WEST OXFORDSHIRE DISTRICT COUNCIL	**WEST OXFORDSHIRE DISTRICT COUNCIL**
Name and date of Committee	**AUDIT AND GOVERNANCE COMMITTEE – 19 MARCH 2024**
Subject	**2023/24 TREASURY MANAGEMENT INDICATORS – QUARTER THREE**
Wards affected	None
Accountable member	Cllr Alaric Smith Cabinet Member for Finance Email: alaric.smith@westoxon.gov.uk
Accountable officer	Madhu Richards, Director of Finance Email: madhu.richards@westoxon.gov.uk
Report author	Sian Hannam, Treasury Accountant Email: sian.hannam@publicagroup.uk
Summary/Purpose	To report to the Audit and Governance Committee the quarter three Treasury Management Indicators as required by the CIPFA Treasury Management Code.
Annexes	Annex A - West Oxfordshire Council Fund Summary – March 2024
Recommendation(s)	That the Audit and Governance Committee Resolves to: 1. a) Note the contents of the report
Corporate priorities	Working Together for West Oxfordshire
Key Decision	NO
Exempt	NO
Consultees/ Consultation	N/A

1. BACKGROUND AND SUMMARY

1.1 The overall performance of investments in the 9 months to 31st December 2023 was positive, returning interest of £1,243,599 or 5.31% against an annual revenue budget of £1,102,228 and also generating an unrealised capital gain of 3.26% or £403,652 in the year to date.

1.2 The capital value of pooled funds continues to be affected by prevailing economic conditions in the world markets. Pooled funds are intended to be long term investments where short term fluctuations in the capital value are expected. These funds are being monitored closely by the Council's Treasury Management adviser (Arlingclose) and they continue to forecast that the capital values will recover over the next 2-3 years as gilts and bond revenue rates start to decline again.

1.3 The Council has continued to benefit from higher revenue returns due to regular increases in the Bank of England Bank Rate to combat high levels of inflation. The Bank base rate reached 5.25% in August 2023 and has remained there to date.

1.4 The Council complied with most of the Prudential Indicators for 2023/24 as set out in the budget approved by full Council in February 2023. Further details can be found in section 8 of this report with the one exception to the Prudential Indicators being explained in 8.7.

1.5 At the Audit and Governance meeting in November 2023, where the Treasury Management Mid Term Report was presented, the committee requested information with regards to how ethical the Council's investment portfolio was. This information is included in Annex A.

2. ECONOMIC & FINANCIAL MARKETS BACKGROUND

2.1 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 of 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 the base rate.

2.2 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.

2.3 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 was positive at 1.3% and 1.4% for total pay and regular pay respectively.

2.4 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%.

2.5 The BoE's Monetary Policy Committee held the 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.

2.6 Following the December Monetary Policy Committee (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.

2.7 **The US and Eurozone -** 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 conciliatory outcome from the December Federal Open Market Committee (FOMC) meeting.

2.8 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).

2.9 **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.

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

2.11 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.

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

3. LOCAL CONTEXT

3.1 On 31st March 2023, the Council had net investments of £37.374m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying resources available for investment. These items are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.23 Actual £m	31.3.24 Forecast £m
General Fund CFR	28.38	31.30
External borrowing	(5.01)	-
Internal borrowing	23.37	31.30
Less: Balance sheet resources	(39.28)	(38.27)
Net investments	**(15.91)**	**(6.97)**

3.2 The treasury management position at 31st December and the change over the nine months is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.23 Balance £m	Movement £m	31.12.23 Balance £m	31.12.23 Rate %
Short-term borrowing	5.013	(5.013)	0	N/A
Total borrowing	5.013	(5.013)	0	
Long-term investments	13.375	0.364	13.739	4.85
Short-term investments	0.064	3.936	4.000	5.31
Cash and cash equivalents	8.159	6.841	15.000	5.31
Total investments	**21.598**	**11.141**	**32.739**	**5.12**
Net investments	**16.585**	**16.154**	**32.739**	

4. BORROWING STRATEGY AND ACTIVITY

4.1 As outlined in the Treasury Management Strategy, the Council's chief objective when borrowing has been to strike a low-risk balance between securing lower interest costs and achieving cost certainty over the period for which funds are required. Flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective. The Council's borrowing strategy thus far has maintained borrowing and investments below their underlying levels, known as internal borrowing.

