Annex I

WEST OXFORDSHIRE DISTRICT COUNCIL

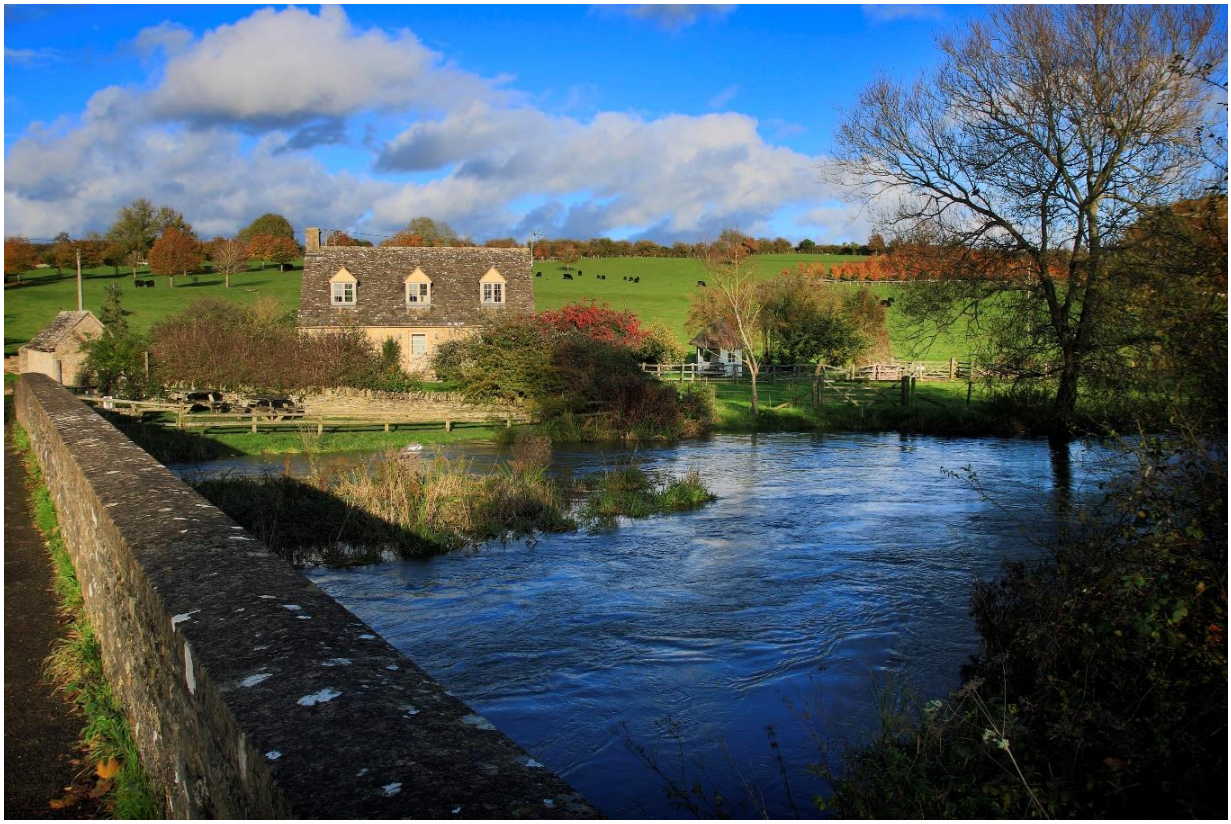
TREASURY MANAGEMENT STRATEGY 2022/2023

Summary

The Council is currently operating with a cash surplus which is invested in various funds, delivering a healthy and important revenue stream to support the Council's revenue budget. While there is an expectation that for the Council to realise its Investment Strategy ambitions, it would look to borrow externally, there is a balance to be struck between recalling the current invested sums and drawing down loans.

Treasury investments that earn less than the cost of external debt will be returned to cash ahead of any external borrowing being undertaken but the Council will endeavour to maintain an investment balance of £10m which allows us to retain our status under MiFiD 2 criteria as a professional investor. This categorisation allows us access to a wider range of financial instruments than we would otherwise be able to use.

The current high levels of Treasury Investment are made up not only of the Council's general reserves but also capital receipts, unspent earmarked reserves and capital grants unapplied. The expectation is that these will be used up over time as they have designated purposes and in some cases we are merely the custodians of them. This is reflected in the reducing forecast for treasury investment income.



While achieving high returns from invested treasury funds is less important to the Council than the need to limit the risk of loss, the size of the portfolio means that changes in fund allocation and strategy have a significant impact on income. The Council is reviewing the level of advice it currently contracts along with the investment decision making processes and protocols and in conjunction with the Finance and Management Overview and Scrutiny Committee will be drafting a revised Treasury Investment Strategy.

Introduction

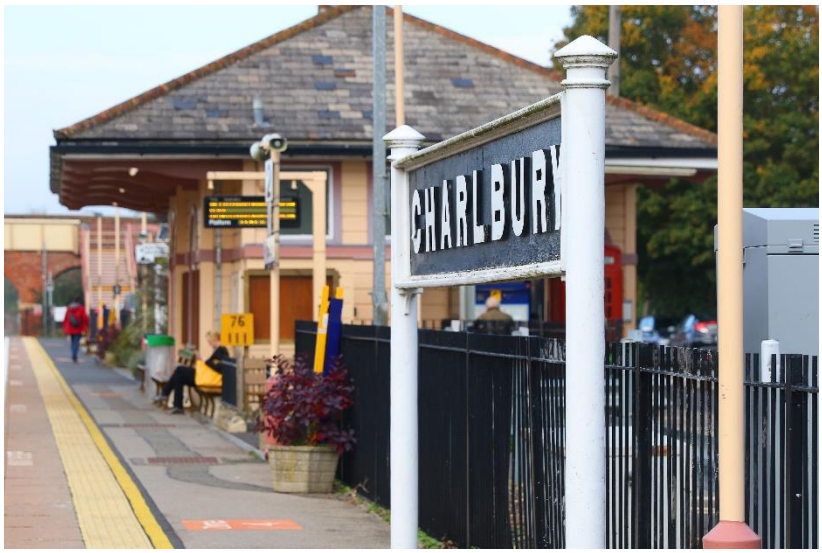
Treasury Management is the management of the Authority's cash flows, borrowing and treasury investments, and the associated risks. The Authority has invested significant sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Authority's prudent financial management.

