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. 6**
Subject	**TREASURY MANAGEMENT ACTIVITY AND PERFORMANCE 2022/23**
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 the Treasury and management activity and the performance of internal and external funds for the period 1st April 2022 – 30th Sept 2022
Annexes	N/A
Recommendations	That Treasury Management and the performance of internal and external Pooled funds' activity for the period 1st April 2022 – 30th Sept 2022 are noted
Key Decision	No
Exempt	No

1. SUMMARY

1.1. Historically, West Oxfordshire District Council has been in a positive cash position, financing its capital programme from working capital and investing the positive cash flows in a range of instruments that gave a balanced approach to security, liquidity and returns.

1.2. Over recent years officers have advised the Council that it was moving towards a position where it would need to borrow externally to support future investment in the capital programme.

1.3. To date, investment has been at a much lower level than anticipated and officers have managed the financing of the capital programme using internal borrowing, which is in effect avoiding taking on external debt by using other cash inflows generated by either trading activities or from monies being held for other purposes. This is a sensible solution while this cash is available because over the last few years while interest rates were exceptionally low, it was a more cost effective form of capital financing to avoid borrowing than to hold balances in cash. However, with a relatively large scale investment imminent and a desire to further invest in the short to medium term, the Council will need to commence external borrowing and consider recalling at least one pooled investment fund. As at 31 March 2022, the Council's accounts stated that the Capital Financing Requirement (the level of financing for capital required from either internal or external sources) was £25.868m and to date this has all been financed through internal borrowing.

1.4. WODC hold discussions with the Council's Treasury Management advisors, Arlingclose, to review the portfolio of investments and seek their recommendations on any that should be liquidated from a risk perspective or any underperforming funds that should be recalled ahead of external borrowing. This assessment identified one underperforming fund for early redemption. Some other funds were ruled out when considering redemption on the grounds that they had recently lost a large amount of their capital value and redemption would crystallise their loss. These funds are being monitored to ensure that the expected recovery materialises. During October and November the capital value recovered by £669,856, 37% of the value lost, leaving a loss of £1,196,404 remaining for 2022/23. While Arlingclose advise that recovery could take up to 5 years, the huge levels of fluctuation in a very short period of time are indicative of the extreme volatility and unpredictability that we have suffered this year.

1.5 Cash-flow forecasts show that the Council expects to need to borrow £10m before the end of the financial year in order to fund two capital transactions currently in progress. New processes are being defined to reduce the need for working capital in order to minimise the amount of external borrowing required.

1.6 Borrowing from external sources remains an option for West Oxfordshire. There are two main sources for accessing loans with relative simplicity - other local authorities and the Public Works Loans Board (PWLB) but all available sources of financing will be considered.

1.7 The ongoing conflict in Ukraine has continued to put pressure on global inflation and the economic outlook for UK and world growth remains weak. The UK political situation towards the end of the period following this 'fiscal event' increased uncertainty further. The economic backdrop during the April to September period continued to be characterised by high oil, gas and commodity prices, ongoing high inflation and its impact on consumers' cost of living, no imminent end in sight to the Russia-Ukraine hostilities and its associated impact on the supply chain, and China's zero-Covid policy.

1.8 On 23rd September the UK government, following a change of leadership, announced a suite of measures in a 'mini budget', loosening fiscal policy with a view to boosting the UK's trend growth rate to 2.5%. With little detail on how government borrowing would be returned to a sustainable path, financial markets reacted negatively. Gilt yields rose dramatically by between 0.7% - 1% for all maturities with the rise most pronounced for shorter dated gilts.

1.9 The April-September period was a very difficult period for bonds. The increase in policy rates in the UK, US and Eurozone and the prospect of low to no growth and a recessionary period ahead meant it was also a challenging period for equities. The FTSE All Share index fell from 4187 on 31st March to 3763 on 30th September. The fall in equity valuations is reflected in the equity and multi-asset income funds, details are shown in the table below. 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.

1.10 The returns on the portfolio generally are on target with a forecast of £670K against a budget of £663K.

2. INVESTMENT PERFORMANCE

Performance Achieved for the period is shown below:-

Performance of Fund 1 April 2022 to 30 September 2022 (annualised returns)	In-House	Bonds	Pooled Funds	Extended Loans	Social Housing REIT
Net Return	1.22%	4.75%	4.17%	2.86%	2.45%

The total investments income return is 2.91%, 0.85% above 121 Local Authorities average rate (Figures supplied by Arlingclose).

