# Treasury Management Strategy Report 2023/24

# West Oxfordshire District Council

## Summary

The Council currently has cash invested in various funds, delivering a healthy and important revenue stream to support the Council's revenue budget. While there is a need for the Council to find funding to realise its investment strategy ambitions, recent events in the financial markets have meant that many of our funds lost significant amounts of their capital value so while we expect them to recover over time, to avoid crystallising these losses, the expectation is that for the short to medium term, our treasury investments will remain relatively static in terms of where they are invested. Revenue returns are currently strong.

The Council has always stated its intention to 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 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.

The Women's Tour cycling event

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 in conjunction with the Finance and

Management Overview and Scrutiny Committee. While no one can say with certainty whether the recent capital losses could have been prevented, a more proactive approach to fund management would have certainly given us more choices. A tender has gone out for an enhanced level of support and a new contract should be in place imminently.

**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 risks are therefore central to the Authority's prudent financial management. Some of these risks have been realised in the current financial year. It was recognised previously that the level of external treasury management support needed to be strengthened but this sought after shift to a more active and proactive support contract was in progress but not yet in place when the upheaval in the markets resulted in large reductions in the capital value of our pooled funds.

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.

Cllr Rizvana Poole at the Chippy Larder

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 2022, the Authority held £35.9m of investments as shown in the tables below.

### WODC Treasury investments – one year return

| **Investments** | 31st Dec 2022 | 31st Dec 21 to 31st Dec 22 Capital Return | Income Return | Total Return |
|---|---|---|---|---|
| | £ | | | |
| Money Market Funds | 11,010,000 | 0.00% | 3.32% | 3.32% |
| Call Accounts | 1,580,000 | 0.00% | 0.40% | 0.40% |
| DMO (Bank of England) | 8,000,000 | 0.00% | 3.08% | 3.08% |
| Internal Investments | 20,590,000 | 0.00% | 3.02% | 3.02% |
| | | | | |
| Cash Plus and Short Bond Fund | 1,989,372 | -2.49% | 1.37% | -1.12% |
| | | | | |
| Strategic Pooled Funds: | | | | |
| Aegon Diversified Monthly Income Fu | 2,659,081 | -12.33% | 4.36% | -7.97% |
| CCLA Diversified Income Fund | 2,759,392 | -10.23% | 2.30% | -7.93% |
| M & G Strategic Corporate Bond | 1,733,749 | -16.30% | 3.10% | -13.21% |
| Royal London Short Dated Credit Fun | 1,769,201 | -10.15% | 2.47% | -7.69% |
| Schroder Income Maximiser Fund | 858,868 | -5.81% | 7.32% | 1.51% |
| Threadneedle UK Equity Income Fund | 1,026,329 | -5.31% | 3.46% | -1.85% |
| UBS Multi Asset Income Fund | 1,463,275 | -19.82% | 5.29% | -14.53% |
| Fundamentum Social Housing REIT | 1,040,000 | 0.97% | 2.48% | 3.45% |
| | 13,309,895 | -11.26% | 3.61% | -7.64% |
| | | | | |
| Total Investment | 35,889,267 | Annualised income return | | 3.25% |
| Pooled funds | 13,309,895 | Annualised income return | | 3.92% |

You can see from the table above that there is a spread of holdings both of shorter term more liquid holdings and of longer term holdings which have an element of both capital appreciation (or depreciation) and income.

The cash position over the last year has started to return to more normal levels after the pandemic which saw 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 which is essential when forecasting cash requirements for borrowing. We have also changed our payment processes to reduce the amount of working capital required. This helps to keep our borrowing requirement at as low a level as possible – which is essential when interest rates are currently running at a much higher level than previously anticipated, which negatively impacts potential investment returns. There is also an active lending market between local authorities for short term requirements making it possible to leave money in higher return funds and supplement a fluctuation in working capital requirements with short term borrowing if interest rates determine that as the more advantageous course of action.

