investments will therefore include both short-term low risk instruments to manage day-to-day cash flows and longer-term instruments where limited additional risk is accepted in return for higher investment income. The Authority aims to further diversify into more secure and/or higher yielding asset classes during 2023/24. A reduced proportion of the Authority's surplus cash remains invested in short-term unsecured bank deposits and money market funds. This diversification will represent a continuation of the strategy adopted in 2022/23 with outer limits set for treasury management operations.

4.7 **Business models:** Under the International Financial Reporting Standard 9, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

4.8 **Approved counterparties:** The Authority may invest its surplus funds with any of the counterparty types as detailed in *Figure 1*, subject to the cash limits (per counterparty), and the time limits shown.

Figure 1: Approved investment counterparties and limits

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£10m	Unlimited
Secured investments *	25 years	£15m	Unlimited
Banks (unsecured) *	13 months	£10m	Unlimited
Building societies (unsecured) *	13 months	£10m	£20m

Registered providers (unsecured) *	5 years	£10m	£50m
Money market funds *	n/a	£10m	Unlimited
Strategic pooled funds	n/a	£10m	£60m
Real estate investment trusts	n/a	£10m	£50m
Other investments *	5 years	£10m	£20m

This table must be read in conjunction with the following notes

a) **Minimum Credit rating:** Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is **no lower than A-.** Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be considered.

   For entities without published credit ratings, investments may be made either:

   (i) where external advice indicates the entity to be of similar credit quality; or

   (ii) to a maximum of £10m per counterparty as part of a diversified pool e.g. via a peer-to-peer platform.

b) **Banks and building societies unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

c) **Secured investments:** Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

d) **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

e) **Registered providers (unsecured):** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

f) **Money Market Funds:** Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

g) **Strategic Pooled funds:** Shares or units in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

The Authority may consider further investment in Pooled Funds during 2023/24 with a view to providing further diversification and the potential for earning a higher investment yield on long-term investment balances. Cash that is not required to meet any short or medium-term liquidity can be invested for the longer term with a greater emphasis on achieving returns that will support spending on local West of England CA services.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow 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 available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

h) **Real estate investment trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

i) **Other investments:** This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Authority's investment at risk.

j) **Operational bank accounts:** The Authority may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £500,000 per bank. This is a relatively low risk as deposits tend to be only held overnight and can be moved without notice. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

k) **Risk assessment and credit ratings**: Credit ratings are obtained and monitored by the Authority's treasury advisers, ArlingClose, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

l) **Other information on the security of investments**: The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Authority's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

   When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will either be deposited with the UK Government, (via the Debt Management Office), invested in government treasury bills or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

m) **Environmental, Social & Governance (ESG) Investments:** Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Authority does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, the Authority will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code. The Authority recognises it can further enhance its efforts through its investment decisions and activity. The Authority will consider options for investments of short-term funds with institutions who ring fence the use of such funds for ESG related matters. The Authority will continue to use the Arlingclose ESG and Responsible Investment Service, designed to guide and advise authorities on incorporating and monitoring ESG in its treasury investment decisions.

n) **UA Short Term Loan Facility:** In order to assist the West of England Unitary Authorities who may continue to face cashflow challenges following Covid-19, the Authority has implemented a short-term loan facility and this will be operated within the parameters of the approved Treasury Management Strategy.

o) **Investment limits**: The maximum that will be lent to any one organisation, (other than the UK Government), will be £10 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries. The Authority's revenue reserves, which could be made available to cover any investment losses, are forecast to be £2.5 million on 31st March 2023. There is also a £1.1m Treasury Management Earmarked Reserve available.

Figure 2: Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£10m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£10m per group
Any group of pooled funds under the same management	£10m per manager
Negotiable instruments held in a broker's nominee account	£10m per broker
Foreign countries	£15m per country (AAA sovereign rating)
	£10m per country (AA+ sovereign rating)
Registered providers and registered social landlords	£50m in total
Unsecured investments with building societies	£20m in total
Loans to unrated corporates	£20m in total
Money market funds	unlimited
Real estate investment trusts	£50m in total

Liquidity management: The Authority uses cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium-term financial plan and cash flow forecast. The Authority will spread its liquid cash over at least five providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

5. Borrowing Strategy

5.1 The Authority currently holds £40m of short-term loans for cash flow purposes. The balance sheet forecast shows that the Authority does not expect the need to borrow in 2023/24.

5.2 **Objectives:** The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.

5.3 **Strategy:** The Authority does not currently have any underlying need to borrow long-term to fund capital expenditure. The Combined Authority holds no long-term loans and no long-term borrowing is anticipated during 2023/24. Therefore, a debt-free strategy will be maintained until such time as the Authority determines that its capital strategy and prioritised programme of investment requires consideration of any borrowing decision.