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.

Non treasury investments, are considered in the Council's Investment Strategy paper but the approach to borrowing outlined here and the availability of cash will underpin both that paper and the Capital Strategy paper.

Treasury Management is important to both the short and long term plans of the Council. On a day to day basis it ensures that there is sufficient immediately available cash to settle all payments the Council needs to make, that surplus cash is earning money where possible and that everywhere that cash is held has been assessed for current risk.

In the longer term it provides an important source of income for the Council and underpins the availability of cash and selection of sources of borrowing for capital spend and investments. The revenue budget is set out at the start of the year and monitored quarterly to ensure that we stay within plan but the management of cash is a daily function that facilitates every transaction the Council undertakes. We regularly receive cash on behalf of third parties such as council tax, business rates, grant funding and S106 monies and the Treasury function must deal appropriately with those monies and forecast when they will need to be "spent" in order to determine the best way to do that.



Balances

On 31st December 2021, the Authority held £31.6m of investments as shown in the tables below.

WODC Treasury investments - one year return		**31.12.20 to 31.12.21**		
Investments	**31/12/2021**	**Capital Return**	**Income Return**	**Total Return**
	£			
Money Market Funds	12,000,000	0.00%	0.50%	0.50%
Call Accounts	4,000,267	0.00%	0.01%	0.01%
Corporate Bonds	2,548,222	0.00%	4.75%	4.75%
Internal Investments	18,548,489			
Cash Plus and Short Bond Fund	2,040,091	0.00%	0.44%	0.44%
Strategic Pooled Funds:				
Aegon Diversified Monthly Income Fund	1,033,052	4.57%	4.82%	9.39%
CCLA Diversified Income Fund	1,073,222	7.73%	2.57%	10.29%
M & G Strategic Corporate Bond	2,071,474	-2.88%	2.41%	-0.47%
Royal London Short Dated Credit Fund	1,969,107	-2.47%	2.19%	-0.28%
Schroder Income Maximiser Fund	911,817	18.50%	7.70%	26.20%
Threadneedle UK Equity Income Fund	1,083,931	15.72%	3.56%	19.28%
UBS Multi Asset Income Fund	1,841,173	-0.70%	3.47%	2.78%
Fundamentum Social Housing REIT	1,030,000	4.57%	2.23%	6.80%
	11,013,776	3.11%	3.26%	6.37%
Total Investment	**31,602,356**	**Annualised Income Return 2.56%**		
Pooled funds	**11,013,776**	**Annualised Income Return 3.26%**		

You can see from the table above that there is a spread of holdings both of shorter term more liquid holdings with lower returns and of longer term holdings where the return is higher and has an element of both capital appreciation (or depreciation) and income.

The cash position over the last two years has fluctuated in an unprecedented fashion with huge influxes of monies for Section 31 support and Covid grants, often with large uncertainty over when the residual monies would need to be paid back to the government. The Council now has a much improved cashflow forecast giving us more certainty of the cash requirements and accordingly has recently moved £8m from the short term lower return holdings to the longer dated higher return funds. The money can still be brought back with roughly a week's notice and indeed, if the cashflow requirements were fairly short term in nature then there is an active lending market between local authorities with borrowing rates currently at less than a percentage making it preferable to leave money in higher return funds and supplement a fluctuation in working capital requirements with short term borrowing.

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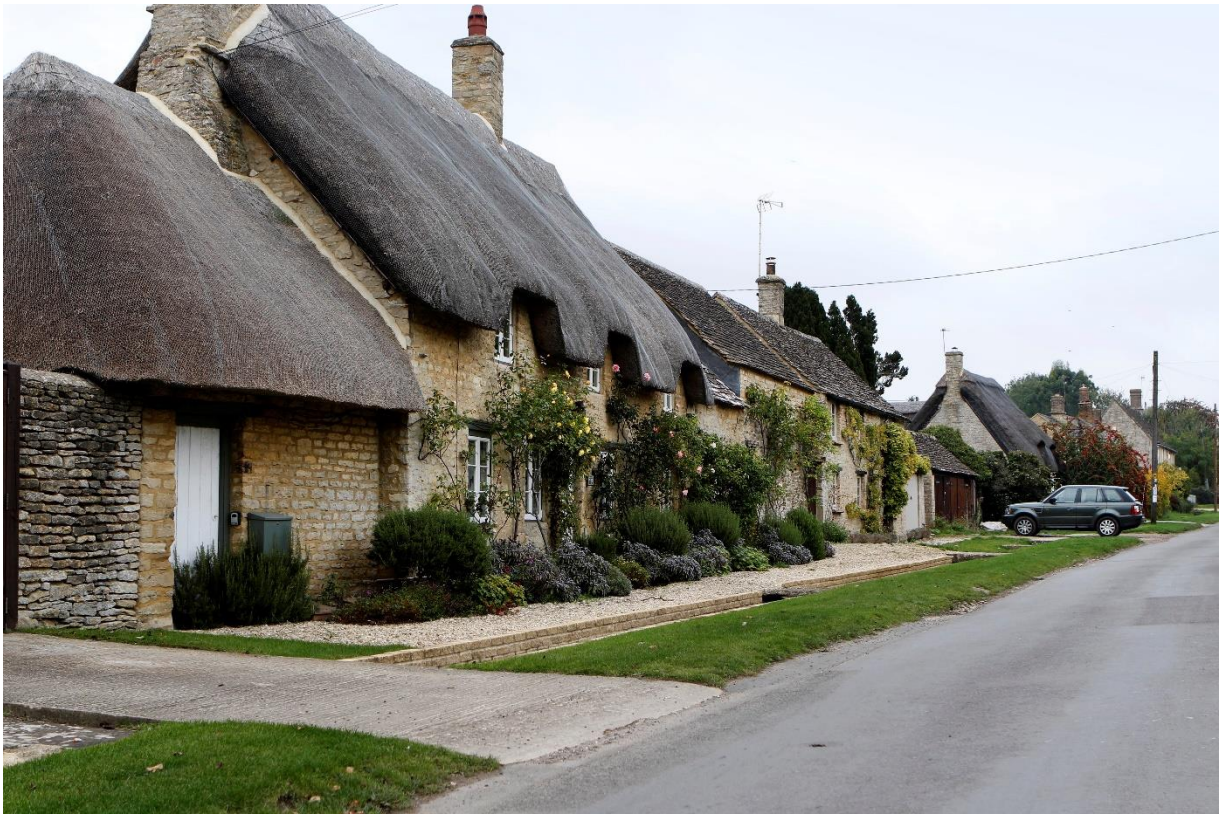
WODC Treasury investments - five year return		**31.12.16 to 31.12.21**		
Investments	**31/12/2021**	**Capital Return**	**Income Return**	**Total Return**
	£			
Strategic Pooled Funds:				
Aegon Diversified Monthly Income Fund	1,033,052	3.31%	11.74%	15.05%
CCLA Diversified Income Fund	1,073,222	7.35%	10.81%	18.16%
M & G Strategic Corporate Bond	2,071,474	2.30%	14.35%	16.65%
Royal London Short Dated Credit Fund	1,969,107	-0.69%	6.38%	5.69%
Schroder Income Maximiser Fund	911,817	-15.58%	32.80%	17.21%
Threadneedle UK Equity Income Fund	1,083,931	8.39%	13.58%	21.97%
UBS Multi Asset Income Fund	1,841,173	-5.79%	21.82%	16.03%
Fundamentum Social Housing REIT	1,030,000	3.00%	3.35%	6.35%
	11,013,776	0.43%	12.47%	12.90%
Pooled funds	**11,013,776**	**Annualised Income Return 3.57%**		



