Agenda Item 16

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OXFORD CITY COUNCIL

To:	**Cabinet**
Date:	**13 December 2023**
Report of:	**Head of Financial Services**
Title of Report:	**Treasury Management Mid-Year Review for April – September 2023**

Summary and recommendations	
Purpose of report:	To report on the performance of the Treasury Management function for the 6 months to 30 September 2023.
Key decision:	No
Executive Board Member:	Councillor Ed Turner, (Deputy Leader) Finance and Corporate Assets
Corporate Priority:	None
Policy Framework:	Council Strategy 2020-24
Recommendations: That Cabinet resolves to:	
1. **Note** the performance of the Treasury Management function for the six months to 30 September 2023.	

Appendices	
Appendix 1	List of investments as at 30 September 2023
Appendix 2	Risk Register
Appendix 3/3A	Confidential Appendix on Fund Investment

Introduction and Background

1. This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury and has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, covering the following:
   - An economic overview for the first part of the 2023/24 financial year
   - A review of the Council's investment portfolio for 2023/24
   - A review of the Council's borrowing strategy for 2023/24
   - A statement of compliance with Treasury and Prudential Limits for 2023/24

2. The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure from a revenue perspective. Greater or lesser demand for cash generally is driven from capital activities. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in suitable counterparties, providing adequate liquidity and security initially before considering optimising investment return.

3. The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

4. The budgeted investment income for 2023/24 is £3.549 million. As at the 30th September 2023, forecast investment income for 2023/24 is £2.625 million.

5. Overall Treasury Management investment and borrowing activity plus the loans to companies is forecast to be beneficial at £1.052 million favourable compared to the budget. External borrowing has been less than anticipated due to delays in the capital programme along with lower than anticipated lending to companies this has meant a higher than anticipated cash for investment which together with higher than anticipated interest rates has resulted in the positive interest forecast.

Economic Overview

6. The second quarter of 2023/24 saw:

- Interest rates rise by a further 1%, taking the Bank of England Rate from 4.25% to 5.25% which is, according to general market opinion, the peak in the current base rate rises
- A 0.5% month on month decline in real GDP in July, mainly due to more strikes.
- CPI inflation falling from 8.7% in April to 6.7% in August, its lowest rate since February 2022, but still the highest in the G7.
- Core CPI inflation declining to 6.2% in August from 7.1% in April and May, (which was a 31 years high).
- Lower unmet labour demand, although there is no evidence yet that it has led to an easing in wage growth

Interest and Interest Rate Forecasts

7. The Council has recently re-appointed Link Group as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. The Public Works Loan Board (PWLB) is a lending facility is operated by the UK Debt Management Office (DMO) on behalf of HM Treasury and provides loans to local authorities. The PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1st November 2012.

8. The latest forecasts set out a view that both short and long-dated interest rates will be elevated for some time, as the Bank of England seeks to reduce inflation levels. The PWLB rate forecasts below are based on the Certainty Rate (the standard rate

minus 20 basis points (0.2%), calculated as gilts plus 80 basis points) which has been accessible to most authorities since 1st November 2012.

Link Group Interest Rate View	25.09.23												
	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26
BANK RATE	5.25	5.25	5.25	5.00	4.50	4.00	3.50	3.00	2.75	2.75	2.75	2.75	2.75
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.00	2.80	2.80	2.80	2.80	2.80
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.10	2.90	2.90	2.90	2.90	2.90
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.20	3.00	3.00	3.00	3.00	3.00
5 yr PWLB	5.10	5.00	4.90	4.70	4.40	4.20	4.00	3.90	3.70	3.70	3.60	3.60	3.50
10 yr PWLB	5.00	4.90	4.80	4.60	4.40	4.20	4.00	3.80	3.70	3.60	3.60	3.50	3.50
25 yr PWLB	5.40	5.20	5.10	4.90	4.70	4.40	4.30	4.10	4.00	3.90	3.80	3.80	3.80
50 yr PWLB	5.20	5.00	4.90	4.70	4.50	4.20	4.10	3.90	3.80	3.70	3.60	3.60	3.60

Investment Portfolio and Performance

9. The budgeted Treasury Management investment income for 2023/24 is £3.549 million. As at the 30th September 2023, forecast investment income to the end of 2023/24 is £2.625 million, an adverse variance of £0.924 million. Note that this is only part of the overall treasury position – the total net impact is shown in paragraph 12.

