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OXFORD CITY COUNCIL

To:	**Cabinet**
Date:	**13 September 2023**
Report of:	**Head of Financial Services**
Title of Report:	**Treasury Management Annual Report 2022/23**

Summary and Recommendations	
Purpose of report:	The report sets out the Council's Treasury Management activity and performance for the financial year 2022/23
Key decision:	No
Executive Board Member:	Councillor Ed Turner, Deputy Leader (Statutory) - Finance and Asset Management
Corporate Priority:	All
Policy Framework:	Treasury Management Strategy

Recommendations: That Cabinet resolves to:

1. **Note** the report.

Appendices	
Appendix 1 (Confidential)	Fund Investment
Appendix 2	Risk Register

Executive Summary

1. The Council held investments of £73.125 million as at 31st March 2023. Net interest earned during the year, including from loans to companies and external borrowing, was £6.25 million against a target of £4.80 million, a favourable variance of £1.45 million. This relates to three factors:
   - Borrowing costs lower by £0.36 million due to long term borrowing on the General Fund not being required, following slippage in the capital programme including lower loan requirements from the Housing Companies;
   - Higher investment income by £1.37 million due to the combination of more funds available to invest, arising from lower internal borrowing than anticipated and higher interest rates during the year than originally forecast; and
   - Lower interest received from companies by £0.28 million in interest received from companies, primarily the Housing Company, due to reduction in loans

required because of reduced development activity, partly offset by interest on loans to Low Carbon Hub in respect of Ray Valley Solar Farm.

2. The average rate of return on the Council's investments in 2022/23 was 3.77% compared to 0.82% in 2021/22. The Bank of England base Rate increased steadily throughout 2022/23, starting at 0.75% and finishing at 4.25%.
3. The Council held £198.5 million of fixed rate Public Works Loan Board (PWLB) debt as at 31st March 2023. The debt was originally borrowed in March 2012 to fund the self-financing of the Housing Revenue Account (HRA) with one of the loans that had matured being replaced on 28th March 2022. All of the debt relates to housing and the maturity profile ranges from 5 to 50 years. Interest paid on the debt in 2020/21 and charged to the HRA was £6.40 million.

Background

4. The primary principle governing the Council's investment decisions is the security of the investment, with liquidity and yield being secondary considerations.
5. The Council has a statutory duty to set, monitor and report on its prudential indicators in accordance with the Prudential Code, which aims to ensure that the capital investment plans of local authorities are affordable, prudent and sustainable.
6. When considering whether to borrow, the Council's Debt Strategy requires a number of factors to be considered. These include:
   - prevailing interest rates;
   - the profile of the Council's debt portfolio;
   - the type of asset being financed; and
   - the availability of cash balances to finance capital expenditure.
7. The Council fully complied with its Treasury Management Strategy in relation to both debt and investment management in 2022/23.
8. The prudential indicators detailed in the body of this report compare the Council's outturn position against the target set for 2022/23.

Financing the Capital Programme 2022/23

9. Table 1 below shows actual capital expenditure and expected financing compared to the original budget.

Table 1 Capital Expenditure and Financing 2022-23			
Capital Expenditure	**2022/23 Original Budget £'000**	**2022/23 Actual £'000**	**Variation £'000**
Non-HRA Capital Expenditure	98,137	29,335	-68,802
HRA Capital Expenditure	112,457	45,563	-66,894
Total Capital Expenditure	**210,594**	**74,898**	**-135,696**
Resourced by:			
Developer Contributions	11,398	2,247	-9,151
Capital Grants and contributions	34,500	6,388	-28,112
Capital Receipts	31,278	10,361	-20,917
Revenue	418	6,719	6,301
Major Repairs Reserve	9,412	6,610	-2,802
Prudential Borrowing	123,588	42,573	-81,015
Total Capital Resources	**210,594**	**74,898**	**-135,696**

10. Much of the variation to the original budget relates to slippage in the programme, the resources for which will be moved into funding the expenditure in future financial years.

The Council's Overall Borrowing Need

11. The Council's underlying need to borrow, or Capital Financing Requirement (CFR), is the measurement and control of the Council's overall debt position. It represents all prior years' net capital expenditure which has not been financed by other means, i.e. revenue, capital receipts, grants etc.

