WEST OXFORDSHIRE DISTRICT COUNCIL	**WEST OXFORDSHIRE DISTRICT COUNCIL**
Name and date of Committee	**Audit and Governance Committee – 23 NOVEMBER 2023**
Subject	**2023/24 HALF YEAR TREASURY MANAGEMENT ACTIVITY AND PERFORMANCE AS AT 30 SEPTEMBER 2023**
Wards affected	All
Accountable member	Cllr Alaric Smith Cabinet Member for Finance Email: alaric.smith@westoxon.gov.uk
Accountable officer	Madhu Richards, Director of Finance Email: madhu.richards@westoxon.gov.uk
Report author	Sian Hannam, Treasury Accountant Email: sian.hannam@publicagroup.uk
Summary/Purpose	To provide Members with an update on Treasury Management activity, the performance of internal and external funds and prudential indicators for the period 1st April 2023 – 30th Sept 2023
Annexes	N/A
Recommendation(s)	That the Committee Resolves to: a) Note the contents of the report
Corporate priorities	Working Together for West Oxfordshire
Key Decision	No
Exempt	No

1. BACKGROUND AND SUMMARY

1.1 The overall performance of investments in the 6 months to 30th September 2023 was mixed, returning interest of £539,169 or 5.04% against an annual revenue budget of £821,741, but also generating an unrealised capital loss of 1.93% or £238,628 in the year to date.

1.2 The capital value of pooled funds continues to be affected by prevailing economic conditions in the world markets. Pooled funds are intended to be long term investments where short term fluctuations in the capital value are expected. These funds are being monitored closely by the Council's Treasury Management adviser (Arlingclose) and they continue to forecast that the capital values will recover over the next 2-5 years as gilts and bond revenue rates start to decline again.

1.3 The Council has benefitted from higher revenue returns due to regular increases in the Bank of England Bank Rate to combat high levels of inflation. The Bank has raised interest rates to try and reduce inflation and bring it closer to the Bank's target of 2%.

1.4 This report includes the new requirement in the 2021 Prudential Code (published by CIPFA), mandatory from 1st April 2023, of quarterly reporting of the treasury management prudential indicators.

1.5 The Council complied with the majority of the Prudential Indicators for 2023/24 as set out in the budget approved by full Council in February 2023. Further details can be found in section 8 of this report.

2. ECONOMIC & FINANCIAL MARKETS BACKGROUND

2.1 UK inflation (based on the Consumer Prices Index) reduced from 7.9% in June 2023 to 6.7% in August. The reduction in inflation was larger than most market forecasts although it remains high when compared to the US and the Eurozone. The largest downward contribution came from food prices.

2.2 The fall in inflation has increased the possibility that the Bank of England Bank Rate may now have peaked (markets previously priced for a peak of between 5.5% and 6%). In September, the Bank Rate was kept on hold at 5.25% following a long period of regular increases. Arlingclose, the Council's treasury adviser, modestly revised its interest forecast to reflect the central view that 5.25% will now be the peak in UK Bank Rate.

2.3 Economic growth in the UK remained relatively weak over the period compared to benchmark performance for an advanced economy of 2% to 3% per annum. The 0.5% growth in GDP achieved in June 2023 was eliminated by a 0.5% fall in July. This is the largest fall to date in 2023 and could be an indication that bank rate increases are starting to cause stagnating or recessionary economic conditions.

2.4 UK unemployment increased to 4.3% (3mth/year) while the employment rate rose to 75.5%. Pay growth remained high at 8.5% for total pay (including bonuses). Adjusting for inflation, pay growth in real terms was positive at 1.2%.

2.5 The delayed impact of increases in the UK Bank Rate together with staggered fixed term mortgage maturities over the next 12 to 24 months means the full impact of this is still yet to be felt by households. Although, consumer confidence (based on the measure published by GfK) has improved over the period, it is forecast to reverse in the short to medium term. Higher interest rates are already affecting the business sector with UK manufacturing and services confidence (based on the S&P/CIPS survey) both contracting during the quarter.