10. Budgeted income from loans to OCHL and Oxwed for the year is £3.295 million. As at the 30th September 2023, forecast income for 2023/24 is £2.794 million, which also includes £0.087 million income from loans to the Low Carbon Hub in resect of the Ray Valley Solar Farm, an adverse variance of £0.501 million.

11. The delays in in the capital programme have resulted in no external borrowing being taken out to finance general fund capital financing borrowing resulting in a favourable variance of £1.318 million against budget. Additionally this has meant that the HRA has not had to utilise external borrowing leading to internal borrowing income of £1.159 million for the General Fund.

12. Overall Treasury Management investment and borrowing activity plus the loans to companies is forecast to be beneficial by £1.052 million compared to the budget. There are a number of factors giving rise to this overall position:

    - Lower than anticipated lending to companies resulting in lower income from companies;
    - The delays in in the capital programme and company lending have resulted in
        - higher than anticipated cash for investment;
        - general fund borrowing being lower than anticipated and all general fund borrowing relating to the financing of the 2022/23 capital programme being internal; and
        - HRA borrowing relating to the financing of the 2022/23 capital programme being able to be temporarily taken from available cash resources.

13. The beneficial impact to the Council of higher interest rates indicated by this report will be also be reported in the regular monitoring reports to Cabinet. However, it is important to note that there are other, detrimental consequences of higher interest rates falling outside the scope of this report and time period, so the medium-term impact of rising interest rates is likely to be negative to the Council's financial position. These detrimental effects include increased external borrowing to finance

the Council's capital programme, which also has a knock on impact on the Council's housing company, and also secondary impacts on other council services such as potential increased pressures on homelessness.

14. The Treasury Management Strategy for 2023/24 was approved by the Council in February 2023; to date the Strategy has been fully adhered to. Prudential indicator information is not included in this report because it relies on a full year picture and, crucially, on capital activity which will not be known in full until the end of the year.
15. As part of its Strategy, the Council aims to maintain a diversified investment portfolio whilst ensuring there are no policy and procedure breaches. Security of investments is always the primary concern when arranging investments with liquidity and yield being secondary, but key considerations.
16. The Council operates an approved counterparty listing which details all institutions with whom the Council may invest, the maximum amount which may be invested with any single counterparty group at any given point and the maximum duration period. The counterparty list is set in association with recommendations from Link Asset Services although ultimate authorisation of approved counterparties rests with the Section 151 Officer. The list is actively managed and reviewed on a weekly basis or more regularly if required.
17. Monthly monitoring meetings are held with the Section 151 Officer, Financial Accounting Manager and Treasury staff to discuss investments in terms of counterparties and maturity dates, cash flow, interest and borrowing rates and Treasury operational and Strategic strategies.
18. The strategy also adopts an ethical approach to investments, summarising that:

    "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:

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

19. The current approach to Environmental & Social governance (ESG) is to weigh up ESG criteria into account when choosing new investment providers as one of the matters that the Council considers, however under the Treasury Management Code, Security, Liquidity and Yield factors have to be prioritised. ESG criteria are used as an overlay to this.
20. The Council regularly reaches out to its current investment providers to give a breakdown of their ESG principles and provide any information they have on their ESG credentials and investment partners are regularly questioned on their policies when the Council meet with them to discuss its investments and, where necessary, to apply what pressure the Council can to improve their ESG position.
21. It should be noted that ESG information is not always available and not always consistent across counterparties.