4.2 CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decisions that will increase the capital financing requirement and so may lead to new borrowing, unless directly and primarily related to the functions of the Council. Public Works Loan Board (PWLB) loans are no longer available to local authorities planning to buy investment assets primarily for yield unless these loans are for refinancing purposes.

4.3 At 31st December 2023, the Council had no loans outstanding, a decrease of £5m from 31st March 2023, The Council's borrowing position at 30th September is summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.23 Balance £m	Net Movement £m	31.12.23 Balance £m
Local authorities (short-term)	5.013	(5.013)	0
Total borrowing	**5.013**	**(5.013)**	**0**

5. TREASURY INVESTMENT ACTIVITY

5.1 A counterparty list recommended and reviewed by the Council's treasury management advisors, Arlingclose is received monthly and the treasury team use this to evaluate investment options. At the end of the period most counterparties remained on a 35 day limit maintaining precautions brought about by uncertainty in the market. The treasury team continues to hold most in-house balances in the liquid Money Market Funds and Call Accounts and making short term deposits with the UK Debt Management Office (DMO). This enables continued cash support for services the Council provides to the public and provides funding for the Council's capital programme, without the need to borrow.

5.2 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.23 Balance £m	Net Movement £m	31.12.23 Balance £m	31.12.23 Income Return %
Banks & building societies (unsecured)	3.843	(0.843)	3.000	5.38
Bank of England DMADF		1.000	1.000	5.19
Money Market Funds	4.316	10.684	15.000	5.35
Other Pooled Funds				
- *Equity & Multi Asset income funds*	8.884	0.218	9.102	4.85
- Bond income funds	3.555	0.122	3.677	4.85
- *Real Estate Investment Trusts*	1.000	(0.030)	0.970	2.85
Total investments	**21.598**	**11.151**	**32.749**	**5.12**

5.3 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 from defaults and the risk of receiving unsuitably low investment income.

5.4 As demonstrated by the liability benchmark in this report, the Council expects to be a long-term borrower and new treasury investments are therefore primarily made to manage day-to-day cash flows using short-term low risk instruments. The existing portfolio of strategic pooled funds will be maintained to diversify risk into different asset classes and boost investment income.

5.5 The progression of risk and return metrics are shown in the Arlingclose quarterly investment benchmarking report; the results of which are summarised in Table 5 below.

Table 5: Investment Benchmarking – Treasury investments managed in-house.

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
31.03.2023	3.92	AA-	61%	4	-1.07
30.09.2023	4.32	AA-	60%	7	6.39
30.12.2023	4.67	A+	95%	2	6.73
Similar LAs	**4.81**	**A+**	**57%**	**54**	**5.12**
All LAs	**4.8**	**A+**	**60%**	**11**	**4.95**

5.6 Externally Managed Pooled Funds: £14m of the Council's investments are invested in externally managed strategic pooled bond, equity, and multi-asset 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 generated an income return of £484,706 which is used to support services in year, and a £403,652 unrealised capital gain. The current Pooled Fund position can be seen in table 6 below.

Table 6: Current Pooled Funds

Fund Manager	Original Investment	Value 31st March 2023	Value 31st December	9 Month Dividend 2023/24	2023/24 Capital Gain/ (Loss)	Capital Gain/(Loss) vs Original Investment
	£	£	£	£	£	£
UBS (B/E)	2,000,000	1,466,810	1,471,524	72,280	4,714	- 528,476
M&G Strategic (B)	2,000,000	1,752,651	1,835,671	62,391	83,020	- 164,329
Royal London (L)	2,000,000	1,784,670	1,841,786	55,730	57,116	- 158,214
Schroders €	1,000,000	886,450	890,678	51,939	4,228	- 109,322
Threadneedle UK €	1,000,000	1,053,841	1,088,528	28,163	34,687	88,528
CCLA Diversified Fund (B/E)	3,000,000	2,771,963	2,891,185	75,764	119,222	- 108,815
Aegon/Kames (L)	3,000,000	2,659,023	2,759,688	138,439	100,665	- 240,312
Total - Current funds	**14,000,000**	**12,375,408**	**12,779,060**	**484,706**	**403,652**	**-1,220,940**

(L = Liquidity; B= Bond; E= Equity)

5.7 The combination of falling inflation and the expectation of interest rate cuts has had a positive effect on the combined value of the Authority's strategic funds since March 2023. The capital values of the Authority's equity, multi-asset and longer-dated bond funds improved and are now above their price on 31st March 2023, as shown in table 6.

