WEST OXFORDSHIRE DISTRICT COUNCIL	WEST OXFORDSHIRE DISTRICT COUNCIL
Name and date of Committee	**FINANCE AND MANAGEMENT OVERVIEW AND SCRUTINY COMMITTEE** **WEDNESDAY 7 DECEMBER 2022**
Report Number	**Agenda Item No. 7**
Subject	**TREASURY OUTTURN 2021/22**
Wards affected	All
Accountable member	Cllr Dan Levy Cabinet Member for Finance Email: dan.levy@westoxon.gov.uk
Accountable officer	Elizabeth Griffiths, Chief Finance Officer and Deputy Chief Executive Tel: (01993) 861188 Email: Elizabeth.Griffith@westoxon.gov.uk
Summary/Purpose	To advise members of Treasury Management activity and the performance of internal and external funds for 2021/22
Annexes	N/A
Recommendations	That Treasury Management activity and the performance of internal and external funds for 2021/22 are noted.
Key Decision	No
Exempt	No

Summary

The overall performance of our investments in 2021/22 was mixed, returning interest of £794,358 against a revenue budget of £787,778 but suffering an unrealised capital loss of 1.3% in the 12 months to 31st March 2022.

The capital value of our pooled funds was affected by prevailing economic conditions in world markets and negatively impacted by Covid, the war in Ukraine and inflation. The pooled funds are intended to be long term investments where short term fluctuations in capital value are expected but will provide capital appreciation over the long term.

There has been significant disruption in markets since the end of the last financial year caused by the unprecedented rise in energy costs, 10% inflation, the rises in Bank of England base rate and the measures introduced by the Liz Truss administration. The impact of this market turmoil on our investments has been both positive and negative but overall unfortunately, negative.

The Council will benefit from a much higher revenue return, estimated at £1.3m in 2022/23 but has suffered further unrealised capital losses, which stood at £1.8m at the end of September. Arlingclose have advised that the capital values of our pooled funds will recover but it will take up to 5 years to reverse the losses we have seen since April 2022. It is encouraging to see that there has been a 10.5% recovery of the capital value lost in 2022/23 during October and November.

No borrowing was undertaken in 2021/22, though the original plans set in February 2021 were to borrow to fund part of the capital programme. There were insufficient suitable investments available during 2021/22 so the need to externally borrow was delayed once more. Due to the cost of long term borrowing and the very low investment returns on short term cash, the strategy has been to internally borrow. Internal borrowing is a treasury management practice whereby the Council utilises its cash balances on a temporary basis until the original plans for the cash fall due. This delays the need to borrow externally.

The Council complied with all Prudential Indicators for 2021/22 as set in the February 2021 budget.

1. Investment Returns

1.1 Interest earned in 2021/22 from investments held was £12,867 from short-term MMF deposits, and £781k from Long term; Pooled Funds, Extended Loans and Bonds. See Table 2 below for more detail. On an average investment balance of £43m with a return of 1.83%. Overall, a surplus of £6,580 was achieved for the financial year. Losses of £11,731 were made on the returns from Pooled Funds due to the lasting effect of COVID on the UK market. A small surplus was made on each of the REIT, External Loans, Fixed term deposits and Money Market Funds of £18,311 leaving a net surplus of £6,580 (see Table 2 below).

1.2 Investments of £12m in Pooled Funds returned 2.94% in dividends and made unrealised loss of 1.28% (£151K) on its capital value compared to 2020/21 (see Table 1). The current capital values now stand at £11.652m, £348k lower than the original investments of £12m as at 31st March 2022. The loss was, in part, attributed to the economic pressures caused by the onset of the war in Ukraine at the start of 2022 and uncertainties that followed in the market.

2 Economic & Financial Markets Background

2.1 The continuing economic recovery from the coronavirus pandemic, together with the war in Ukraine, higher inflation, and higher interest rates were major issues over the period.