Pooled Investment Funds

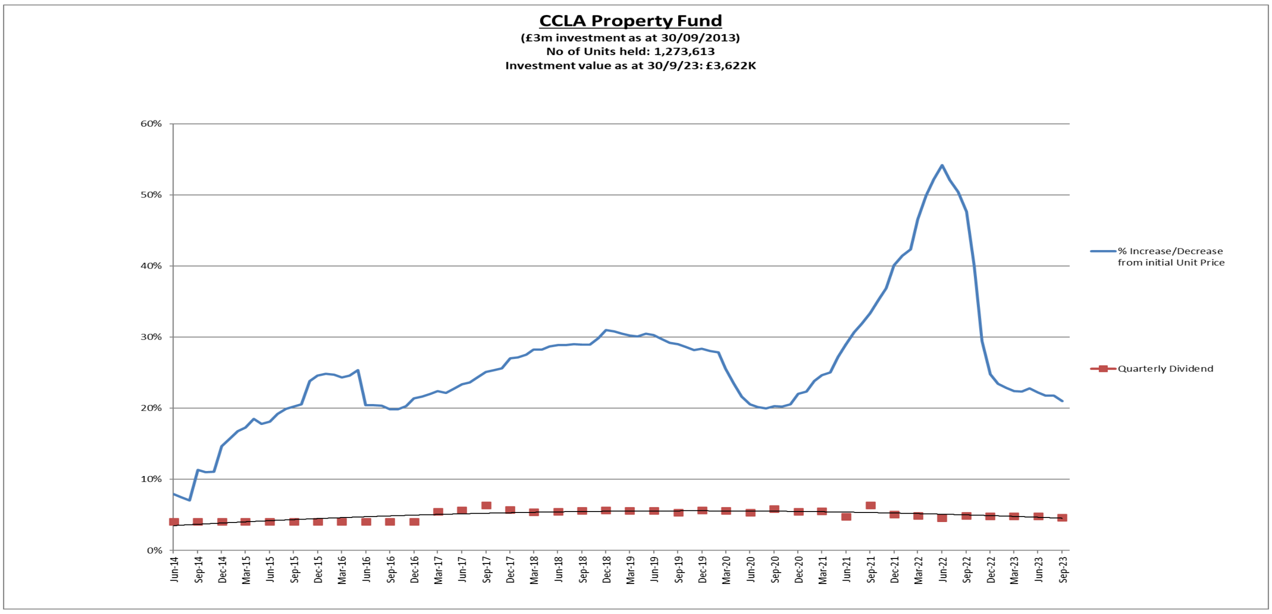
22. The Council currently has £20 million invested in 4 separate pooled investment funds. The current economic climate is proving difficult for many of the funds and although the revenue return is being maintained at expected levels, there are pressures on the capital values. There are different reasons for this, part of which is outlined in confidential appendix 3 and part of it being associated with the underlying levels of assets held by the funds being supressed due to market conditions.
23. Changes to the accounting rules on pooled investment funds means that the principal gain or loss will now be charged to the Surplus or Deficit on the Provision of Services, within the Council's Income and Expenditure Account, rather than being held on the balance sheet. However, following consultation by Ministry for Housing Communities and Local Government (MHCLG), the government has introduced a mandatory statutory override for local authorities to reverse out the effect for five years from 1st April 2018 after which surpluses as well as deficits will impact on the Councils revenue position. Whilst the council currently has a 'surplus' in the principal value of the investments to cushion any adverse effect on the revenue account when the accounting overrides are removed. Given the fluctuations in the property and money markets there is high of risk of some adverse revenue impact when the overrides are removed. The position continues to be closely monitored.

Property Investment Funds

24. At present, the Council has placed investments with two property funds; CCLA Investment Management, which is a property fund that limits its investors to Charities, Churches and Local Authorities and Lothbury Investment Management, a specialist UK property fund manager with a range of funds providing high quality exposure to different property sectors. Property values have recovered from the shock of the Covid Pandemic and are still giving the Council a good return on its investments. Both property funds have reduced their retail holdings which de-risks the capital value they hold.