**WODC Treasury investments – five year return**

| | | 31st Dec 17 to 31st Dec 22 | | |
|---|---|---|---|---|
| **Investments** | 31st Dec 22 | Capital Return | Income Return | Total Return |
| | £ | | | |
| Strategic Pooled Funds: | | | | |
| Aegon Diversified Monthly Income Fund | 2,659,081 | -11.36% | 8.32% | -3.04% |
| CCLA Diversified Income Fund | 2,759,392 | -8.04% | 5.95% | -2.09% |
| M & G Strategic Corporate Bond | 1,733,749 | -15.40% | 15.49% | 0.09% |
| Royal London Short Dated Credit Fund | 1,769,201 | -10.77% | 8.83% | -1.95% |
| Schroder Income Maximiser Fund | 858,868 | -20.97% | 31.35% | 10.38% |
| Threadneedle UK Equity Income Fund | 1,026,329 | 2.63% | 17.33% | 19.97% |
| UBS Multi Asset Income Fund | 1,463,275 | -26.47% | 22.03% | -4.44% |
| Fundamentum Social Housing REIT | 1,040,000 | 4.00% | 5.90% | 9.90% |
| | 13,309,895 | -3.76% | 3.52% | -0.24% |
| | | | | |
| Pooled Funds | 13,309,895 | Annualised income return | | 3.52% |


Cllr Joy Aitman (centre) with members of the Charlbury Bowls Club

## Borrowing requirement

The forecast borrowing requirement tracks the transition from internal borrowing to external borrowing showing our Capital Financing Requirement (CFR) and how increasing capital funding requirements will affect the amount of cash available for investment. The balance between retained treasury investments and external borrowing will be dictated by the relative interest rates for both borrowing and investment and the recovery of the capital values of the funds.

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 strategy has been 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 from 22/23 onwards, should sufficient investment opportunities be found.

### Forecast borrowing requirement £m

| | 2022/23 Budget £m | 2023/24 Forecast £m | 2024/25 Forecast £m | 2025/26 Forecast £m | 2026/27 Forecast £m |
|---|---|---|---|---|---|
| Capital Financing Requirement (CFR) | 39.66 | 48.06 | 56.45 | 58.71 | 55.81 |
| Less external borrowing | (10.00) | (17.00) | (26.50) | (31.50) | (31.50) |
| Internal borrowing | 29.66 | 31.06 | 29.95 | 27.21 | 24.31 |
| Usable reserves | (35.43) | (32.49) | (29.78) | (24.33) | (19.27) |
| Working capital | (10.85) | (10.70) | (10.87) | (11.03) | (11.19) |
| Cash available for investments | 16.62 | 12.13 | 10.69 | 8.14 | 6.15 |

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.

The Council is asked to approve the following authorised limit:

### Authorised limit and operational boundary for external debt £m

| | 2022/23 Budget £m | 2023/24 Forecast £m | 2024/25 Forecast £m | 2025/26 Forecast £m | 2026/27 Forecast £m |
|---|---|---|---|---|---|
| Capital Financing Requirement (CFR) | 39.66 | 48.06 | 56.45 | 58.71 | 55.81 |
| Operational Boundary | 41.66 | 50.06 | 58.45 | 60.71 | 57.81 |
| Authorised Borrowing Limit | 46.66 | 55.06 | 63.45 | 65.71 | 62.81 |

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 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 funding requirement we currently have (CFR) and how we are projecting that into the future and how much of that could be funded by usable reserves should we choose to do so. It takes into account our balance sheet working capital in the form of debtors and creditors, plus a liquidity allowance which we have set around the balance we intend to maintain in pooled funds till they recover their capital value. The liability benchmark should then show the level of external funding required. Our estimated borrowing is within this indicator showing that we are making good use of internal borrowing before going externally. While it shows that if we are unable to recover the capital value of our currently invested funds we may have to increase our external borrowing, it's important to note that working capital balances are very difficult to project accurately far in advance and this indicator will be reviewed regularly. What it does show is that our expected external borrowing levels are justified and prudent. The liquidity allowance of £16m allows us to hold our current treasury investments pending capital recovery and also keeps us above the £10m threshold required to qualify as a professional investor under MiFiD 2.

**Liability Benchmark £m**

| | 2022/23 Forecast £m | 2023/24 Budget £m | 2024/25 Forecast £m | 2025/26 Forecast £m | 2026/27 Forecast £m |
|---|---|---|---|---|---|
| Capital Financing Requirement (CFR) | 39.66 | 48.06 | 56.45 | 58.71 | 55.81 |
| Less usable reserves | (35.43) | (32.49) | (29.78) | (24.33) | (19.27) |
| Less working capital | (10.85) | (10.70) | (10.87) | (11.03) | (11.19) |
| Net loans requirement | (6.62) | 4.87 | 15.81 | 23.36 | 25.35 |
| Plus liquidity allowance | 16.00 | 16.00 | 16.00 | 16.00 | 16.00 |
| Liability Benchmark | 9.38 | 20.87 | 31.81 | 39.36 | 41.35 |

**Borrowing Strategy**

The Authority will enter into debt before the end of 2022/23 to fund the recent purchase under the investment strategy. Going forward, we are unlikely to be able to fund the replacement of the waste vehicle fleet and other planned capital expenditure out of working capital which is demonstrated by the table above.