2.2 UK CPI was 0.7% in March 2021 but thereafter began to steadily increase. Initially driven by energy price increases and by inflation in sectors such as retail and hospitality that were re-opening after the pandemic lockdowns, this inflation was initially believed to be temporary. Thereafter price rises slowly became more widespread, as a combination of rising global costs and strong demand was exacerbated by supply shortages and transport dislocations. The surge in wholesale gas and electricity prices led to elevated inflation expectations. CPI for February 2022 registered 6.2% year on year, up from 5.5% in the previous month and the highest reading in the National Statistic series.

2.3 Ultra-low interest rates prevailed throughout the majority of the financial year, with yields remaining at all-time lows. In December the Bank of England, reacting to the marked increase in inflation, increased the Bank Rate to 0.25% and hiked it a further 0.50% in February to 0.75%. This had the effect of seeing short-term deposit rates and Money Market Fund rates slowly start to increase to between 0.14% and 0.55% at the end of the financial year.

3. Investment Activities

3.1 A counterparty list recommended and reviewed by treasury management advisors Arlingclose was received monthly and the treasury team used this to evaluate options. At the end of the period Arlingclose had increased the majority of their approved counterparties to a recommended maximum duration of 100 days. Consistent with 2020/21, the majority of in-house balances were held in liquid MMF's, but toward the end of the year we were able to take advantage of short-term deposits with the UK Debt Management Office (DMO) achieving higher rates than the MMF's. This enabled continued working capital for the Council's activities and provided funding for the capital programme, without the need to borrow.

3.2 Both the CIPFA and the CLG's Investment Guidance require the Authority to invest prudently and have regard to the security and liquidity of investments before seeking the optimum yield. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2021/22. Investments during the year included:

- Investments in AAA-rated Stable Net Asset Value Money Market Funds
- Call accounts and deposits with Banks and Building Societies that underpin the UK banking system
- Pooled funds (collective investment schemes) meeting the criteria in SI 2004 No 534 and subsequent amendments
- Real Estate Investment Trust (REIT)

- Housing Association Bond

4. Investment Background

4.1 The Authority held significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2021/22, the Authority investment balance ranged between £22.7 million and £37.3 million. On average the Council held £27.3m in treasury investments, not including Extended Loans, which is higher than usual largely due to the additional COVID grants.

4.2 Multiple years of funding the capital programme with internal borrowing have reduced cash reserves and the expectation is that there will be significantly reduced levels of invested short term and overnight funds going forward and the Council will need to borrow to fund future capital programmes. New processes are being put in place to manage cashflow more effectively and reduce the need for large buffers of cash on hand. Managing working capital more effectively reduces our need to borrow and ensures we are earning the maximum amount of return from long term pooled funds.

5. Externally Managed Funds

5.1 Eight years ago the authority decided to invest £12m over several pooled funds. Some of the original funds have been sold and then re-invested into new ones. The performance of each of the current Pooled Funds can be seen in the table below.

Table 1 - Current Pooled Funds

Fund Manager	Investment	31st March 2021	31st March 2022	Dividends Received 2021/22	2021/22 Gain/(Loss)	Gain/(Loss) v Original Investment
	£	£	£	£	£	£
Payden & Rygel (L)	2,000,000	2,049,368	2,022,253	9,885	(27,115)	22,253
UBS (B/E)	2,000,000	1,844,708	1,753,180	80,136	(91,528)	(246,820)
Schroders (E)	1,000,000	844,976	936,380	60,199	91,404	(63,620)
Threadneedle UK (E)	1,000,000	984,746	1,047,851	33,371	63,105	47,,851
CCLA Div (B/E)	1,000,000	988,176	1,033,970	24,693	45,794	33,970
M&G Strategic (B)	2,000,000	2,090,468	1,950,281	50,329	(140,187)	(49,719)
Royal London (L)	2,000,000	1,999,053	1,907,033	43,949	(92,019)	(92,967)
Aegon (L)	1,000,000	1,001,836	1,000,826	50,707	(1,010)	826
Total –current funds	**12,000,000**	**11,803,331**	**11,651,773**	**353,269**	**(151,558)**	**(348,226)**

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

5.2 These monies are invested in externally managed strategic pooled bond, equity and multi-asset funds where short-term security and liquidity are lesser considerations when compared with short term cash deposits, and the objectives instead are regular revenue income and long-term price stability. In 2021/22, these funds generated an average total return of 1.70%, comprising a return of dividends of £353,269 (2.94%) income that is used to support services in year, and £151,558 (1.28%) of capital loss.