5.8 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 is due to end on 31st March 2025 and is identified as a key risk in the Medium Term Financial Strategy (MTFS). The Authority will discuss with Arlingclose the implications for the investment strategy and what action may need to be taken.

6. TREASURY PERFORMANCE

6.1 The Council measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 7.

Table 7: Performance

	Q3 Actual £m	2023_24 Budget £m	Over/ under	Actual %	LA's Average Benchmark %	Over/ under
Short-term investments	0.138	0	0.138	5.31	5.08	0.23
MMF & Call Accounts	0.451	0.162	0.289	5.31	5.08	0.23
Strategic Funds	0.485	0.629	-0.144	4.85	4.86	-0.01
Long Term Loans	0.149	0.28	-0.131	2.84	N/A	N/A
REIT	0.021	0.031	-0.010	2.85	N/A	N/A
Total treasury investments	**1.244**	**1.102**	**0.142**	**5.12**	**5.04**	**0.08**

7. COMPLIANCE

7.1 The Director of Finance reports that all treasury management activities undertaken during the quarter complied with the principles in the Treasury Management Code and the Council's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 8 below.

Table 8: Investment Limits

	2023/24 Maximum £m	31.12.23 Actual £m	2023/24 Limit £m	Complied? Yes/No
Any single organisation, except the UK Government	3	0	5	YES
Any group of organisations under the same ownership	3	0	5	YES
Any group of pooled funds under the same management	0	0	5	YES
Limit per non-UK country	0	0	1	YES
Registered providers and registered social landlords	9.8	9.72	10	YES
Unsecured investments with banks	3	3	10	YES
Money Market Funds	15	15	25	YES
Strategic pooled funds	14	14	25	YES
Real Estate Investment Trusts	1	1	5	YES

7.2 Compliance with the Authorised Limit and Operational Boundary for external debt is demonstrated in table 9 below.

Table 9: Debt and the Authorised Limit and Operational Boundary

	Q3 2023/24 Maximum	31.12.23 Actual	2023/24 Operational Boundary	2023/24 Authorised Limit	Complied? Yes/No
	£m	£m	£m	£m	
Borrowing	0	0	50.06	55.06	YES
Total debt	**0**	**0**	**50.06**	**55.06**	

7.3 Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

8. TREASURY MANAGEMENT PRUDENTIAL INDICATORS

8.1 As required by the 2021 CIPFA Treasury Management Code, the Council monitors and measures the following treasury management prudential indicators.

8.2 **Liability Benchmark** – This indicator compares the Council's existing borrowing against a liability benchmark that has been calculated to show the lowest risk level of borrowing. The liability benchmark is a valuable tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. It represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level of £4m required to manage day-to-day cash flow.

	31.3.23 Actual	31.3.24 Forecast	31.3.25 Forecast	31.3.26 Forecast
Loans CFR	28.38	30.74	33.58	35.19
Less: Balance sheet resources	(39.28)	(37.51)	(35.71)	(31.63)
Net loans requirement	(10.90)	(6.77)	(2.13)	3.56
Plus: Liquidity allowance	14.00	14.00	14.00	14.00
Liability benchmark	**3.10**	**7.23**	**11.87**	**17.56**
Existing borrowing	**5.01**	**0.00**	**3.50**	**6.85**

8.3 Long-term Treasury Management Investments: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury management limits are:

	2023/24	2024/25	2025/26	No fixed date
Limit on principal invested beyond year end	£20m	£20m	£20m	£20m
Actual principal invested beyond year end	0	n/a	n/a	£15m
Complied?	YES	YES	YES	YES

8.4 Long-term investments with no fixed maturity date include strategic pooled funds, real estate investment trusts and directly held equity but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

8.5 **Security:** The Council 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. Unrated investments are assigned a score based on their perceived risk.

	2023/24 Target	31.12.23	Complied?
Portfolio average credit rating	A-	A+	YES

8.6 **Interest Rate Exposures:** This indicator is set to control the Council's exposure to interest rate risk. Bank Rate rose by 1.25% from 4.25% on 1st April to 5.25% in August, it remained at this level as at 31st December.