Borrowing requirement

The forecast borrowing requirement tracks the transition from internal borrowing to external borrowing showing our Capital Financing Requirement (CFR) - which currently shows only internal borrowing - and how increasing borrowing requirements will affect the amount of capital available for investment. The balance between retained treasury investments and external borrowing will be dictated by both the PWLB restrictions in place at the time of borrowing and the relative interest rates for both borrowing and investment.

In the table below, the underlying need to borrow for capital purposes is measured by the CFR, while usable reserves and working capital are the underlying resources available for investment. The Authority's current strategy is to maintain investments below their underlying levels, using the cash for internal borrowing as discussed above.

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. The table below shows the use of borrowing expected to change the Council's debt free position in 22/23, should sufficient investment opportunities be found.

Forecast borrowing requirement

	2020/21 actual £m	2021/22 forecast £m	2022/23 budget £m	2023/24 forecast £m	2024/25 forecast £m
CFR	23.37	25.56	35.90	64.27	67.30
Less external borrowing	0.00	0.00	(10.00)	(35.00)	(35.00)
Internal borrowing	23.37	25.56	25.90	29.27	32.30
Usable reserves	(46.10)	(38.01)	(38.74)	(36.41)	(34.83)
Average working capital	(7.72)	(19.15)	(18.76)	(17.36)	(15.97)
Investments	30.45	31.60	31.60	24.50	18.50

The authorised limit for external debt uses the calculated CFR to set limits for agreement on the amount of external debt that it would be prudent for the authority to stay within. Above the CFR there is an operational boundary which should provide an early warning system that we are close to our limits, followed by the Council approved Authorised limit, which should never be exceeded.

This limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

The Council is asked to approve the following authorised limit:

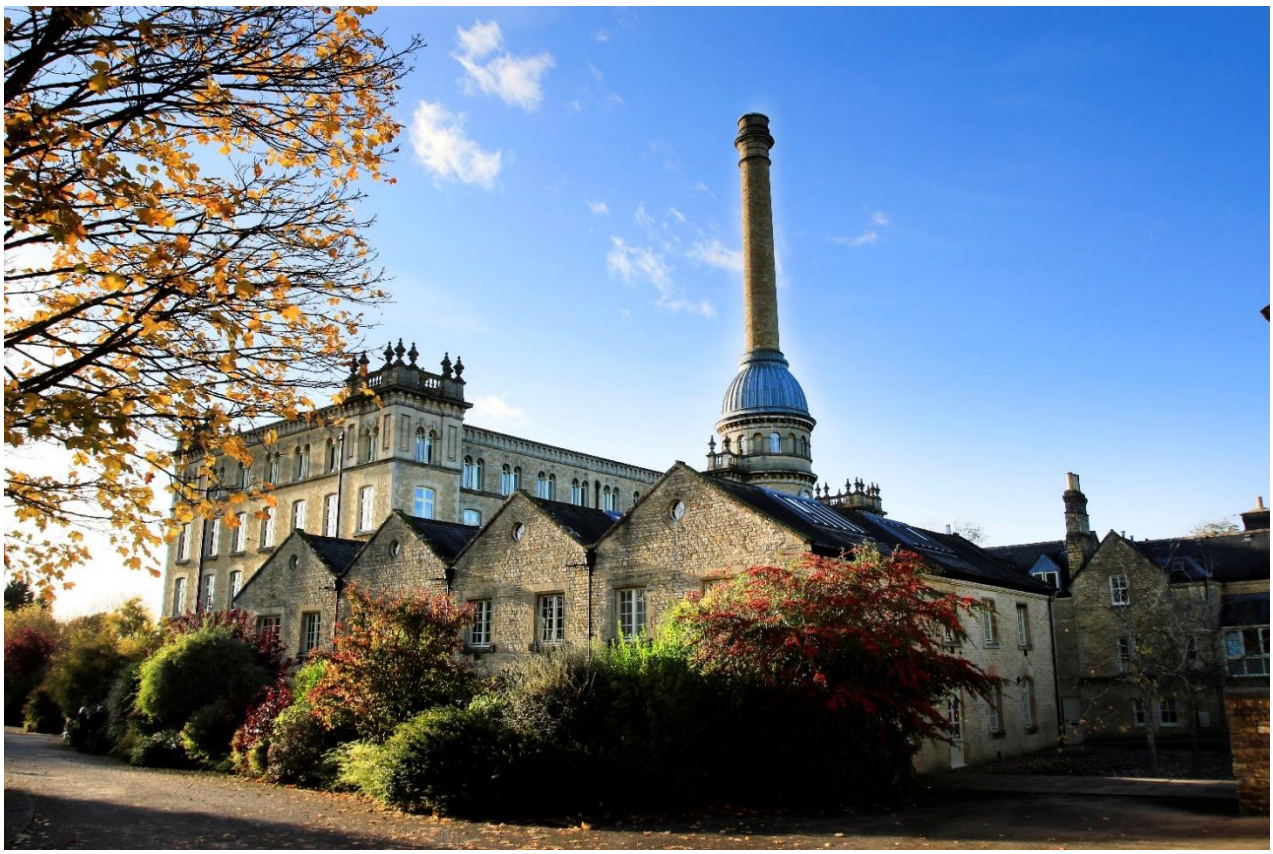
Authorised limit and operational boundary for external debt £m