5.4 As part of its approach to liquidity management, the Authority may borrow short-term loans to cover any unplanned cash flow shortages as they arise. Rather than always keeping cash on instant access for unplanned cash flows, (where security and liquidity will mean yields will be low), the Authority will retain the option of short-term borrowing at low rates to enable it to explore increasing investments in longer-term and more diversified assets. The Authority will test access to borrowing occasionally even where this is not required to ensure liquidity is available.

5.5 **Sources of borrowing:** The approved sources of short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except Avon Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

5.6 **Other sources of debt finance:** In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

5.7 **Short-term and variable rate loans**: These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits as detailed in the treasury management indicators.

6. Treasury Management Indicators

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

6.2 **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
Minimum portfolio average credit rating	A-

6.3 **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
Total sum borrowed in past 3 months without prior notice	£40m

6.4 **Interest rate exposures**: 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
Upper limit on one-year revenue impact of a 1% fall in interest rates	£1m

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

6.5 **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	2022/23	2023/24	2024/25	+3 years
Limit on principal invested beyond 364 days as % of total cash balance	50%	30%	20%	20%

7. Related Matters

The Chartered Institute of Public Finance and Accountancy Code requires the Authority to include the following in its treasury management strategy.

7.1 **Financial Derivatives:** Authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. Lender Option Borrower Option loans and callable deposits). The general power of competence in section 113A of the Local Democracy, Economic Development and Construction Act 2009 removes much of the uncertainty over authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.

In line with the CIPFA code, the Authority will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

7.2 **Markets in Financial Instruments Directive (MiFID II)**: As a result of the directive, Local Authorities will be treated as retail clients, but can opt up to professional client status, providing that they meet certain criteria which includes having an investment balance of at least £10m and the persons authorised to make investment decisions on behalf of the Combined Authority having at least a year's relevant professional experience. In addition, the regulated financial services firms to whom this directive applies must assess that these persons have the expertise, experience and knowledge to make investment decisions and understand the risks involved.

The Authority has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

8. Financial Implications

The budget for the West of England CA investment income in 2023/24 is £4 million, based on an average investment portfolio of £200 million at an average interest rate of 2.00% and making an allowance for impairment as required.

Where investment income exceeds budget, e.g. from higher risk investments including pooled funds, then 50% of the revenue savings will be transferred to a treasury management reserve to cover the risk of capital losses or lower interest rates payable in future years.

9. Other Options Considered

9.1 The Chartered Institute of Public Finance and Accountancy Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer, having consulted the West of England Mayor and Chief Executive, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management

Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller

Appendix A – Arlingclose Economic & Interest Rate Forecast – November 2022

Underlying assumptions:

- UK interest rate expectations have eased following the mini-budget, with a growing expectation that UK fiscal policy will now be tightened to restore investor confidence, adding to the pressure on household finances. The peak for UK interest rates will therefore be lower, although the path for interest rates and gilt yields remain highly uncertain.
- Globally, economic growth is slowing as inflation and tighter monetary policy depress activity. Inflation, however, continues to run hot, raising expectations that policymakers, particularly in the US, will err on the side of caution, continue to increase rates and tighten economies into recession.
- The new Chancellor dismantled the mini-budget, calming bond markets and broadly removing the premium evident since the first Tory leadership election. Support for retail energy bills will be less generous, causing a lower but more prolonged peak in inflation. This will have ramifications for both growth and inflation expectations.
- The UK economy is already experiencing recessionary conditions, with business activity and household spending falling. Tighter monetary and fiscal policy, alongside high inflation will bear down on household disposable income. The short- to medium-term outlook for the UK economy is bleak, with the Bank of England projecting a protracted recession.
- Demand for labour remains strong, although there are some signs of easing. The decline in the active workforce has fed through into higher wage growth, which could prolong higher inflation. The development of the UK labour market will be a key influence on Monetary Policy Committee decisions. It is difficult to see labour market strength remaining given the current economic outlook.
- Global bond yields have steadied somewhat as attention turns towards a possible turning point in US monetary policy. Stubborn US inflation and strong labour markets mean that the Federal Reserve remains hawkish, creating inflationary risks for other central banks breaking ranks.
- However, in a departure from Fed and European Central Bank policy, in November the Bank of England attempted to explicitly talk down interest rate expectations, underlining the damage current market expectations will do to the UK economy, and the probable resulting inflation undershoot in the medium term. This did not stop the Governor affirming that there will be further rises in Bank Rate.