2.1. The table below shows the current valuations of the Pooled Funds portfolio at the end of September 2022 compared with the values at the close of the 2021/22 financial year. In the first six months of the year, we have seen a capital loss of £1,896,260, equivalent to 11.85% of the original capital investment due to unprecedented economic times. However, since the change in Prime Minister and the appointment of a new Chancellor, bringing a new confidence in the market, there has been a capital gain across all funds of £699,856 in October and November. It is expected that we will see a continued recovery in capital value as the economy recovers but this could take up to 5 years.

2.2. Dividend returns have seen a slight increase against expected compared with this time last year. The table below shows the current valuations of the Pooled Funds portfolio at the end of September 2022 compared with the values at the close of the 2021/22 financial year.

In April 2022 an additional £2m each was invested into the CCLA Diversified fund and the Aegon-Kames monthly diversified funds. At the time the advice was received the capital value for both funds was favourable and the dividend return achieving 2.50% and 5.06% respectively. The capital loss shown in the table below was gradual between April and August which is attributed to the effect on the economy of the war in Ukraine and the fuel crisis and onset of the cost of living crisis, all factors which were hoped to be short term. The far more significant losses of 8.33% for CCLA and 15.84% for Kames occurred in September and was caused by the Truss mini budget. Both of these unforeseen events had an unprecedented effect on the market and therefore the capital value of West Oxfordshire's existing and newly made investments.

Pooled funds performance is shown in the table below:

	Initial Investment	01/04/2022 Fund Value	Purchase of Additional Units	30/09/2022 Fund Value	Dividends paid out in 2022/23 as at 30 September	Gain / (Loss) for 2022/23	Gain / (Loss) to Initial Principal
	£	£	£	£	£	£	£
Payden & Rygel – Cash+	2,000,000	2,022,253		1,967,842	13,366	(54,411)	(32,158)
Royal London Investment Grade	1,982,791	1,907,033		1,707,128	24,431	(199,905)	(275,663)
UBS – Bond / Equity	2,000,000	1,753,180		1,467,989	50,674	(285,191)	(532,011)
M&G Strategic – Bond	2,000,000	1,950,281		1,612,887	33,182	(337,394)	(387,113)
Schroders – Equity	1,000,000	936,380		767,264	43,688	(169,116)	(232,736)
Threadneedle - UK Equity	1,000,000	1,047,851		925,472	16,643	(122,379)	(74,528)
CCLA Diversified	1,000,000	1,033,970	2,000,000	2,781,390	46,213	(252,580)	(218,610)
Aegon/Kames Diversified	1,000,000	1,000,826	2,000,000	2,525,543	98,125	(475,283)	(474,457)
September 2022 Total	**11,982,791**	**11,651,774**	**4,000,000**	**13,755,514**	**326,322**	**(1,896,260)**	**(2,227,277)**

Payden Sterling Reserve Fund – The fund invests in a diversified range of sterling-denominated, highly-rated and very liquid government agency securities and corporate fixed – and floating-rate and covered bonds. The Fund is currently returning 1.32% annualised. It has a current loss of just over £32k

UBS Multi-Asset Income Fund – The fund seeks to provide an income, through a diversified portfolio of investments in bonds and equities. The fund is over achieving and is currently returning an income of around 5.7% against expected 4.85%. However, the fund is valued at circa £532k less than the amount invested.

M&G Strategic Corporate Bond Fund - The aim of the Fund is to provide income and capital growth, through a top-down approach of the fund manager's economic outlook determining the fund duration, the sector allocation and stock concentration. It invests primarily in investment grade corporate bonds. Returns are likely to be around 3.4% against a budgeted return of 3.1%. The capital value has reduced by over £387k against the invested amount.

Royal London Short Dated Credit Fund – The Fund aims to offer income and capital growth by investing in a diversified portfolio of investment grade short dated bonds (issued by companies and organisations which meet the Fund's predefined ethical criteria). These bonds will include corporate bonds, asset backed securities, floating rate notes, UK government bonds and supranational and agency bonds. Income return is estimated at around 2.56% slightly higher than budgeted return. The value of the fund is under £275k less than originally invested.