	2020/21 revised £m	2021/22 forecast £m	2022/23 budget £m	2023/24 forecast £m	2024/25 forecast £m
CFR	23.37	25.56	35.90	64.27	67.30
Operational boundary	25.37	27.56	37.90	66.27	69.30
Authorised borrowing limit	**30.37**	**32.56**	**42.90**	**71.27**	**74.30**

The final prudential indicator in this set is the liability benchmark. It tracks the projected situation were we to use up all of our available funds ahead of borrowing. It shows the point in 2023/24 where the authority would be forced to borrow externally, even if it used up all its available reserves, the bulk of which are currently held as treasury investments. There is an approximate liquidity allowance of £13m which is £10m of investments held in order to qualify as a professional investor under MiFiD 2 plus a small working capital buffer of £3m. In reality, if we were to use all of our reserves ahead of borrowing we would consider carefully whether maintaining £10m of investments was of huge benefit and we may decide that in the absence of readily liquid funds, the working capital threshold needed to be higher than £3m. Regardless of whether we would change that balance, the £13m liquidity allowance is overly prudent and our access to reserves and treasury investments shows that our minimum level of borrowing is well within the limits suggested by the CFR.

Liability Benchmark

	2020/21 actual £m	2021/22 forecast £m	2022/23 budget £m	2023/24 forecast £m	2024/25 forecast £m
CFR	23.37	25.56	35.90	64.27	67.30
Less usable reserves	(46.10)	(38.01)	(38.74)	(36.41)	(34.83)
Less working capital	(7.72)	(19.15)	(18.76)	(17.36)	(15.97)
Net loans requirement	(30.45)	(31.60)	(21.60)	10.50	16.50
Plus liquidity allowance	13.00	13.00	13.00	13.00	13.00
Liability benchmark	(17.45)	(18.60)	(8.60)	23.50	29.50



Borrowing Strategy

The Authority currently does not hold any debt, but the expectation is that debt will be required in the short term to implement the investment strategy. Even without this, we are unlikely to be able to fund the replacement of the waste vehicle fleet and the purchase or construction of a new waste depot out of working capital.

The Authority may, to avoid borrowing at higher interest rates in the future, convert some of its current internal borrowing into external borrowing, providing this does not exceed the authorised limit but there are no current plans to borrow in advance of need.

The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities.

The Council'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 Council's long-term plans change is a secondary objective.

Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective to use short term borrowing where possible - but this should only be done where the cash shortage results from a timing difference and can be paid back in the short to medium term. Care should be taken not to defer long term borrowing past the point where interest rates start to rise again.

By taking advantage of low interest rates where possible, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. There is a potential scenario where the Council would be advised to refinance some of its previous internal borrowing at long-term fixed rates in 2022/23 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

While very short term requirements may involve borrowing from other local authorities, if longer term loans were considered appropriate, the preferred option would be to use the Public Works Loan Board (PWLB). The Council will however consider long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield but the Council's investment strategy aims to find investments within the local area that deliver the Council's priorities.

Sources of borrowing:

The approved sources of long-term and short-term borrowing are:

- HM Treasury's PWLB lending facility (formerly Public Works Loan Board)
- any institution approved for investments (see below)
- 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 Oxfordshire County Council Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues
- Community bonds