CCLA Investment Management Limited

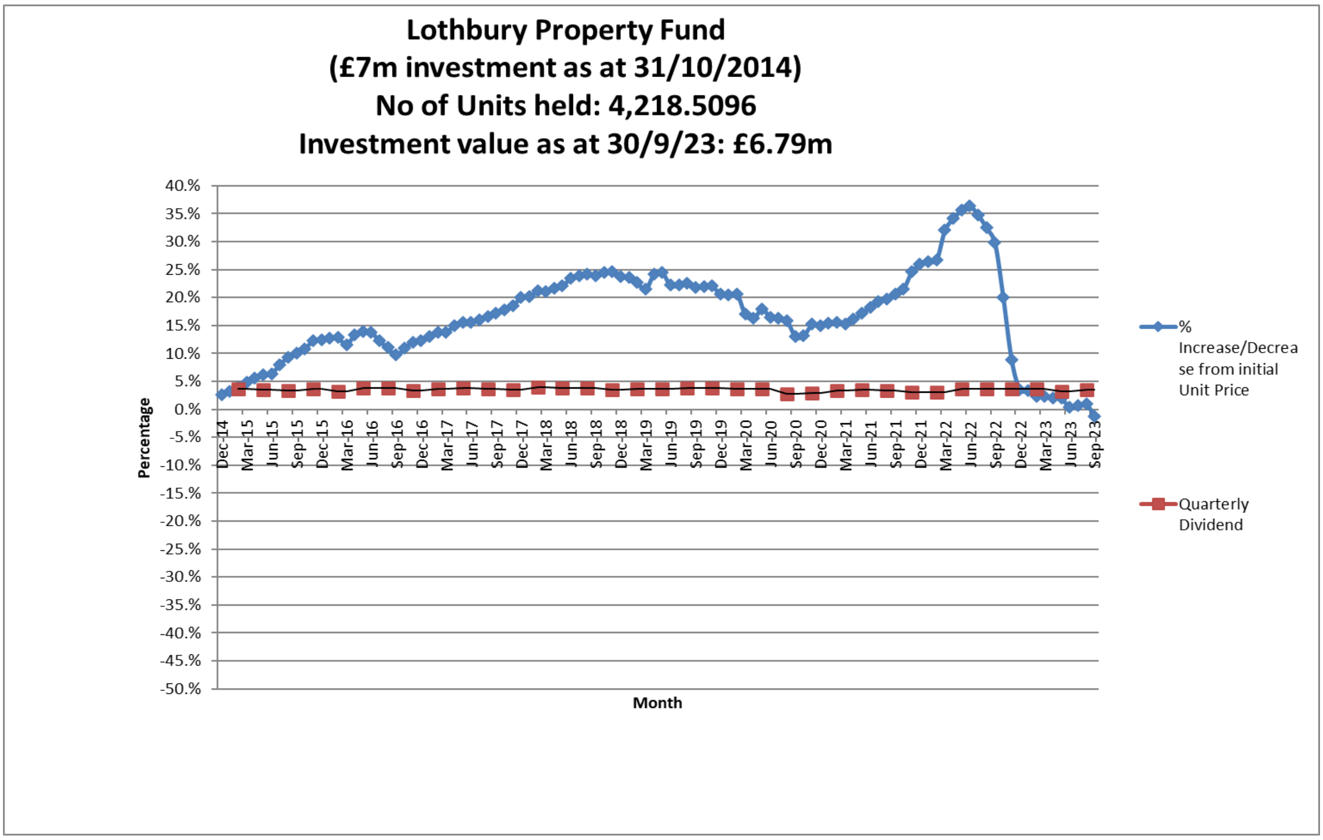
25. The Council has held a £3m investment in the CCLA fund since September 2013. The investment has produced quarterly revenue returns ranging between 5% and 6% and it is expected that the Fund will continue to achieve rates in this region.
26. Additionally, the value of the Council's investment with CCLA has appreciated from £3m to £3.622m as at 30th September 2023, equating to growth of 24.86% to date from inception. However, the values of the individual unit prices have fluctuated over time and the effect of capital appreciation (and depreciation) is illustrated in the graph below. There has been pressure on the overall property value but the dividend is being maintained and prices are always going to fluctuate over time. This is seen as a long term investment.