The Authority may need to 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. A mixture of short term and long term borrowing will be used as prudent determined by the medium to long term expectations on interest rates.

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 and are compliant with the PWLB requirements.

**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 expect in 2022/23 and the £7m we are forecasting spread evenly through 23/24, 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 | (135) |
| Upper limit on one year revenue impact of a 1% fall in interest rates | 135 |

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% |


Collecting donations for Ukraine in Carterton

## 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. While this is a sensible objective it is obviously more difficult in times of unprecedentedly high inflation.

### Strategy

Given the relatively low returns from short-term unsecured bank investments, the Council, in previous years, diversified into more secure and/or higher yielding asset classes and this strategy has been maintained through 2022/23. The majority of the Council's current surplus cash is invested in money market funds and pooled funds.

**Approved counterparties:** The Authority may invest its surplus funds with any of the counterparty types in the table 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 | 3 years | £15m | Unlimited |
| Other Government Entities | 25 years | £4m | Unlimited |
| Secured investments* | 25 years | £10m | Unlimited |
| Banks (unsecured)* | 13 months | £3m | £10m |
| Building societies (unsecured)* | 13 months | £2m | £5m |
| 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 | £5m | £10m |

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

Some Government entities 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. All transactions 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.

Cllrs join residents at Charlbury warm spaces

**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 our external treasury advisors 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 seek 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 2023/24:-

- 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, and 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, 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 may cause investment returns to fall but would protect the principal sum invested.

**Investment limits**:

The Council's revenue reserves available to cover investment losses are forecast to be £29.1 million on 31st March 2023. In order that no more than 20% 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 £5.8 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 over £7.5m 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 Govt | 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 | £1m per country |
| Registered providers | £10m 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.


Cllrs Dan Levy, Duncan Enright & Joy Aitman with Michelle Morgan on a Facebook Live session

## 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 Average Credit Target | A- |
| Portfolio Credit Risk at 31st Dec 22 | AA- |

**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 | 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, at time of writing, 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 for the reasons explained above, longer term investment opportunities are likely to need to be held where they are in the short to medium term to avoid crystallising capital losses. 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:

**Price risk indicator**

| | 2023/24 | 2024/25 | 2025/26 | No fixed date |
|---|---|---|---|---|
| Limit on principal invested beyond year end | £20m | £20m | £20m | £20m |

**Other Items**

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 is coming to an end, a tender process has already been run, the level of desired treasury support has been increased and a new contract will be placed imminently.

Cabinet on tour

## Appendix 1

## Arlingclose Limited Economic Forecast January 2023

### Economic background:

The ongoing impact on the UK from the war in Ukraine, together with higher inflation, higher interest rates, uncertain government policy, and a deteriorating economic outlook, will be major influences on the Authority's treasury management strategy for 2023/24.

The Bank of England (BoE) increased Bank Rate by 0.5% to 3.5% in December 2022. This followed a 0.75% rise in November which was the largest single rate hike since 1989 and the ninth successive rise since December 2021. The December decision was voted for by a 6-3 majority of the Monetary Policy Committee (MPC), with two dissenters voting for a no-change at 3% and one for a larger rise of 0.75%.

The November quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with CPI inflation remaining elevated at over 10% in the near-term. While the projected peak of inflation is lower than in the August report, due in part to the government's support package for household energy costs, inflation is expected remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising.

The UK economy contracted by 0.3% between July and September 2022 according to the Office for National Statistics, and the BoE forecasts Gross Domestic Product (GDP) will decline 0.75% in the second half of the calendar year due to the squeeze on household income from higher energy costs and goods prices. Growth is then expected to continue to fall throughout 2023 and the first half of 2024.