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

Municipal Bonds Agency: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

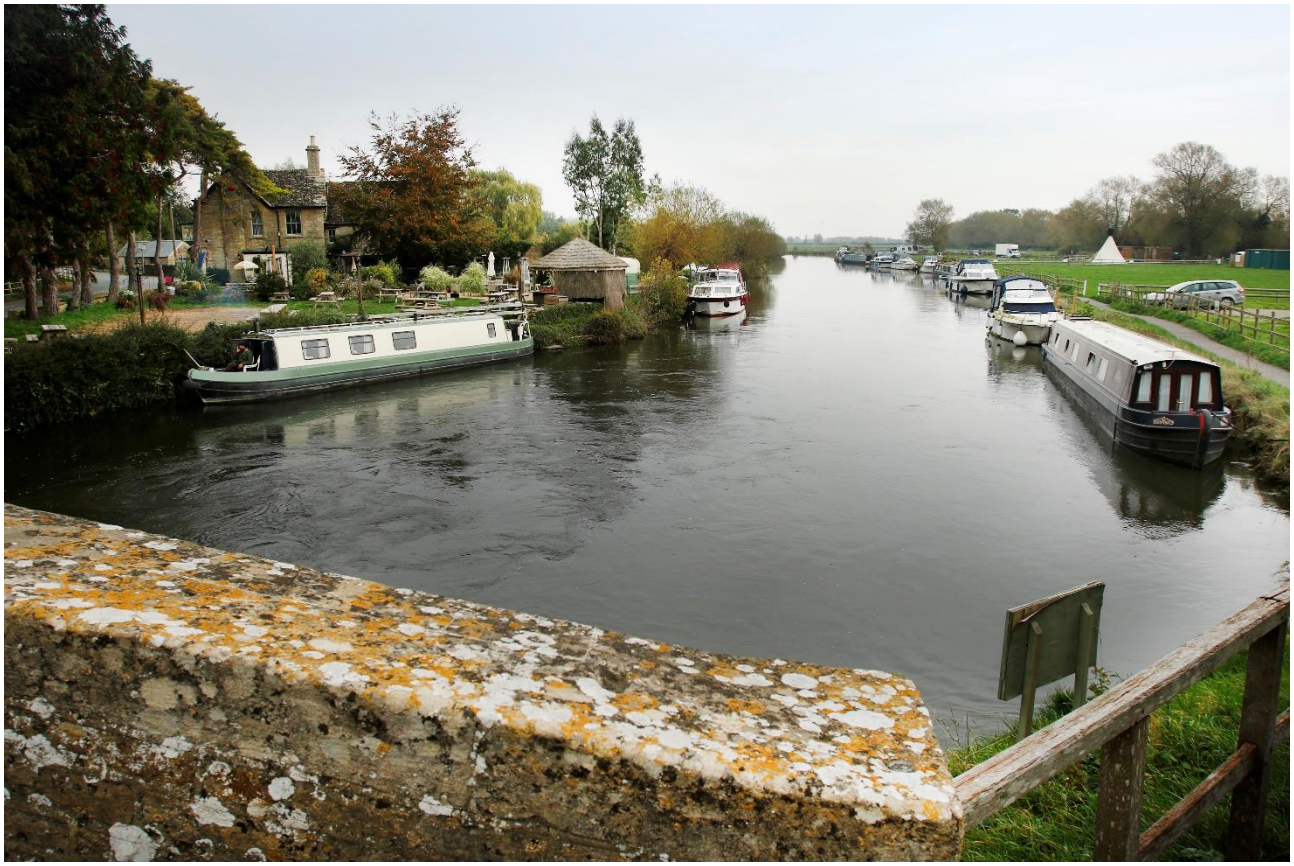
Short-term and variable rate loans: These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

If we were to borrow the full £10m we are forecasting in 22/23, the impact of a 1% rise or fall in variable interest rates would be as follows:

Interest rate exposures	Limit £k
Upper limit on one year revenue impact of a 1% rise in interest rates	(100)
Upper limit on one year revenue impact of a 1% fall in interest rates	100

We are also required to set upper and lower limits for the maturity structure of any borrowing. The reality is that the period of the loan will be determined by the optimum affordability based on the cashflows delivered by the project but should not exceed the life of the underlying asset it is funding.

Maturity structure of borrowing	Upper Limit	Lower Limit
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and within 30 years	100%	0%
30 years and above	100%	0%



Treasury Investment Strategy

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held.

Objectives

Both the CIPFA Code and the CLG Guidance require the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest 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. Where balances are expected to be invested for more than one year, the Council 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.

Strategy

Given the increasing risk and very low returns from short-term unsecured bank investments, the Council has diversified into more secure and/or higher yielding asset classes and this strategy has been maintained through 2021/22. The majority of the Council's surplus cash is currently invested in money market funds and pooled funds. While they give a greater return than the cost of borrowing externally, the Council will hold them, but if external borrowing becomes more expensive we may look to use them as liquidity instead.

Approved counterparties: The Authority may invest its surplus funds with any of the counterparty types in table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

Treasury investment counterparties and limits

Sector	Time Limit	Counterparty Limit	Sector Limit
The UK Government	50 years	Unlimited	n/a
Local Authorities	25 years	£4m	Unlimited
Other Government Entities	25 years	£4m	Unlimited
Secured investments*	25 years	£10m	Unlimited
Banks (unsecured)*	13 months	£3m	Unlimited
Building societies (unsecured)*	13 months	£2m	£10m
Registered providers (unsecured)*	5 years	£3m	£5m
Money market funds*	n/a	£5m	£25m
Strategic pooled funds	n/a	£5m	£25m
Real estate investment trusts	n/a	£3m	£5m
Other investments*	5 years	£1m-£12.5m	£12.5m

*Treasury Management investments will only be made with entities whose lowest published long term rating is no lower than A-

While some short term funds were loaned to another local authority in 21/22, the level of return currently available for this type of lending makes the risk / reward ratio disproportionate. The current very low level of interest available for Council to Council lending works in our favour should we need to borrow short term.

Clearly also some Government entities such as Transport For London, who were previously viewed as a very secure counterparty are currently experiencing financial difficulties. While the ability to lend to them has not been restricted in the table above, this is because the limits are set by sector. This should however be considered with a suitable level of due diligence. Lending appraisal and approval processes are being reviewed and revised under the new treasury investment strategy which will restrict the authority to approve these to the Section 151 Officer, within the limits of the table above.

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 taken into account. For entities without published credit ratings, investments may be made where external advice indicates the entity to be of similar credit quality.

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 Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

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 and reverse repurchase agreements with banks and building societies 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. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

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.

Registered providers (unsecured): Loans to, and bonds issued or guaranteed by, registered providers of social housing or registered social landlords, formerly known as housing associations. These bodies are 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. If the Registered Provider has no credit rating then due diligence checks through Arlingclose will be carried out beforehand.

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.

Strategic Pooled funds: Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council 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 Council's investment objectives will be monitored regularly.

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. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

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 Council's investment at risk. This is reflected in the lower time and sector limits. Additional due diligence and monitoring would be required in these instances.

Operational bank accounts: The Council banks with Lloyds (Lloyds Banking Group). On adoption of this Strategy, it will meet the minimum credit criteria of A- (or equivalent) long term. It is the Councils intention that even if the credit rating of Lloyds Bank falls below the minimum criteria A- the bank will continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements. This would of course be reviewed should the credit rating fall significantly.