2.6 **The US and Eurozone -** The US Federal Reserve increased its key interest rate to 5.25%-5.50% over the period, pausing in September following a 0.25% rise the month before. The Federal Reserve indicated that further interest rate increases may be necessary to further reduce inflation.

2.7 Having fallen throughout 2023, annual US inflation started to increase again in July 2023, rising from 3% in June to 3.7% in August. Rising oil prices were the main cause of the increase. US economic growth was 2.1% annualised in the second calendar quarter of 2023 representing a strong performance compared to the UK and the Eurozone.

2.8 The European Central Bank (ECB) increased its key deposit, main refinancing, and marginal lending interest rates to 4.00%, 4.50% and 4.75% respectively in September, and hinted these levels may represent the peak. However, the ECB suggested rates would stay high for as long as required to reduce inflation.

2.9 Eurozone inflation has declined steadily but remains higher than the ECB's target of 2%. Inflation (measured by CPI) fell to 5.2% in August while annual core inflation reduced to 5.3% having remained at 5.5% for the previous two months. GDP growth remains weak with recent data showing the region expanded by only 0.1% in the three months to June 2023.

2.10 **Credit Review -** Having completed a review of its credit advice on unsecured deposits at UK and non-UK banks following concerns of a wider financial crisis after the collapse of Silicon Valley Bank, purchase of Credit Suisse by UBS, as well as other banking sector issues, Arlingclose reduced the advised maximum duration limit for all banks on its recommended counterparty list to 35 days. This stance continued to be maintained at the end of the period.

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

3. LOCAL CONTEXT

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

Table 1: Balance Sheet Summary

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

3.2 The treasury management position at 30th September and the change over the six months is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.23 Balance £m	Movement £m	30.9.23 Balance £m	30.9.23 Rate %
Short-term borrowing	5.013	(5.013)	0	N/A
Total borrowing	**5.013**	**(5.013)**	**0**	
Long-term investments	13.375	(0.248)	13.127	4.83
Short-term investments	0.064	4.936	5.000	5.27
Cash and cash equivalents	8.159	(0.686)	7.473	4.73
Total investments	**21.598**	**4.002**	**25.60**	**5.04**
Net investments	**16.585**	**9.015**	**25.60**	

4. BORROWING STRATEGY AND ACTIVITY

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

4.2 CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decisions that will increase the capital financing requirement and so may lead to new borrowing, unless directly and primarily related to the functions of the

Council. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield unless these loans are for refinancing purposes.

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

Table 3A: Borrowing Position

	31.3.23 Balance £m	Net Movement £m	30.9.23 Balance £m
Local authorities (short-term)	5.013	-5.013	0
Total borrowing	**5.013**	**-5.013**	**0**

5. TREASURY INVESTMENT ACTIVITY

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

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

Table 4: Treasury Investment Position

	31.3.23 Balance £m	Net Movement £m	30.9.23 Balance £m	30.9.23 Income Return %
Banks & building societies (unsecured)	3.843	(1.873)	1.970	5.14
Bank of England DMADF		5.000	5.000	5.25
Money Market Funds	4.316	1.1873	5.503	4.73
Other Pooled Funds				
- *Equity & Multi Asset income funds*	8.884	(0.222)	8.662	4.83
- Bond income funds	3.555	(0.080)	3.475	4.83
- *Real Estate Investment Trusts*	1.000	(0.010)	0.990	2.85
Total investments	**21.598**	**4.002**	**25.600**	**5.04**

5.3 Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

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

5.5 Bank Rate increased by 1%, from 4.25% at the beginning of April to 5.25% by the end of September. Short-dated cash rates rose commensurately, with 3-month rates rising to around 5.25% and 12-month rates to nearly 6%. The rates on DMADF deposits also rose, ranging between 4.8% and 5.4% by the end of September and Money Market Rates between 4.16% and 5.29%

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

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

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
31.03.2023	3.92	AA-	61%	4	-1.07
30.09.2023	4.32	AA-	60%	7	6.39
Similar LAs	**4.43**	**AA-**	**56%**	**63**	**3.47**
All LAs	**4.47**	**AA-**	**59%**	**13**	**3.65**