CPI inflation is expected to have peaked at around 11% in the last calendar quarter of 2022 and then fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if Bank Rate follows the path implied by financial markets at the time of the November MPR (a peak of 5.25%). However, the BoE stated it considered this path to be too high, suggesting that the peak in interest rates will be lower, reducing the risk of inflation falling too far below target. Market rates have fallen since the time of the November MPR.

The labour market remains tight for now, with the most recent statistics showing the unemployment rate was 3.7%. Earnings were up strongly in nominal terms by 6.1% for both total pay and for regular pay but factoring in inflation means real pay for both measures was -2.7%. Looking forward, the November MPR shows the labour market weakening in response to the deteriorating outlook for growth, leading to the unemployment rate rising to around 6.5% in 2025.

Interest rates have also been rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.5% in December 2022 to 4.25%-4.5%. This rise follows four successive 0.75% rises in a pace of tightening that has seen rates increase from 0.25%-0.50% in March 2022. Annual inflation has been slowing in the US but remains above 7%. GDP grew at an annualised rate of 3.2% (revised up from 2.9%) between July and September 2022, but with official interest rates expected to rise even further in the coming months, a recession in the region is widely expected at some point during 2023.

Inflation rose consistently in the Euro Zone since the start of the year, hitting a peak annual rate of 10.6% in October 2022, before declining to 10.1% in November. Economic growth has been weakening with an upwardly revised expansion of 0.3% (from 0.2%) in the three months to September 2022. As with the UK and US, the European Central Bank has been on an interest rate tightening cycle, pushing up its three key interest rates by 0.50% in December, following two consecutive 0.75% rises, taking its main refinancing rate to 2.5% and deposit facility rate to 2.0%.

## Credit outlook:

Credit default swap (CDS) prices have generally followed an upward trend throughout 2022, indicating higher credit risk. They have been boosted by the war in Ukraine, increasing economic and political uncertainty and a weaker global and UK outlook, but remain well below the levels seen at the beginning of the Covid-19 pandemic.

CDS price volatility was higher in 2022 compared to 2021 and the divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities has emerged once again.

The weakening economic picture during 2022 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several local authorities and financial institutions, revising them from to negative from stable.

There are competing tensions in the banking sector which could impact bank balance sheet strength going forward. The weakening economic outlook and likely recessions in many regions increase the possibility of a deterioration in the quality of banks' assets, while higher interest rates provide a boost to net income and profitability.

However, the institutions on our adviser Arlingclose's counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

## Interest rate forecast:

The Authority's treasury management adviser Arlingclose forecasts that Bank Rate will continue to rise in 2022 and 2023 as the Bank of England attempts to subdue inflation which is significantly above its 2% target.

While interest rate expectations reduced during October and November 2022, multiple interest rate rises are still expected over the forecast horizon despite looming recession. Arlingclose expects Bank Rate to rise to 4.25% by June 2023 under its central case, with the risks in the near- and medium-term to the upside should inflation not evolve as the Bank forecasts and remains persistently higher.

Yields are expected to remain broadly at current levels over the medium-term, with 5-, 10- and 20-year gilt yields expected to average around 3.5%, 3.5%, and 3.85% respectively over the 3-year period to December 2025. The risks for short, medium and longer-term yields are judged to be broadly balanced over the forecast horizon. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.

## Arlingclose Economic & Interest Rate Forecast – December 2022

**Underlying assumptions:**

- The influence of the mini-budget on rates and yields continues to wane following the more responsible approach shown by the new incumbents of Downing Street.
- Volatility in global markets continues, however, as investors seek the extent to which central banks are willing to tighten policy, as evidence of recessionary conditions builds. Investors have been more willing to price in the downturn in growth, easing financial conditions, to the displeasure of policymakers. This raises the risk that central banks will incur a policy error by tightening too much.
- The UK economy is already experiencing recessionary conditions and recent GDP and PMI data suggests the economy entered a technical recession in Q3 2022. The resilience shown by the economy has been surprising, despite the downturn in business activity and household spending. Lower demand should bear down on business pricing power – recent data suggests the UK has passed peak inflation.
- The lagged effect of the sharp tightening of monetary policy, and the lingering effects of the mini-budget on the housing market, widespread strike action, alongside high inflation, will continue to put pressure on household disposable income and wealth. The short- to medium-term outlook for the UK economy remains bleak.
- Demand for labour appears to be ebbing, but not quickly enough in the official data for most MPC policymakers. The labour market remains the bright spot in the economy and persisting employment strength may support activity, although there is a feeling of borrowed time. The MPC focus is on nominal wage growth, despite the huge real term pay cuts being experienced by the vast majority. Bank Rate will remain relatively high(er) until both inflation and wage growth declines.
- Global bond yields remain volatile as investors price in recessions even as central bankers push back on expectations for rate cuts in 2023. The US labour market remains tight and the Fed wants to see persistently higher policy rates, but the lagged effects of past hikes will depress activity more significantly to test the Fed's resolve.
- While the BoE appears to be somewhat more dovish given the weak outlook for the UK economy, the ECB seems to harbour (worryingly) few doubts about the short term direction of policy. Gilt yields will be broadly supported by both significant new bond supply and global rates expectations due to hawkish central bankers, offsetting the effects of declining inflation and growth.