12. The CFR can be reduced by:

- The application of additional capital resources, such as unapplied capital receipts;
- Repayment of debt financed by borrowing; or
- Charging a Minimum Revenue Provision (MRP), or a Voluntary Revenue Provision (VRP).

13. Table 2 below shows the Council's CFR as at the 31st March 2023, this is a key prudential indicator, and shows that actual borrowing is below the CFR:

Table 2 Capital Financing Requirement (CFR) 2021-22 and 2022-23			
CFR	**31st March 2023 Estimate £'000**	**31st March 2023 Actual £'000**	**Variation £'000**
Opening Balance	**359,948**	**295,308**	**-64,640**
Prudential Borrowing	123,588	42,573	**-81,015**
Repayment of debt	-23,195	-3,161	**20,034**
Minimum Revenue Provision	-254	-38	**216**
CFR Closing Balance	**460,087**	**334,682**	**-125,405**
External Borrowing	**198,528**	**198,528**	**0**
Internal Borrowing	**261,559**	**136,154**	**-125,405**

14. No new external debt was taken out during 2022/23 and as at 31st March 2023 the Council's total external debt remains at £198.5 million, all in relation to HRA. This is below the CFR and indicates that the Council continues to internally borrow from its cash balances which is the cheapest form of borrowing.

Treasury Position at 31st March 2023

15. Whilst the Council's gauge of its underlying need to borrow is the CFR, the treasury function manages the Council's actual need to borrow by either:

- Borrowing to the CFR;
- Choosing to utilise temporary cash flow funds, instead of borrowing (known as "under borrowing"); or
- Borrowing for future increases in the CFR (borrowing in advance of need*)*

16. The Council's treasury position as at the 31st March 2023 for both debt and investments, compared with the previous year is set out in Table 3 below:

Table 3 : Borrowing and Investments 2021-22 and 2022-23				
	31st March 2022		31st March 2023	
Treasury Position	**Principal £'000**	**Average Rate %**	**Principal £'000**	**Average Rate %**
Borrowing				
Fixed Interest Rate Debt	198,528	3.23	198,528	3.09
Total Debt	**198,528**	**3.23**	**198,528**	**3.09**
Investments				
Fixed Interest Investments	48,000	0.48	43,000	3.50
Call Accounts	7,500	0.90	0	0.00
Variable Interest Investments	8,940	0.01	10,125	4.09
Property Funds	15,000	3.54	20,000	3.54
Total Investments	**79,440**	**1.01**	**73,125**	**3.71**
Net Position	**119,088**		**125,403**	

17. Overall, the Council earned a weighted average return of 3.77% on its investment which is above the target of 0.2% above average base rate, which equated to 2.40% as at 31st March 2023.

Prudential Indicators and Compliance Issues

18. Some of the prudential indicators provide an overview, others a specific limit on treasury activity. These are detailed below:

19. ***Net Borrowing and the CFR*** – In order to ensure that borrowing levels are prudent, the Council's external borrowing (net of investments) over the medium-term must only be for a capital purpose, and not exceed the CFR except in the short-term. In the short term the Council can borrow for cash flow purposes. Table 4 below highlights the Council's net borrowing position against the CFR, and shows that it is significantly below the limit, due to the level of internal borrowing that has been undertaken.

Table 4 : Net Borrowing CFR 2021-22 and 2022-23		
Net Borrowing & CFR	**31st March 2022 Actual £'000**	**31st March 2023 Actual £'000**
Total Debt	198,528	198,528
Total Investment	112,053	73,125
Net Borrowing Position	**86,475**	**125,403**
CFR	**295,308**	**334,682**
Under Borrowing plus Investments	**208,833**	**209,279**

20. In the current climate, internal borrowing is preferable to borrowing externally as the interest rate payable on an external loan is much higher than that which can be earnt on investments. Therefore, forfeiting interest receivable on investments is more economical than paying additional interest charges for new external debt. If the net borrowing position, interest rate position and/or CFR changed significantly, the prospect of taking on additional debt would be reviewed.

21. ***The Authorised Limit*** – The Authorised Limit is the ‘affordable borrowing limit’ required by section 3 of the Local Government Act 2003. The Council does not have the power to borrow above this level unless it explicitly agrees to do so. Table 5 below demonstrates that during 2022/23 the Council’s gross borrowing was within its Authorised Limit. The Authorised Limit allows for some headroom above the Council’s projected CFR.