Policy Investments: The Council provides cash-flow cover for third-party organisations linked to the Council. The following limit is set for 2022/23:-

- Publica Group - £500k up to one year duration
- Ubico - £500k up to one year duration

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the Council's treasury advisers, 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, avoided completely if possible, 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.

Other information on the security of investments: The Council 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 financial statements, information on potential government support and reports in the quality financial press and analysis and advice from the Council'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 credit rating 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 be deposited with the UK

Government, via the Debt Management Office or invested in government treasury bills for example. This will cause investment returns to fall but will protect the principal sum invested.

Investment limits: The Council's revenue reserves available to cover investment losses are forecast to be £22.7 million on 31st March 2022. In order that no more than 25% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government and registered providers) will not exceed £5.67 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 as below. 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.

In reality most investments will fall well below this threshold but we do currently have just under £7.75m invested with Cottsway Housing Association secured on the houses being built.

Investment limits	Cash limit
Any single organisation, except the UK Central Govt	£5m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£5m per group
Any group of pooled funds under the same mgmt	£5m per manager
Real Estate Investment Trusts (REITS)	£3m max per REIT
Foreign countries	£3m per country
Registered providers	£15m in total
Unsecured investments with building societies	£2m in total per BS
Money Market Funds	£5m per MMF

Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.

Treasury Management Indicators

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

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.

Credit Risk Indicator	Rating
Portfolio credit rating target	A
Portfolio credit rating actual (as at 31st Dec 2021)	A+

Interest rate exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

Interest rate exposures

	2022/23	2023/24	2024/25
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	100%	100%	100%

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate. The table above reflects the fact that we have no current borrowing and that any future borrowing would be recommended on its merit and suitability as the need arose. The Councils preference is not to undertake variable rate borrowing over long periods of time.

Principal sums invested for periods longer than 364 days: The purpose of this indicator is to quantify and control cash tied up for longer than the current financial year. Penalties may be incurred for money withdrawn early but in the context of current investment opportunities, longer term holdings represent returns of around 4% with shorter term holdings returning virtually nothing. Although removing funds early potentially risks a variation in capital value, in most cases the money can be withdrawn in around a week and the returns that can be earned in the meantime are significant. Where funds are known to be needed they would not be placed in long term funds but in the absence of firm timescales, it is beneficial to the Council to earn as much on the available funding as possible, within the constraints in the tables above.

The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Principal sums invested for periods longer than a year

	2022/23	2023/24	2024/25
Limit on principal invested > year	£35m	£35m	£35m
Treasury invested with no fixed maturity date	£35m	£35m	£35m

<u>Other Items</u>

There are a number of additional items that the Authority is obliged by CIPFA or CLG to include in its Treasury Management Strategy.

Policy on the use of financial derivatives: Local 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. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Council 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 Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be

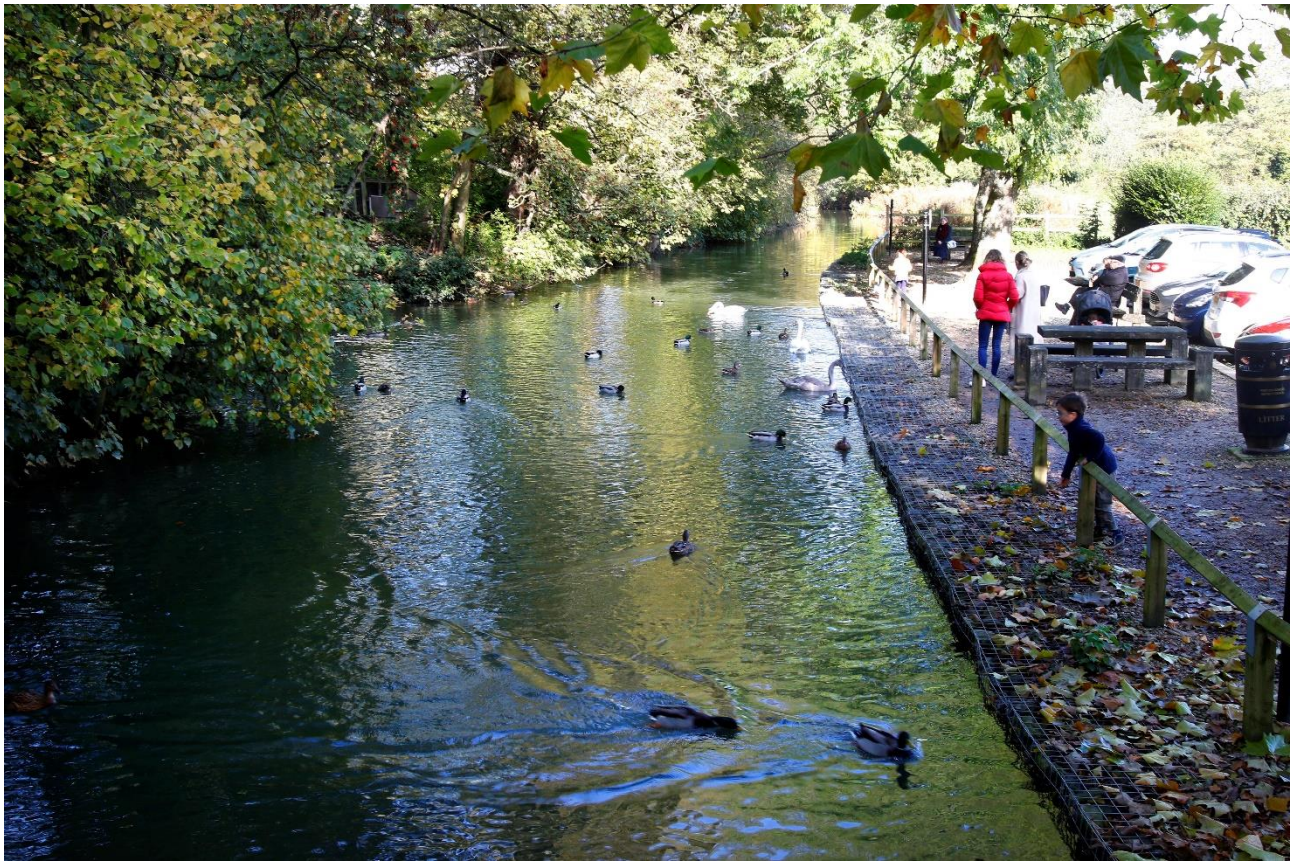
taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

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

Miffid 2: Is a legislative framework instituted by the European Union to regulate the financial markets and improve protections for investors. This Council has elected for Professional Client Status which means that to be able to invest in certain investments, it must hold a minimum of £10m in investments. If this falls below the minimum level then access to certain financial market instruments could be made unavailable to this Council. This threshold will be monitored and taken into consideration when evaluating whether to borrow externally or cash in an investment.