Schroder Income Maximiser Fund – The Fund's investment objective is to provide income with potential for capital growth primarily through investment in equity and equity related securities of UK companies. The fund aims to deliver a target yield of 9.6% per year and in its first quarter returned 9.33% annualised. This fund has seen a £233k fall in capital value since its original investment.

CCLA Diversified Income Fund – The aim of the fund is to provide a balanced return from income and capital growth over time. The portfolio invests with UK and overseas equities, property, bonds and cash. The fund aims to achieve a 3.5% annual return. Current returns for the first half annualised are 3.05%. This fund has seen just under £219k fall in capital value against the amount invested.

Threadneedle UK Equity Income Fund - The aim of the Fund is to provide income with the potential to grow the amount invested. The Fund invests at least two-thirds of its assets in shares of UK companies. The Fund aims to achieve slow returns of income but also growth on the capital invested. The fund aims to return between 2.5% and 3.5% and is currently achieving 3.18%. The capital value of this fund is just under £74.5k less than the amount invested.

Kames Diversified Monthly Income Fund - The investment objective is to generate income with a target yield of approximately 7.5% per annum, with the potential for capital growth over the medium term (being any 5 year period). The fund is currently achieving 6.54% to date but is £474k down in capital value against the original amount invested.

3. FUNDAMENTUM SOCIAL HOUSING REIT

3.1 In November 2019 the Council invested £1m into the new Fundamentum Social Housing REIT that purchases property and holds long-term leases with Housing Associations who house vulnerable adults. For the six months to September 2022 West Oxfordshire has received dividends of £12,625 achieving a return of 2.45%. The quarter to September dividend has been declared at 2.85%pa, and increased returns are expected to continue as the portfolios of properties increases and a full annual rental income is received. The net asset value (NAV) of the investments has increased to £1.04 per share, a capital increase of £40k.

4. ECONOMIC AND INTEREST RATE FORECAST

4.1. UK interest rate expectations have eased following the explosive mini budget, with a growing expectation that UK fiscal policy will now be tightened to restore investor confidence, adding to the pressure on household finances. The peak for UK interest rates will therefore be lower, although the path for interest rates and gilt yields remain highly uncertain.

4.2. The UK economy is already experiencing recessionary conditions, with business activity and household spending falling. Tighter monetary and fiscal policy, alongside high inflation will put pressure on household disposable income. The short to medium term outlook for the UK economy is bleak, with the BoE projecting a protracted recession.

4.3. Following the exceptional 75 bp rise in November, Arlinglcose believe the MPC will slow the rate of increase at the next few meetings. Arlingclose now expects Bank Rate to peak at 4.25 with a further 50 bp rise in December and smaller rises in 2023. The UK economy entered a recession in Q3, which will continue for some time. Once inflation has fallen from peak, the MPC will cut Bank Rate.

4.4 As can be seen from the table below Arlingclose's view on interest rates is that they will peak at 4.25 and start reducing from Q3 2024.

	Current	Dec 22	Mar 23	Jun 23	Sep 23	Dec 23	Mar 24	Jun 24	Sep 24	Dec 24	Mar 25	Jun 25	Sep 25
Official Bank Rate													
Upside risk	0.00	0.25	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25
Central case	**3.00**	**3.50**	**4.00**	**4.25**	**4.25**	**4.25**	**4.25**	**4.00**	**3.75**	**3.50**	**3.50**	**3.50**	**3.50**
Downside risk	0.00	0.25	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00

5. FINANCIAL IMPLICATIONS

5.1 Investment income in the Authority's 2022/23 budget was set with the expectation that interest rates on short-term investments would remain low in the long term. However, due to unprecedented economic events, the Bank of England had to increase the Base Rate in unparalleled increases from 0.5 in March 2022 to 3% in November, to slow increasing inflation. Therefore, interest earned from short-dated money market investments and short-term deposits will be significantly higher.

5.2 The original investment interest budget for 2022/23 was set at £1,139,501which was based on an average balance of £42.725 million from all the different type of investments (e.g. fixed term deposits, pooled funds, bonds) achieving an overall average return of 2.48%.

5.3 The analysis of the budget and estimated performance for the year is as follows:

	2022/23 Budget	2022/23 Estimate Outturn
Pooled Funds	663,025	669,732
In-House Investments	100,000	275,100
Housing REIT	23,175	26,875
Extended Loans	288,233	288,233
Bonds	65,068	55,958
Total	**1,139,501**	**1,315,898**

Elizabeth Griffiths
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