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

DATE: 4 MARCH 2024

REPORT TITLE: TREASURY MANAGEMENT MONITORING REPORT Q3 2023/24

RESPONSIBLE OFFICER: STRATEGIC DIRECTOR OF RESOURCES

Key Decision	**No**
Purpose of Report This quarterly report provides a review of performance to 31 January 2024 and includes the new requirement in the 2021 Code, mandatory from 1 April 2023, of quarterly reporting of the treasury management prudential indicators.	
Recommendation That The Audit Committee: Note the Treasury Management Monitoring Report to 31 January 2024, prepared in accordance with the CIPFA Treasury Code of Practice and the Treasury Management Indicators.	
Reasons for recommendation Statutory Requirement.	
Voting arrangements The voting arrangements of the West of England Combined Authority Audit Committee as set out at page A51 para. A20 of Part A of the West of England Combined Authority Constitution (as amended 17.3.2023) are not applicable as the West of England Combined Authority Audit Committee is asked only to note the report.	
Publication Requirements For Publication.	

Background

1. The Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services Code of Practice requires the Mayoral Combined 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.

Treasury Investment Activity

2. The Mayoral Combined Authority holds £390.5m of invested funds, representing income received in advance of expenditure, plus balances and reserves held. The investment position is shown in table 1 below.

Table: 1 Investments by Type

	31-Mar-23 Actual Portfolio £m	Net Movement £m	31-Jan-24 Actual Portfolio £m	31-Jan-24 Average Rate %
Treasury investments by type:				
Banks & building societies (unsecured)	16.9	-7.0	9.9	1.56
Government (incl. local authorities)	272.0	11.0	283.0	4.00
Registered Providers	10.0	0	10.0	2.90
Money Market Funds	3.9	31.7	35.6	5.29
Social Housing Real Estate Investment Trust	5.00	0	5.00	2.85
Other pooled funds:				
CCLA Property Fund	10.0	0	10.0	3.87
Investec	10.0	0	10.0	4.04
Kames	10.0	0	10.0	6.20
Threadneedle	3.5	0	3.5	4.27
M & G	3.5	0	3.5	6.00
Royal London Enhanced Cash Plus Fund	10.0	0	10.0	5.28
Total treasury investments	354.8	35.7	390.5	4.18

2.1 Both the CIPFA Code and government guidance require the Mayoral Combined 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 Mayoral Combined 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.

2.2 The Mayoral Combined Authority expects to be a long-term investor and treasury investments 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 to support local public services.

2.3 Bank Rate increased by 1% over the period, from 4.25% at the beginning of April to 5.25% by the end of December. Short term rates peaked at 5.6% for 3-month rates and 6.6% for 12-month rates during the period, although these rates subsequently began to reduce towards the end of the period. Money Market Rates also rose and were between 5.12% and 5.35% by the end of December.

2.4 £47m of the Mayoral Combined Authority's investments are invested in externally managed strategic pooled funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds are generating an average total return of 4.46% which is used to support services in year, and £4.6m of unrealised capital loss. See table 2 below.

2.5 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 Mayoral Combined Authority's medium to long-term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three-to-five-year period total returns will exceed cash interest rates.

Table 2: Pooled Funds

Fund Name	Asset Class	Purchase Value £000s	Fair Value as at 31/10/23 £000s	Capital Growth/(Loss) £000s	Income Return In Year
CCLA Property Fund	Property	9,956	8,853	-1,103	3.87%
Ninety One Diversified Income Fund (Investec)	Multi Asset	10,000	8,788	-1,212	4.04%
Aegon Diversified Monthly Income Fund (Kames)	Multi Asset	10,000	8,701	-1,299	6.20%
Threadneedle Strategic Bond Fund	Bond	3,500	3,078	-422	4.27%
M&G UK Income Distribution Fund	Equity - UK	3,500	3,341	-159	6.00%
Royal London Short Term Enhanced Cash Fund	Cash Plus	10,000	9,977	-23	3.60%
Fundamentum Social Housing REIT	Property	5,000	4,619	-381	2.74%
		51,956	47,357	-4,599	4.46%

2.6 Financial market conditions remained volatile between October and December. Global government bond yields initially rose before inflation data undershooting estimates led to a rally with prices rising and yields falling on the premise that the major central banks' rate hiking cycles were over. Optimism that bond yields would fall further rapidly was tempered by tight labour markets and core inflation remaining above central banks' targets. Nevertheless, for existing longer-term investors in fixed income securities, the prospect of interest rate cuts in 2024 improved sentiment.