Investment training: The needs of the Council's treasury management staff for training in investment management are assessed annually as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Staff will regularly attend training courses, seminars and conferences provided by Arlingclose, CIPFA and other such organisations.

Investment advisers: This Council appointed Arlingclose Limited as treasury management advisers back in December 2018 after a joint tender with Cotswold District Council. The contract will end in 2022 and the investment policy review will also recommend the appropriate level of support that the contract should give to the Council.



Appendix 1

Arlingclose Limited Economic Forecast December 2021

Economic background:

The ongoing impact on the UK from coronavirus, together with higher inflation, higher interest rates, and the country's trade position post-Brexit, will be major influences on the Authority's treasury management strategy for 2022/23.

The Bank of England (BoE) increased Bank Rate to 0.25% in December 2021 while maintaining its Quantitative Easing programme at £895 billion. The Monetary Policy Committee (MPC) voted 8-1 in favour of raising rates, and unanimously to maintain the asset purchase programme.

Within the announcement the MPC noted that the pace of the global recovery was broadly in line with its November Monetary Policy Report. Prior to the emergence of the Omicron coronavirus variant, the Bank also considered the UK economy to be evolving in line with expectations, however the increased uncertainty and risk to activity the new variant presents, the Bank revised down its estimates for Q4 GDP growth to 0.6% from 1.0%. Inflation was projected to be higher than previously forecast, with CPI likely to remain above 5% throughout the winter and peak at 6% in April 2022. The labour market was generally performing better than previously forecast and the BoE now expects the unemployment rate to fall to 4% compared to 4.5% forecast previously, but notes that Omicron could weaken the demand for labour.

UK CPI for November 2021 registered 5.1% year on year, up from 4.2% in the previous month. Core inflation, which excludes the more volatile components, rose to 4.0% y/y from 3.4%. The most recent labour market data for the three months to October 2021 showed the unemployment rate fell to 4.2% while the employment rate rose to 75.5%.

In October 2021, the headline 3-month average annual growth rate for wages were 4.9% for total pay and 4.3% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 1.7% while regular pay was up 1.0%. The change in pay growth has been affected by a change in composition of employee jobs, where there has been a fall in the number and proportion of lower paid jobs.

Gross domestic product (GDP) grew by 1.3% in the third calendar quarter of 2021 according to the initial estimate, compared to a gain of 5.5% q/q in the previous quarter, with the annual rate slowing to 6.6% from 23.6%. The Q3 gain was modestly below the consensus forecast of a 1.5% q/q rise. During the quarter activity measures were boosted by sectors that reopened following pandemic restrictions, suggesting that wider spending was flat. Looking ahead, while monthly GDP readings suggest there had been some increase in momentum in the latter part of Q3, Q4 growth is expected to be soft.

GDP growth in the euro zone increased by 2.2% in calendar Q3 2021 following a gain of 2.1% in the second quarter and a decline of -0.3% in the first. Headline inflation has been strong, with CPI registering 4.9% year-on-year in November, the fifth successive month of inflation. Core CPI inflation was 2.6% y/y in November, the fourth month of successive increases from July's 0.7% y/y. At these levels, inflation is above the European Central Bank's target of 'below, but close to 2%', putting some pressure on its long-term stance of holding its main interest rate of 0%.

The US economy expanded at an annualised rate of 2.1% in Q3 2021, slowing sharply from gains of 6.7% and 6.3% in the previous two quarters. In its December 2021 interest rate announcement, the Federal

Reserve continue to maintain the Fed Funds rate at between 0% and 0.25% but outlined its plan to reduce its asset purchase programme earlier than previously stated and signalled they are in favour of tightening interest rates at a faster pace in 2022, with three 0.25% movements now expected.

Credit outlook:

Since the start of 2021, relatively benign credit conditions have led to credit default swap (CDS) prices for the larger UK banks to remain low and had steadily edged down throughout the year up until mid-November when the emergence of Omicron has caused them to rise modestly. However, the generally improved economic outlook during 2021 helped bank profitability and reduced the level of impairments many had made as provisions for bad loans. However, the relatively recent removal of coronavirus-related business support measures by the government means the full impact on bank balance sheets may not be known for some time.

The improved economic picture during 2021 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several financial institutions, revising them from negative to stable and even making a handful of rating upgrades.

Looking ahead, while there is still the chance of bank losses from bad loans as government and central bank support is removed, general credit conditions across the sector are expected to remain benign. Duration limits for counterparties on the Authority's lending list are under regular review and will continue to reflect economic conditions and the credit outlook.

Interest rate forecast:

The Authority's treasury management adviser Arlingclose is forecasting that Bank Rate will continue to rise in calendar Q1 2022 to subdue inflationary pressures and the perceived desire by the BoE to move away from emergency levels of interest rates.

Investors continue to price in multiple rises in Bank Rate over the next forecast horizon, and Arlingclose believes that although interest rates will rise again, the increases will not be to the extent predicted by financial markets. In the near-term, the risks around Arlingclose's central case are to the upside while over the medium-term the risks become more balanced.

Yields are expected to remain broadly at current levels over the medium-term, with the 5, 10 and 20 year gilt yields expected to average around 0.65%, 0.90%, and 1.15% respectively. The risks around for short and medium-term yields are initially to the upside but shifts lower later, while for long-term yields the risk is to the upside. However, as ever there will almost certainly be short-term volatility due to economic and political uncertainty and events.