Table 5 : Authorised Lending Limits 2021-22 and 2022-23				
Authorised Limit compared to Actual Borrowing	**31st March 2022**		**31st March 2023**	
	Limit £'000	**Actual £'000**	**Limit £'000**	**Actual £'000**
Borrowing	662,122	198,528	662,122	198,528
Other Long Term Liabilities	0	0	0	0
Total Borrowed	**662,122**	**198,528**	**662,122**	**198,528**
Amount under Limit	**463,594**		**463,594**	

22. ***The Operational Boundary Limit*** – the Operational Boundary Limit is the expected borrowing position of the Council during the year. It is possible to exceed the Operational Boundary Limit, for a short period of time, providing that the Authorised Borrowing Limit is not breached. Table 6 below shows the limits for the last two financial years. Actual borrowing remained unchanged at £198.5m hence the limits were not breached during either period.

Table 6 : Operational Boundary Limits 2021-22 and 2022-23		
Operational Boundaries	**31st March 2022 £'000**	**31st March 2023 £'000**
Operational Borrowing Limit	423,525	525,924
Other Long Term Liabilities	0	0
Totals	**423,525**	**525,924**

Investment Income

23. High inflation has put pressure on the Bank of England to increase the interest rate to reduce the rate of inflation. It's predicted that the rate will rise to a peak of around 5.5% later in 2023 before falling back in 2024. The Council manages its investments in-house and invests with institutions listed in the Council's approved counterparty list. The Council invests for a range of periods from overnight to 364 days, dependant on cash flow requirements, its view on interest rates and duration limits set out in the Council's Investment Strategy.

24. During 2022/23, the Council maintained an average investment balance of £103 million and received an average return of 3.77%. The upper limit of non-specified investments allowed in the strategy is 30% of the average investment balance for the preceding calendar year. The average balance for 2021/22 was £101 million giving a limit on non-specified investments of £30.3 million (being the higher of 30% of the previous calendar year's average investment portfolio and £30 million). Property funds and Multi Asset Funds fall into the non-specified investment category; their original investment value was £20 million which is within the non-specified limit at 19.8% of the average investment balance.

25. The property funds and the Multi asset Funds are classified as Non-specified Investments within the approved Investment Strategy. The current rate of return on the investments is circa 3.54% per annum.

26. The capital value of the Communities, Churches and Local Authorities (CCLA) Fund has increased by 22.34% between April 2013 and March 2023. The overall value of the Lothbury property fund investment has increased by 2.37% as at 31st March 2023 since its inception in August 2014. It is important to understand that fluctuations in value are to be expected with property fund investments over the short term and that they are a long term investment; as such, any gains and losses in fund value should be considered over the long term. More information about the current position can be found in the confidential appendix to this report.

27. Two Multi Asset Funds each for the amount of £5m are held with two fund managers, Fidelity and Artemis. The value as at 31-3-2023 was £4.1 million and £4.8 million respectively. The position on both continues to fluctuate. As with the property funds any gains or losses should be considered over the long term. Investment losses currently are approximately 10.1% and since inception the total of the funds has outstripped bank interest over the same period by 2.1%.

28. Fund managers are reporting that the funds continue to deliver stable income in line with objectives. Yields across asset classes have risen materially and have been incorporating yield-additive trade rotations in the fund, which will remain the focus over the coming months. The funds are well positioned to continue to deliver objectives of a stable yield of around 4-6% per annum over a market cycle. The

funds have generated positive returns year to date, with April strengthening these gains. Returns also remain positive over 6 months and continue to make progress on recovering from last year's challenging market conditions.

29. Actual treasury investment income for 2022/23 was £2.51 million; £1.37m Higher than the estimate of £1.14 million. The difference is mainly due to slippage in the capital programme and higher interest rate rises than anticipated.

30. Fluctuations in the Council's balances have been managed through a mix of instant access and notice accounts, money market funds and short term deposits (up to 364 days). This approach is in line with the Investment Strategy approved by the Council.

Other Loans

31. The Council currently have non treasury loans to Oxplace of £45.3m with an average interest rate of 4% per annum and £12.7 million to Oxwed LLP with an interest rate of 6.5% per annum which has unpaid accrued interest of £5.9 million also 2 loans with the Low Carbon Hub with total interest £2m at 2.85% per Annum and £2m at 1.45 per Annum.