Forecast:

- The Monetary Policy Committee remains concerned about inflation but sees the path for Bank Rate to be below that priced into markets.
- Following the exceptional 75bp rise in November, Arlingclose believes the MPC will slow the rate of increase at the next few meetings. Arlingclose now expects Bank Rate to peak at 4.25%, with a further 50bp rise in December and smaller rises in 2023.

- The UK economy likely entered into recession in Q3, which will continue for some time. Once inflation has fallen from the peak, the Monetary Policy Committee will cut Bank Rate.
- Arlingclose expects gilt yields to remain broadly steady despite the Monetary Policy Committee's attempt to push down on interest rate expectations. Without a weakening in the inflation outlook, investors will price in higher inflation expectations given signs of a softer monetary policy stance.
- Gilt yields face pressures to both sides from hawkish US/Euro Zone central bank policy on one hand to the weak global economic outlook on the other. Bank of England bond sales will maintain yields at a higher level than would otherwise be the case.

Appendix B – Investment & Debt Portfolio Position

	31-Oct-22 Actual Portfolio £m	31-Oct-22 Average Rate %
Short-Term External borrowing:	40.0	1.50
Other long-term liabilities:	0	0
Total gross external debt	40.0	1.50
Treasury investments:		
Banks & building societies (unsecured)	19.7	1.94
Covered bonds & repo (secured)	0	0
Government (incl. local authorities)	297.0	0.85
Registered Providers	10.0	1.25
Money Market Funds	22.5	1.45
Social Housing Real Estate Investment Trust	5.00	2.85
Other pooled funds:		
CCLA Property Fund	10.0	3.70
Investec	10.0	3.48
Kames	10.0	4.62
Threadneedle	3.5	1.90
M & G	3.5	4.84
Royal London Enhanced Cash Plus Fund	10.0	1.08
Total treasury investments	401.2	1.21
Net debt	361.2	-

Appendix C – Treasury Management Monitoring

The Authority's investment position as at 31st October 2022 is detailed below in Table 1. This shows a balance held of £401m which is an increase from £281m at 31st March 2022.

As shown in the charts, the investment portfolio has been diversified across UK banks, Building Societies and Local Authorities. The Authority also uses AA rated Money Market Funds to maintain short term liquidity with £19.7m invested as at 31st October 2022. The Authority also retains units in pooled funds with £10m invested with the CCLA Property Fund, £10m with Investec, £10m with Kames, £10m with Royal London, £3.5m with Threadneedle and £3.5m with M&G as shown below in Table 2.

The forecast investment income to 31st March 2023 is £3.2m with an average rate of interest earned of circa 1%.

Investments are forecast to fall to £300m by the end of the 2022/23 financial year as capital grants are used to finance capital expenditure and project spend. Investments have been staggered, in terms of maturity dates, to ensure that there is a reasonable balance of available liquidity to finance required spend.

Table 1

The Authority's term of investments are as follows:	**Balance as at 31st Oct 2022 £000s**
Instant Access Funds	32,000
Pooled Including REIT	51,957
Up to 1 month	10,000
1 month to 3 months	35,185
4 months to 6 months	70,000
6 months to 12 months	182,000
More than 12 months	20,000
	401,142

Table 2: Pooled Funds

Fund Name	Asset Class	Purchase Value £000s	Fair Value as at Oct £000s	Capital Growth/(Loss) £000s	Total Investment Income Earned £000's
CCLA Property Fund	Property	9,956	10,910	954	859
Ninety One Diversified Income Fund (Investec)	Multi Asset	10,000	8,819	-1,181	914
Aegon Diversified Monthly Income Fund (Kames)	Multi Asset	10,000	8,605	-1,395	1,090
Threadneedle Strategic Bond Fund	Bond	3,500	2,891	-609	139
M&G UK Income Distribution Fund	Equity - UK	3,500	3,520	20	299
Royal London Short Term Enhanced Cash Fund	Cash Plus	10,000	9,767	-233	69
Fundamentum Social Housing REIT	Property	5,000	5,200	200	94
		51,956	49,712	-2,244	3,464

Following the mini-budget in September, the difficult current economic conditions have had a negative impact on our Pooled Funds. 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 2022-23 will provide an average total return of 3.7%.