Arlingclose Limited underlying assumptions as at December 2021

The global recovery from the pandemic has entered a more challenging phase. The resurgence in demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. The advent of the Omicron variant of coronavirus is affecting activity and is also a reminder of the potential downside risks.

Despite relatively buoyant activity survey data, official GDP data indicates that growth was weakening into Q4 2021. Other data, however, suggested continued momentum, particularly for November. Retail sales volumes rose 1.4%, PMIs increased, and the labour market continued to strengthen. The end of furlough did not appear to have had a significant impact on unemployment. Wage growth is elevated.

The CPI inflation rate rose to 5.1% for November and will rise higher in the near term. While the transitory factors affecting inflation are expected to unwind over time, policymakers' concern is persistent medium term price pressure.

These factors prompted the MPC to raise Bank Rate to 0.25% at the December meeting. Short term interest rate expectations remain elevated.

The outlook, however, appears weaker. Household spending faces pressures from a combination of higher prices and tax rises. In the immediate term, the Omicron variant has already affected growth – Q4 and Q1 activity could be weak at best.

Longer-term government bond yields remain relatively low despite the more hawkish signals from the BoE and the Federal Reserve. Investors are concerned that significant policy tightening in the near term will slow growth and prompt the need for looser policy later. Geo-political and coronavirus risks are also driving safe haven buying. The result is a much flatter yield curve, as short-term yields rise even as long-term yields fall.

The rise in Bank Rate despite the Omicron variant signals that the MPC will act to bring inflation down whatever the environment. It has also made clear its intentions to tighten policy further. While the economic outlook will be challenging, the signals from policymakers suggest their preference is to tighten policy unless data indicates a more severe slowdown.

Update to the economic and interest rate forecast – February 2022

The post Covid global economy has entered a higher inflationary phase, driven by a combination of resurgent demand and supply bottlenecks in goods and energy markets. Geopolotics are also playing a role, driving energy prices upwards which are being passed on to consumers. Tighter labour markets due to reduced participation rates have prompted concerns about wage-driven inflation, leading central banks to tighten policy to ensure inflation expectations remain anchored.

While some indicators suggest supply bottlenecks in goods markets are easing, oil and gas prices have risen significantly and threaten a more sustained level of uncomfortably high inflation than previously expected. In the UK, Ofgem has confirmed a significant rise in retail energy prices, which will maintain relatively high CPI rates throughout 2022.

The lower severity of Omicron means that the economic impact should be limited. The UK economy had a weak Q4 2021 due to the virus, but growth is likely to bounce back in Q1 2022.
However, higher inflation will dampen demand. In the UK, households face a difficult outlook. Fiscal and monetary headwinds alongside a sharp reduction in real income growth will weigh on disposable income, ultimately leading to slower growth. •

Arlingclose believe that The Bank of England will tighten policy further over the next few months to ensure that aggregate demand slows to reduce business pricing power and labour wage bargaining power. Markets have priced in a significant rise in Bank Rate, but they believe the MPC will be more cautious given the medium term outlook, assessing the impact of the first round of rises rather than following the market higher.

Bond yields have risen sharply to accommodate tighter monetary policy, including the run off of central bank bond portfolios. The interplay between slowing growth and falling inflation, and tightening policy, will likely keep yields relatively flat.

The MPC will raise Bank rate further to dampen aggregate demand and reduce the risk of sustained higher inflation.
Arlingclose therefore expects Bank Rate to rise to 0.75% in March and 1.0% in May. Despite this expectation, risks to the forecast remain weighted to the upside for 2022, becoming more balanced over time. The Arlingclose central forecast remains below the market forward curve.

Gilt yields will remain broadly flat from current levels, which have risen sharply since mid-December 2021. Significant volatility is, however, likely which should offer tactical opportunities for borrowing and investment. The risks around the gilt yield forecasts are broadly balanced. While gilt yields may face downward pressure as Bank Rate expectations ease from current levels, the run off of the Bank's corporate bond portfolio, and later the gilt portfolio, as it reverses QE, could impact some upward pressure on yields.

	Current	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.50	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Downside risk	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
3-month money market ra													
Upside risk	0.00	0.05	0.20	0.35	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.50	0.85	1.20	1.25	1.15	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10
Downside risk	0.00	-0.25	-0.25	-0.30	-0.30	-0.30	-0.35	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50
5yr gilt yield													
Upside risk	0.00	0.35	0.45	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55
Arlingclose Central Case	1.22	1.20	1.20	1.20	1.20	1.20	1.20	1.15	1.15	1.15	1.15	1.15	1.15
Downside risk	0.00	-0.20	-0.25	-0.25	-0.30	-0.35	-0.40	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
10yr gilt yield													
Upside risk	0.00	0.40	0.45	0.55	0.60	0.65	0.65	0.70	0.70	0.70	0.70	0.70	0.70
Arlingclose Central Case	1.37	1.35	1.35	1.35	1.35	1.35	1.35	1.35	1.35	1.35	1.35	1.35	1.35
Downside risk	0.00	-0.20	-0.30	-0.35	-0.40	-0.45	-0.50	-0.55	-0.55	-0.55	-0.60	-0.60	-0.60
20yr gilt yield													
Upside risk	0.00	0.40	0.45	0.50	0.55	0.60	0.60	0.65	0.65	0.65	0.65	0.65	0.65
Arlingclose Central Case	1.54	1.55	1.55	1.55	1.55	1.55	1.55	1.55	1.55	1.55	1.55	1.55	1.55
Downside risk	0.00	-0.30	-0.35	-0.40	-0.40	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
50yr gilt yield													
Upside risk	0.00	0.40	0.45	0.50	0.55	0.60	0.60	0.65	0.65	0.65	0.65	0.65	0.65
Arlingclose Central Case	1.22	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20
Downside risk	0.00	-0.30	-0.35	-0.40	-0.40	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%
PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%