Interest Rates since 31st March 2022

32. The Council takes advice from Link Asset Services on the appropriate durations to place investments with counterparties. These durations and also the availability of individual counterparties are subject to change dependant on market conditions and the credit ratings of the individual institutions. This means that the investment portfolio has to be actively managed to ensure both the availability of enough suitable counterparties and that the Council achieves the best interest rates possible within the agreed security and liquidity parameters. The contract for treasury advisors is currently going through a procurement process.

33. The economy has seen inflationary pressures which are remaining despite interest rate rises. Over the period there has been the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and implications on energy, food and raw materials supply putting inflationary pressures into the economy. UK interest rates have been volatile across all investment and borrowing durations, from bank rate through to 50-year gilt yields, for all of 2022/23, with the bank rate increasing steadily throughout 2022/23, starting at 0.75% and finishing at 4.25%.

34. The Council continues to use money market funds and instant access accounts for liquidity purposes, whilst seeking to maximise its returns by arranging longer term deposits where possible. As the interest rate has risen very quickly it may take several months for the council to take advantage of the increased rates due as it waits for previous investments to mature. In order to achieve this position, it is vital to maintain a robust cash-flow model which is continuously reviewed and updated. The council holds £10 million investments in property funds and £10 million in Multi asset funds. The overall capital value of the funds have fallen due to the pressures on the gilt and bond market; these are seen as long term investments and fluctuations over time are to be expected. Dividends from the funds were still paid and are now back at the return levels of previous years.

Environmental Social and Governance (ESG)

35. The Council adopted an ethical investment policy in 2015/16. No changes were made to the policy in setting the 2022/23 Treasury Management Strategy which is set out below:

    The Council will not knowingly invest directly in businesses whose activities and practices pose a risk of serious harm to individuals or groups, or whose activities are inconsistent with the Council's mission and values. This would include, inter alia, avoiding direct investment in institutions with material links to:

    a. Human rights abuse (e.g. child labour, political oppression)
    b. Environmentally harmful activities (e.g. pollutants, destruction of habitat, fossil fuels)
    c. Socially harmful activities (e.g. tobacco, gambling)

36. The council will look to invest in green deposits where possible when funds become available and has recently invested in a sustainable fixed term deposit from Standard Chartered.

37. The Council set a separate Environmental Social and Governance policy within the 2022/23 Treasury Strategy which was then updated in the 2023/24 Treasury Strategy. Environmental, Social, and Governance (ESG) criteria are a set of measures of a company's operations that socially conscious investors can use to inform potential investments. Environmental criteria consider how a company performs as a steward of nature. Social criteria examine how it manages relationships with employees, suppliers, customers, and the communities where it operates. Governance deals with a company's leadership, executive pay, audits, internal controls, and shareholder rights. Due to the number of different agencies producing ESG data, which are not comparable between the agencies because of the different methodologies used, the Council is limited on how this information can be used to inform investment decisions. Due to the focus that has to be placed on the treasury management principles of Security, Liquidity and Yield, caution needs to be applied in order to not restrict the number of counterparties that the Council can invest in such that there is no remaining capacity for further investments or so that the level of interest income is not significantly affected which would cause unexpected financial pressure on the Council. However the Council does monitor the activities of its various counterparties and questions and challenges them on their ESG credentials at any meeting held with them.

Financial implications

38. These are set out within the body of the report.

Legal Issues

39. The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2022/23. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

Level of risk

40. The key risk going forward is around uncertainty caused by interest rate rises from the Bank of England. These are being driven by the overall economic position both at the national and the global level. Arguably some of the inflationary pressures will remain despite the interest rate rises which could lead the Bank of England to raise rates more. There are also concerns that the Bank of England may have raised rates too quickly – not allowing time for the effect of the increases to take effect before raising rates again – which could lead to a recession. Equally it is uncertain how long interest rates will remain high before coming back down. This gives uncertainty around both investment and borrowing decisions. Risk assessment and management is a key part of Treasury Management activity, especially in the selection of counterparties when investment is being considered and in the timing and duration of any borrowing being planned. The Council uses external advisors and counterparty credit ratings issued by the rating agencies to assist in this process.

Equalities impact

41. The Council follows an ethical investment policy, investment interest helps provide council services, which has a beneficial equalities impact.

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Background Papers: None