Interest rate risk indicator	2023/24 Target	31.12.23 Actual	Complied?
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	-135,000	- 460,548	No
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	135,000	460,548	No

8.7 Due to the lack of capital expenditure and £3m received in advance from the Ministry of Defence for their annual Business Rates liability, the weighted average on variable rate investments (MMFs) has been higher than originally forecast and we have generated more interest income.

9. NON TREASURY MANAGEMENT PRUDENTIAL INDICATORS

9.1 The Authority measures and manages its capital expenditure, borrowing and service investments with references to the following indicators.

9.2 It is now a requirement of the CIPFA Prudential Code that these are reported on a quarterly basis.

9.3 Capital Expenditure: The Authority has undertaken and is planning capital expenditure as summarised below.

	2022/33 Actual	2023/24 Forecast	2024/25 budget	2025/26 budget
General Fund services	15.29	9.44	7.20	4.77

9.4 The Capital Strategy approved in February 2024 has reduced the level of capital investment over the life of the MTFS until interest rates have fallen sufficiently for the cost of capital for projects to be affordable. The capital, treasury management and investment strategies have all been updated as part of the 2024/25 budget setting process.

9.5 <u>**Capital Financing Requirement:**</u> The Authority's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with Minimum Revenue Provision (MRP) / loans fund repayments and capital receipts used to replace debt.

	31.03.2023	31.03.2024	31.03.2025	31.03.2026
	actual	forecast	budget	budget
General Fund services	17.78	20.14	22.98	24.59
Capital Investments	10.60	10.60	10.60	10.60
TOTAL CFR	**28.38**	**30.74**	**33.58**	**35.19**

9.6 <u>**Gross Debt and the Capital Financing Requirement:**</u> Statutory guidance is that debt should remain below the capital financing requirement, except in the short term. The Authority has complied and expects to continue to comply with this requirement in the medium term as is shown below.

	31.03.2023 actual	31.03.2024 forecast	31.03.2025 budget	31.03.2026 budget	Debt at 31.12.2023
Debt (Incl.PFI & leases)	5.013	0.00	3.50	6.85	0
Capital Financing Requirement	28.38	30.74	33.58	35.19	

9.7 <u>**Debt and the Authorised Limit and Operational Boundary:**</u> The Authority is legally obliged to set an affordable borrowing limit (also termed the Authorised Limit for external debt) each year. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

	Maximum debt H1 2023/24	Debt at 31.12.23	2023/24 Authorised Limit	2023/24 Operational Boundary	Complied? Yes/No
Borrowing	5.013m	0	55.06m	50.06m	Yes
Total Debt	**5.013m**	**0**	**0**	**0**	**Yes**

Since the operational boundary is a management tool for in-year monitoring it is not significant if the boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

9.8 <u>Net Income from Commercial and Service Investments to Net Revenue Stream:</u> The Authority's income from commercial and service investments as a proportion of its net revenue stream is indicated below.

	2022/33 actual	2023/24 forecast	2024/25 budget	2025/26 budget
Total net income from service and commercial investments	4.25m	3.53m	5.06m	5.06m
Proportion of net revenue stream	30.56%	23.29%	33.21%	32.71%

9.9 <u>Proportion of Financing Costs to Net Revenue Stream:</u> Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP / loans fund repayments are charged to revenue.

9.10 The net annual charge is known as financing costs; this is compared to the net revenue stream i.e., the amount funded from Council Tax, business rates and general government grants.

	2022/33 actual	2023/24 forecast	2024/25 budget	2025/26 budget
Financing costs (£m)	0.420m	0.515m	0.648m	0.894m
Proportion of net revenue stream	3.02%	3.40%	4.26%	5.%

9.11 Conclusion

Overall the Q3 position is positive, with above budget returns on investment income and the beginning of the recovery of pooled fund capital values. The risk to the Council's revenue budget from the end of the Statutory Override has been mitigated with the Executive approval to set up an earmarked reserve to support the General Fund position from 1st April 2025. This will be reviewed annually with the reserve held at a prudent level dependant on the market conditions that effect the capital value of our pooled funds.

10. FINANCIAL IMPLICATIONS

There are no financial implications arising from this report.

11. LEGAL IMPLICATIONS

There are no legal implications arising from this report.

12. RISK ASSESSMENT

None required as a result of this report

13. EQUALITIES IMPACT

No direct equalities impact with regards to the content of this report

14. CLIMATE AND ECOLOGICAL EMERGENCIES IMPLICATIONS

None

15. BACKGROUND PAPERS

None