2.7 November and December were good months for UK, Euro area and US equity markets as investors priced in a soft landing with the economies avoiding recession. Despite cautionary central bank warnings that the full effects of monetary tightening are yet to be felt and corporate refinancing in coming years will be at higher levels, expectations of interest rate cuts helped propel sentiment. On 31 December 2023 the FTSE All Share index was 4232 compared with 4127 on 30 September and 4157 on 31 March. The MSCI All Countries World Index was 3169 compared to 2853 on 30 September and 2791 on 31 March.

2.8 Investor sentiment for UK commercial property remained subdued with caution showed by buyers and sellers. With interest rates and bond yields remaining relatively high and investors demanding higher yields, property prices remained under pressure. The outlook for offices remains challenging from changing working practices. This was evident in the capital value of the Authority's property funds which were below those in March and September.

2.9 **Statutory override**: In April 2023 the Department for Levelling Up, Housing and Communities (DLUHC) published the full outcome of the consultation on the extension of the statutory override on accounting for gains and losses on pooled investment funds. The override has been extended for two years until 31 March 2025 but no other changes have been made; whether the override will be extended beyond the new date is unknown but commentary to the consultation outcome suggests not. The Mayoral Combined Authority will discuss with Arlingclose the implications for the investment strategy and what action may need to be taken.

Summary of Borrowings

3 The Mayoral Combined 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 Mayoral Combined Authority may borrow short term loans to cover any unplanned cash flow shortages as they arrive. As at 31 January 2024 the Mayoral Combined Authority held no loans.

Treasury Management Prudential Indicators

4 As required by the 2021 CIPFA Treasury Management Code, the Mayoral Combined Authority monitors and measures the below treasury management prudential indicators. The Mayoral Combined Authority's Prudential Indicators for 2023/24 were agreed by the Mayoral Combined Authority at its meeting on 27 January 2023 and performance against the key indicators is shown below.

4.1 **Security**: The Mayoral Combined 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+

4.2 **Liquidity**: The Mayoral Combined 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	£40m	£0

4.3 **Interest rate exposures**: This indicator is set to control the Mayoral Combined 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	£1m	£1.3m

The impact of a change in interest rates is calculated on the assumption that maturing investments will be replaced at new market rates. Due to the current high levels of investment balances, of which £164m matures within the next six months, this has resulted in the actual calculated impact exceeding the target.

4.4 **Principal sums invested for periods longer than a year**: The purpose of this indicator is to control the Mayoral Combined 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	2023/24 Target	2023/24 Actual	2024/25 Target	2024/25 Actual	2025/26 Target	2025/26 Actual	+3 Years Target	+3 Years Actual
Limit on principal invested beyond 364 days as % of total cash balance	50%	19%	30%	19%	20%	16%	20%	14%

Key Risks

5 The Mayoral Combined 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 Mayoral Combined Authority nominate a committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies. The West of England Mayoral Combined Authority Audit Committee carries out this role.

Equality, Diversity and Inclusion Implications

6. There are no specific implications arising directly from this report.

Climate Change Implications

7. The Mayoral Combined Authority will continue to work with its Treasury Advisors Arlingclose for support and advice through its Environmental, Social and Governance (ESG) and responsible investment service. As part of this process, we will ensure it aligns with our developing Corporate Carbon Management approach.

Reviewed by Michael Guthrie, Head of Climate and Nature Delivery

Finance Implications

8. A breakdown of the revenue budget that was set for interest income and the January outturn position is included in table 3 below. The full year budget for 2023-24 investment income is £4m and following the Mayoral Combined Authority’s successful treasury strategy and investment decisions, will expect to achieve a forecast year end outturn position of £12.8m which is a positive variance of £8.8m.

Table 3: Interest Income and Financing Costs as at 31 January 2024

April 2023 to January 2024	Budgeted Income £'000	Outturn Income £'000	Outturn over or under spend £'000	Adv/Fav
Interest & Capital Financing				
- Debit Costs (Borrowing)	0	(16)	(16)	Adv
- Interest on Balances				
West of England Mayoral Combined Authority	3,333	10,557	7,224	Fav
Total - Interest & Capital Financing	**3,333**	**10,541**	**7,208**	**Fav**

Legal Implications:

8. There are no legal implications arising directly from this report.

Advice provided by Gareth Jones, Interim Senior Commercial Lawyer

Human Resources Implications:

9. There are no HR implications.

As standard, in situations where funding is reduced, with implications of reducing the workforce on a specific project, the Combined Authority's internal managing change will be applied, with options of redeployment and/or redundancy where appropriate. The Combined Authority will aim, as a priority, to redeploy staff into suitable alternative roles.

Any change that will have a financial implication through redundancy will be signed off first in principle by the Director of Resources, appropriate Strategic Director/ senior leader and the Director of People & Assets.

For situations that result in increased funding with the need for more staff, any CLT-approved posts (fixed term/permanent) and interim/agency staffing will be recruited to, supported through the Human Resources team, through recruitment or agency processes.