5.7 Externally Managed Pooled Funds: £14m of the Council's investments are invested in externally managed strategic pooled bond, equity, and multi-asset funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds generated an income return of £265,301 which is used to support services in year, and £238,628 unrealised capital loss. The current Pooled Fund position can be seen in table 6 below

Table 6 Current Pooled Funds

Fund Manager	Original Investment	Value 31st March 2023	Value 30th September	6 Month Dividend 2023/24	2023/24 Capital Gain/ (Loss)	Capital Gain/(Loss) vs Original Investment
	£	£	£	£	£	£
UBS (B/E)	2,000,000	1,466,810	1,395,316	51,460	- 71,494	- 604,684
M&G Strategic (B)	2,000,000	1,752,651	1,699,474	20,622	- 53,177	- 300,526
Royal London (L)	2,000,000	1,784,670	1,775,548	35,683	- 9,122	- 224,452
Schroders €	1,000,000	886,450	863,297	23,082	- 23,153	- 136,703
Threadneedle UK €	1,000,000	1,053,841	1,059,274	17,384	5,433	59,274
CCLA Diversified Fund (B/E)	3,000,000	2,771,963	2,729,341	30,318	- 42,622	- 270,659
Aegon/Kames (L)	3,000,000	2,659,023	2,614,530	86,751	- 44,493	- 385,470
Total - Current funds	**14,000,000**	**12,375,408**	**12,136,780**	**265,301**	**- 238,628**	**-1,863,220**

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

5.8 Financial market conditions were volatile during the six-month period. Global bond yields rose and remained elevated as it became apparent that policymakers were looking to keep rates high for some time amid persistently higher core inflation and tight labour markets.

5.9 For existing longer-term investors in fixed income securities, the prospect of a higher-for-longer rate environment weighed on sentiment. Yields rose in Q2 2023 on the expectation that central banks would continue increasing rates but fell in August as investors grew confident that policy rates were close to their peak, then rose again in September as oil prices climbed above $90/barrel. There was also some effect from quantitative tightening by the Bank of England. This affected capital values of the Council's longer-dated bond funds during the six-month period and, to a lesser extent, the multi-asset funds where there was some offset from equity performance.

5.10 The combination of the above had a marginal effect on the combined value of the Council's strategic funds since March 2023. Income from the Council's short bond funds has improved as maturing securities are replaced by higher yielding ones in these funds.

5.11 The change in the Council's funds' capital values and income return over the 6-month period is shown in Table 6.

5.12 In April 2023 the Department for Levelling Up, Housing and Communities published the full outcome of the consultation on the extension of the statutory override on accounting for gains and losses on pooled investment funds. The override has been extended for two years until 31st March 2025, but no other changes have been made; whether the override will be extended beyond the new date is unknown but commentary to the consultation outcome suggests not. The Council will discuss with Arlingclose the implications for the investment strategy and what action may need to be taken.

6. TREASURY PERFORMANCE

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

Table 7: Performance

	Q2 Actual £m	2023/24 Budget £m	Over/ under	Actual %	LA's Average Benchmark %	Over/ under
Short-term investments	0.038	0	0.038	5.27	4.92	0.35
MMF & Call Accounts	0.222	0.162	0.060	5.27	4.92	0.35
Strategic Funds	0.265	0.629	(0.364)	4.83	4.35	0.48
REIT	0.014	0.031	(0.017)	2.85	n/a	n/a
Total treasury investments	**0.539**	**0.822**	**(0.283)**	**5.04**	**4.79**	**0.25**

7. COMPLIANCE

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

Table 8: Investment Limits

	2023/24 Maximum £m	30.09.23 Actual £m	2023/24 Limit £m	Complied? Yes/No
Any single organisation, except the UK Government	3	0	5	YES
Any group of organisations under the same ownership	3	0	5	YES
Any group of pooled funds under the same management	0	0	5	YES
Limit per non-UK country	0	0	1	YES
Registered providers and registered social landlords	9.8	9.8	10	YES
Unsecured investments with banks	3	2	10	YES
Money Market Funds	15	5.503	25	YES
Strategic pooled funds	14	14	25	YES
Real Estate Investment Trusts	1	1	5	YES