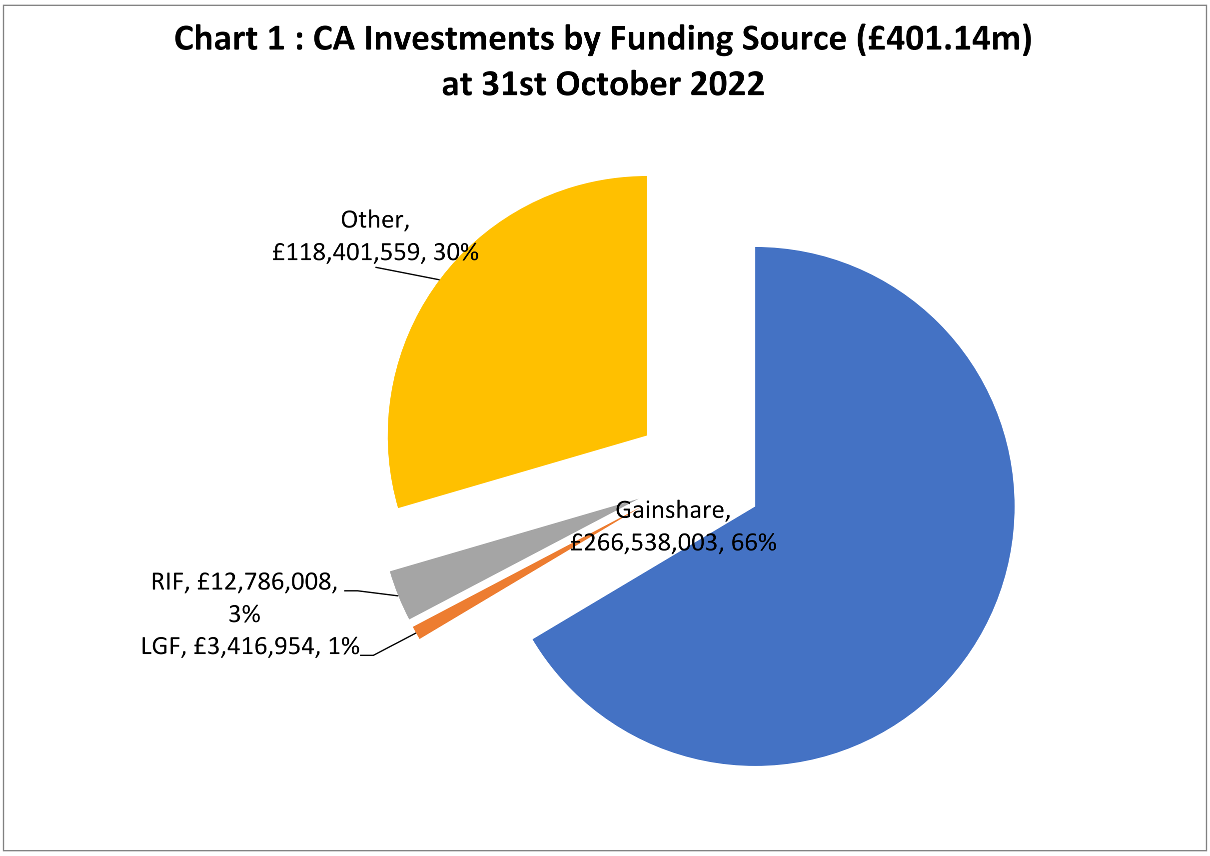

Chart 2: CA Investments per lowest equivalent Long Term credit rating (£401.14m) at 31st October 2022

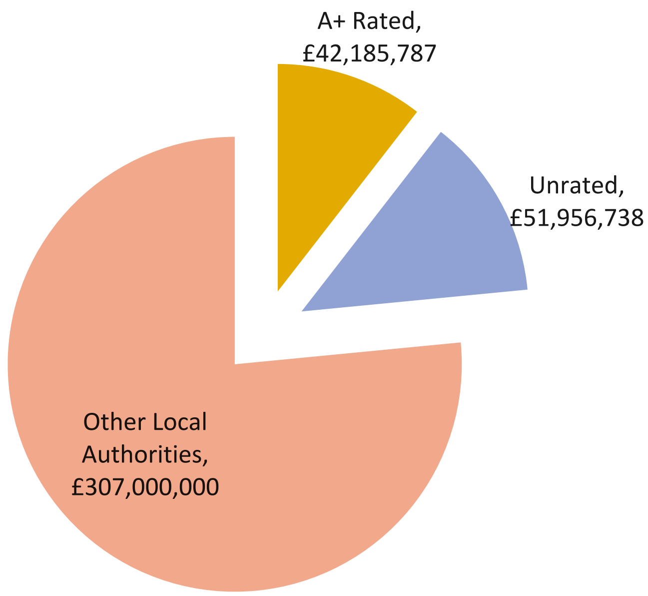

Chart 3: CA Investments by Type (401.14m) as at 31st October 2022