5.3 During the initial phase of the pandemic in March 2020, the sharp falls in corporate bond and equity markets had a negative impact on the value of the Council's pooled fund holdings and was reflected in the 31st March 2020 fund valuations with every fund registering negative capital returns over a 12 month period. These rallied in 2020-21 and in the first half of 2021-22 there was again improvement in the stock market values, however, capital values dipped in the latter half of the year. The funds were reviewed towards the close of 2021-22 with Arlingclose and it was decided to invest £2m more each into CCLA Diversified and Aegon at the start of 2022-23 in the expectation that the funds would appreciate. This has unfortunately not proved to be the case in 2022/23 for a variety of unforeseen global economic reasons.

5.4 The investment income budget for 2021/22 was set at £787,778 in February 2021. Actual investment receipts exceeded budget by £6,580 with the overall level of return of 1.83% and with an average investment balance of £27.3m for the financial year. The overall performance against the forecast is shown in the table 2 below:

Table 2 – Investment Performance

Investment Performance: 1st April 2021 to 31st March 2022	**Pooled Funds**	**Working Capital**	**Housing Association Bond**	**Housing REIT**	**Extended Loans**	**Total**
Budget (£)	365,000	0	110,000	20,000	292,778	787,778
Budgeted Return (%)	3.04	0	4.75	2	2.45	1.69
Average Balances (£)	12,000,000	17,588,880	2,500,000	1,000,000	10,216,781	43,305,621
Interest Earned (£)	353,269	12,867	110,249	22,750	295,223	794,358
Over/Under Budget (£)	(11,731)	12,867	249	2,750	2,445	6,580
Gross Rate of Return (%)	2.94	0.07	4.41	2.28	2.89	1.83

6. Compliance with Prudential Indicators

6.1 The Council can confirm that it has complied with its Prudential Indicators for 2021/22, which were set in February 2021 as part of the Council's Treasury Management Strategy and Capital Strategy. In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during 2021/22. None of the Prudential Indicators have been breached and a prudent approach has been taking in relation to investment activity with priority being given to security and liquidity over yield.

6.2 Debt Limits

	2021/22 Maximum	31.3.22 Actual	2021/22 Operational Boundary	2021/22 Authorised Limit	Complied? Yes/No
Borrowing	0	0	£42.4m	£47.4m	Yes
PFI and Finance Leases	**0**	**0**	**0**	**0**	N/A
Total debt	**0**	**0**	**£42.4**	**£47.4m**	

The Authority's chief objective when borrowing will be to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required.

7. Looking Forward

7.1 The Bank of England (BoE) Bank Rate currently stands at 3% and is expected to increase further during 2023/24. Due to economic pressures of the cost of living and the dramatic increase in energy prices, inflation was expected to rise to near 14% this autumn and currently stands at 9.9%. However, the energy bills cap that has been put in place shows encouraging signs that inflation could peak at below 11% and have slowed significantly by December 2023.

7.2 The Council will need to borrow externally to fund the Investment Recovery Strategy asset purchases over the life of the current Medium Term Financial Strategy. £10m will be required before the end of this financial year for which the Council can either utilise short term peer to peer lending or the PWLB facility. Whilst interest rates are high, the strategy is to take on short term borrowing and then refinance with long term borrowing when interest rates have fallen in 18 months to 2 years.

7.3 If we reduce our working capital balance from £10m to £2m by tightly controlling our cashflow we can reduce the amount of external borrowing needed in the short term, keeping our costs down as much as possible. When the capital value of our pooled funds has recovered, which may take up to 5 years, we will have the option of cashing in some of our investments, but the Council will need to balance the need to generate a revenue return from interest - which supports the delivery of front line services, against the cost of external borrowing. If the return from Treasury Management activity is higher than the cost of borrowing then it would be wise to retain the pooled funds as the long term investments they were intended to be. There are also implications to our status as a professional investor under MiFID 2 if we reduce our balance of external investments below £10m.

(END)