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

Table 9: Debt and the Authorised Limit and Operational Boundary

	Q2 2023/24 Maximum	30.09.23 Actual	2023/24 Operational Boundary	2023/24 Authorised Limit	Complied? Yes/No
	£m	£m	£m	£m	
Borrowing	0	0	50.06	55.06	YES
Total debt	**0**	**0**	**50.06**	**55.06**	

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

8. TREASURY MANAGEMENT PRUDENTIAL INDICATORS

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

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

	31.3.23 Actual	31.3.24 Forecast	31.3.25 Forecast	31.3.26 Forecast
Loans CFR	28.38	31.30	40.23	43.02
Less: Balance sheet resources	(39.28)	(38.27)	(37.00)	(34.13)
Net loans requirement	(10.90)	(6.97)	3.23	9.34
Plus: Liquidity allowance	14.00	14.00	14.00	14.00
Liability benchmark	**3.10**	**7.03**	**17.23**	**23.34**
Existing borrowing	**5.01**	**0.00**	**5.00**	**10.00**

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

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

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

8.5 Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	2023/24 Target	30.9.23	Complied?
Portfolio average credit rating	A-	AA-	YES

8.6 Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. Bank Rate rose by 1.25% from 4.25% on 1st April to 5.25% by 30th September.

Interest rate risk indicator	2023/24 Target	30.9.23 Actual	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	(135,000)	(330,249)	No
Upper limit on one-year revenue impact of a 1% fall in interest rates	135,000	330,249	No

Due to the lack of capital expenditure and £3m received in advance from the Ministry of Defence for their annual Council Tax liability, the weighted average on variable rate investments (MMFs) has been higher than originally forecast. The 1% increase was therefore higher than the target and we have generated more interest income.

Non Treasury Management Prudential Indicators

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

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

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

	2022/23 actual	2023/24 forecast	2024/25 budget	2025/26 budget
General Fund services	15.29	9.44	7.01	3.89

The main capital projects to date have included the purchase of Marriotts Close shopping centre for £9.54m, to regenerate Witney town centre, and £1.8m on the provision of affordable housing in partnership with Cottsway Housing Association & Heylo. The Capital Strategy approved in February 2023 anticipated higher levels of capital expenditure of £30m in 2022/23 and £12m in each of 2023/24 & 2024/25. These estimates have been reduced based on the lack of available Investment Recovery strategy projects given that interest rates are high and it is more difficult to return 2% above the cost of capital as per the strategy. The capital, treasury management and investment strategies will be updated as part of the 2024/25 budget setting process.

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

	31.3.2023 actual	**31.3.2024 forecast**	**31.3.2025 budget**	**31.3.2026 budget**
General Fund services	28.38	31.30	40.23	43.02
TOTAL CFR	**28.38**	**31.30**	**40.23**	**43.02**

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

	31.3.2023 actual	**31.3.2024 forecast**	**31.3.2025 budget**	**31.3.2026 budget**	**Debt at 30.9.2023**
Debt (incl. PFI & leases)	5.013	0	5.00	10.00	0
Capital Financing Requirement	28.38	31.30	40.23	43.02	

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

	Maximum debt H1 2023/24	Debt at 30.9.23	2023/24 Authorised Limit	2023/24 Operational Boundary	Complied? Yes/No
Borrowing	5.013m	0	55.06m	50.06m	Yes
Total debt	**5.013m**	**0**	**0**	**0**	Yes

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

Net Income from Commercial and Service Investments to Net Revenue Stream: The Authority's income from commercial and service investments as a proportion of its net revenue stream has been and is expected to be as indicated below.

	2022/23 actual	2023/24 forecast	2024/25 budget	2025/26 budget
Total net income from service and commercial investments	3.92m	5.20m	5.50m	5.50m
Proportion of net revenue stream	25.9%	37.4%	38.8%	42.4%

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

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

	2022/23 actual	2023/24 forecast	2024/25 budget	2025/26 budget
Financing costs (£m)	0.433m	0.546m	0.808m	1.070m
Proportion of net revenue stream	2.87%	3.93%	5.69%	8.25%