Commercial Implications

10. There are no Commercial Implications to note in this report.

Appendices & Background papers:

Appendix 1 – Arlingclose's Economic & Market Review for Q3 2023/24
Appendix 2 – Summary Guide to Credit Ratings

Background Papers: Treasury Management Strategy Statement & Investment Strategy 2023/24 – As reported to West of England Mayoral Combined Authority Committee on 27 January 2023.

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APPENDIX 1

Economic and Market Review for Q3 2023/24

Economic background: UK inflation rates finally started to decline, mirroring the sharp but earlier drop seen in the Eurozone and US. Despite the fall, the Consumer Price Index (CPI) remained substantially in excess in the Bank of England's (BoE) 2% target, at 3.9% for November 2023. Market expectations for further rises in Bank Rate fell from October through to year end, indicating that the 5.25% level reached in August 2023 was indeed the peak for Bank Rate.

Economic growth in the UK remained weak over the period, edging into recessionary territory. In calendar Q3 2023, the economy contracted by 0.1%, following no change in Q2. Monthly GDP data showed a 0.3% contraction in October, following a 0.2% rise in September. While other indicators have suggested a pickup in activity in the subsequent months, Q4 GDP growth is likely to continue the weak trend.

July data showed the unemployment rate increased to 4.2% (3mth/year) while the employment rate rose to 75.7%. Pay growth edged lower as the previous strong pay rates waned; total pay (including bonuses) growth was 7.2% over the three months to October 2023, while regular pay growth was 7.3%. Adjusting for inflation, pay growth in real terms were positive at 1.3% and 1.4% for total pay and regular pay respectively.

Inflation continued to fall from its peak as annual headline CPI declined to 3.9% (down from 4.6%) in November 2023. The largest downward contribution came from energy and food prices. The core rate also surprised on the downside, falling to 5.1% from 5.7%.

The Bank of England's Monetary Policy Committee held Bank Rate at 5.25% throughout the period, although a substantial minority continued to vote for a 25 basis point rate rise. The Bank continues to tighten monetary policy through asset sales, as it reduces the size of its balance sheet. Financial market Bank Rate expectations moderated over the period as falling inflation and weakening data showed that higher interest rates were working in the UK, US, and Eurozone.

Following the December MPC meeting, Arlingclose, the authority's treasury adviser, maintained its central view that 5.25% is the peak in Bank Rate. Short term risks are broadly balanced, but over the remaining part of the time horizon the risks are to the downside from economic activity weakening more than expected.

The lagged effect of monetary policy together with the staggered fixed term mortgage maturities over the next 12-24 months means the full impact from Bank Rate rises are still yet to be felt by households. As such, while consumer confidence continued to improve over the period, it is likely this will reverse at some point and spending will struggle. Higher rates will also impact exposed businesses; according to S&P/CIPS survey data, the UK manufacturing and construction sectors contracted during the quarter. The services sector recovered, however, with the PMI rising strongly in December, possibly due to improving consumer confidence.

The US Federal Reserve held its key interest rate at 5.25-5.50% over the period. While policymakers continued to talk up the risks to inflation and therefore interest rates, this stance ebbed over the quarter culminating in a relatively dovish outcome from the December FOMC meeting.

The European Central Bank continues to resist market policy loosening expectations, but the Eurozone CPI rate has fallen sharply as GDP growth as markedly slowed, hitting 2.4% in November (although rising to 2.9% on energy-related base effects)

Financial markets: Financial market sentiment and bond yields remained volatile, but the latter rapidly trended downwards towards the end of 2023 on signs of sharply moderating inflation and economic growth.

Gilt yields fell towards the end of the period. The 10-year UK benchmark gilt yield rose from 4.57% to peak at 4.67% in October before dropping to 3.54% by the end of December 2023. The Sterling Overnight Rate (SONIA) averaged 5.19% over the period.

Credit review: Arlingclose maintained the advised maximum duration limit for all banks on its recommended counterparty list to 35 days over the period.

In October, Moody's revised the outlook on the UK's Aa3 sovereign rating to stable from negative. This led to similar rating actions on entities that include an element of government support in their own credit ratings, including banks and housing associations. Local authorities were, however, downgraded on expectations of lower government funding.

Following the issue of a Section 114 notice, in November Arlingclose advised against undertaking new lending to Nottingham City Council. After reducing its recommended duration on Warrington Borough Council to a maximum of 100 days in September, the local authority was subsequently suspended from the Arlingclose recommended list following a credit rating downgrade by Moody's to Baa1.

Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress, but no changes were made to recommended durations over the period.

Heightened market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Mayoral Combined Authority's counterparty list recommended by Arlingclose remains under constant review.

APPENDIX 2

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.