**Forecast:**

- The MPC raised Bank Rate by 50bps to 3.5% in December as expected, with signs that some members believe that 3% is restrictive enough. However, a majority of members think further increases in Bank Rate might be required. Arlingclose continues to expect Bank Rate to peak at 4.25%, with further 25bps rises February, March and May 2023.
- The MPC will cut rates in the medium term to stimulate a stuttering UK economy, but will be reluctant to do so until wage growth eases. We see rate cuts in the first half of 2024.
- Arlingclose expects gilt yields to remain broadly steady over the medium term, although with continued volatility across shorter time periods.
- Gilt yields face pressures to both sides from hawkish US/EZ central bank policy on one hand to the weak global economic outlook on the other. BoE bond sales and high government borrowing will provide further underlying support for yields.

| | Current | Mar-23 | Jun-23 | Sep-23 | Dec-23 | Mar-24 | Jun-24 | Sep-24 | Dec-24 | Mar-25 | Jun-25 | Sep-25 | Dec-25 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Official Bank Rate | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.50 | 0.75 | 1.00 | 1.00 | 1.00 | 1.25 | 1.50 | 1.75 | 1.50 | 1.25 | 1.25 | 1.25 |
| Arlingclose Central Case | 3.50 | 4.00 | 4.25 | 4.25 | 4.25 | 4.25 | 4.00 | 3.75 | 3.50 | 3.25 | 3.25 | 3.25 | 3.25 |
| Downside risk | 0.00 | 0.50 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| | | | | | | | | | | | | | |
| 3-month money market rate | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.50 | 0.75 | 1.00 | 1.00 | 1.00 | 1.25 | 1.50 | 1.75 | 1.50 | 1.25 | 1.25 | 1.25 |
| Arlingclose Central Case | 3.00 | 4.40 | 4.40 | 4.40 | 4.35 | 4.30 | 4.25 | 4.00 | 3.75 | 3.50 | 3.40 | 3.40 | 3.40 |
| Downside risk | 0.00 | 0.50 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| | | | | | | | | | | | | | |
| 5yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.70 | 0.80 | 0.90 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| Arlingclose Central Case | 3.43 | 3.60 | 3.80 | 3.80 | 3.80 | 3.70 | 3.60 | 3.50 | 3.40 | 3.30 | 3.30 | 3.30 | 3.30 |
| Downside risk | 0.00 | 0.80 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| | | | | | | | | | | | | | |
| 10yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.70 | 0.80 | 0.90 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| Arlingclose Central Case | 3.47 | 3.50 | 3.60 | 3.60 | 3.60 | 3.60 | 3.50 | 3.50 | 3.50 | 3.50 | 3.50 | 3.50 | 3.50 |
| Downside risk | 0.00 | 0.80 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| | | | | | | | | | | | | | |
| 20yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.70 | 0.80 | 0.90 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| Arlingclose Central Case | 3.86 | 3.85 | 3.85 | 3.85 | 3.85 | 3.85 | 3.85 | 3.85 | 3.85 | 3.85 | 3.85 | 3.85 | 3.85 |
| Downside risk | 0.00 | 0.80 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| | | | | | | | | | | | | | |
| 50yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.70 | 0.80 | 0.90 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| Arlingclose Central Case | 3.46 | 3.60 | 3.60 | 3.60 | 3.60 | 3.60 | 3.60 | 3.60 | 3.60 | 3.60 | 3.60 | 3.60 | 3.60 |
| Downside risk | 0.00 | 0.80 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%
PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
UKIB Rate (Maturity Loans) = Gilt yield + 0.60%