27. The investment returns around £40k revenue per quarter.

Lothbury Investment Management

28. During 2014/15, the Council invested £7m in the Lothbury Property fund and the Fund has produced quarterly returns in the range of 3-4%. Furthermore, the Fund has seen a capital depreciation over the period with the value currently standing at £6.794m, compared with £7m at inception, equating to overall decline of 4.58% to date. However, as with CCLA, the values of the individual unit prices have fluctuated over time and the effect of capital appreciation (and depreciation) is illustrated in the graph below. Since inception the fund has returned £2.168 million, return of 3.54% on average, outstripping returns from bank funds (which were earning an average of 0.88%) by around £1.628 million. Recent structural changes on the fund together with their impact on the Council is explained in more detail in Appendix 3 and 3A.



29. The investment returns around £60k per quarter.

Multi-Asset Funds

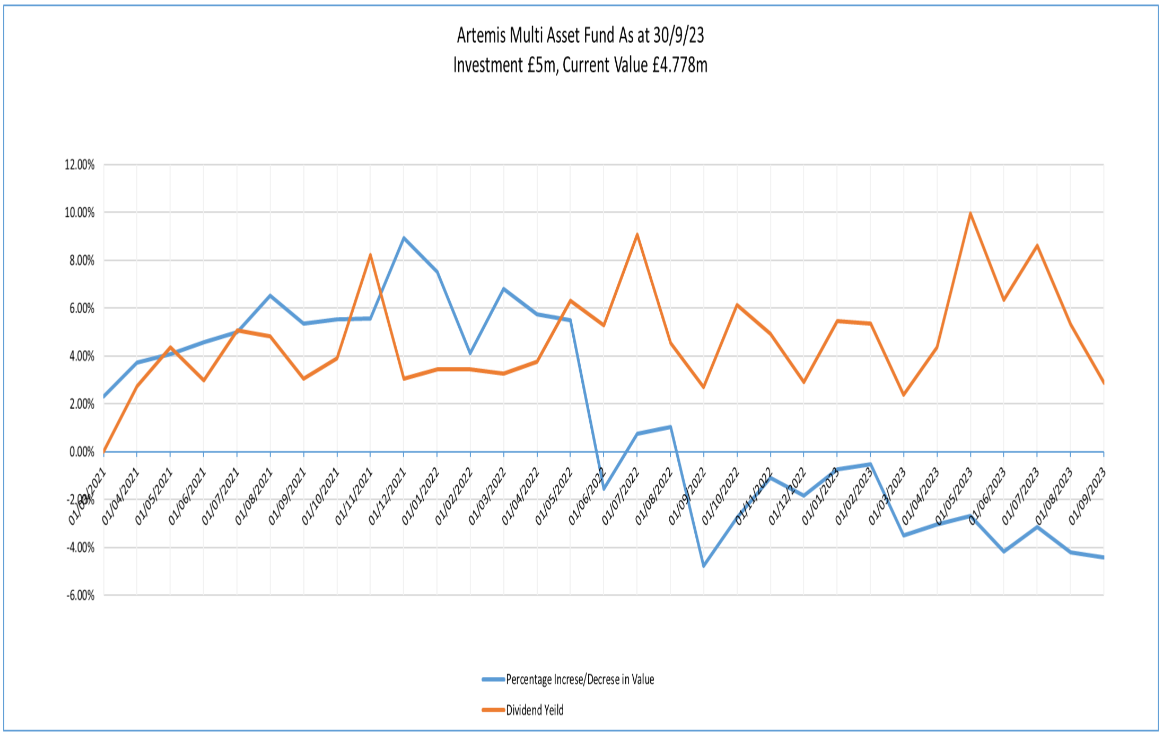
30. The Council has invested in two multi asset funds as set out in the treasury strategy, Multi-asset funds are able to invest across the investment landscape and may include equities, bonds and cash. This provides a greater degree of diversification than investing in a single asset class. The same accounting rules apply to multi-asset funds as apply to property funds.

Artemis Multi Asset Fund

31. £5m is invested into the Artemis multi asset fund. Since inception the capital value has fallen to £4,779m equating in a fall of (4.43)% with an average monthly dividend payment of £21k giving an average percentage return of 4.82%

32. Reasons behind the stock market falls are well-documented, inflation, rising interest rates, an energy crisis made worse by Russia's war in Ukraine.

33. Capital values should improve when interest rates start to fall.

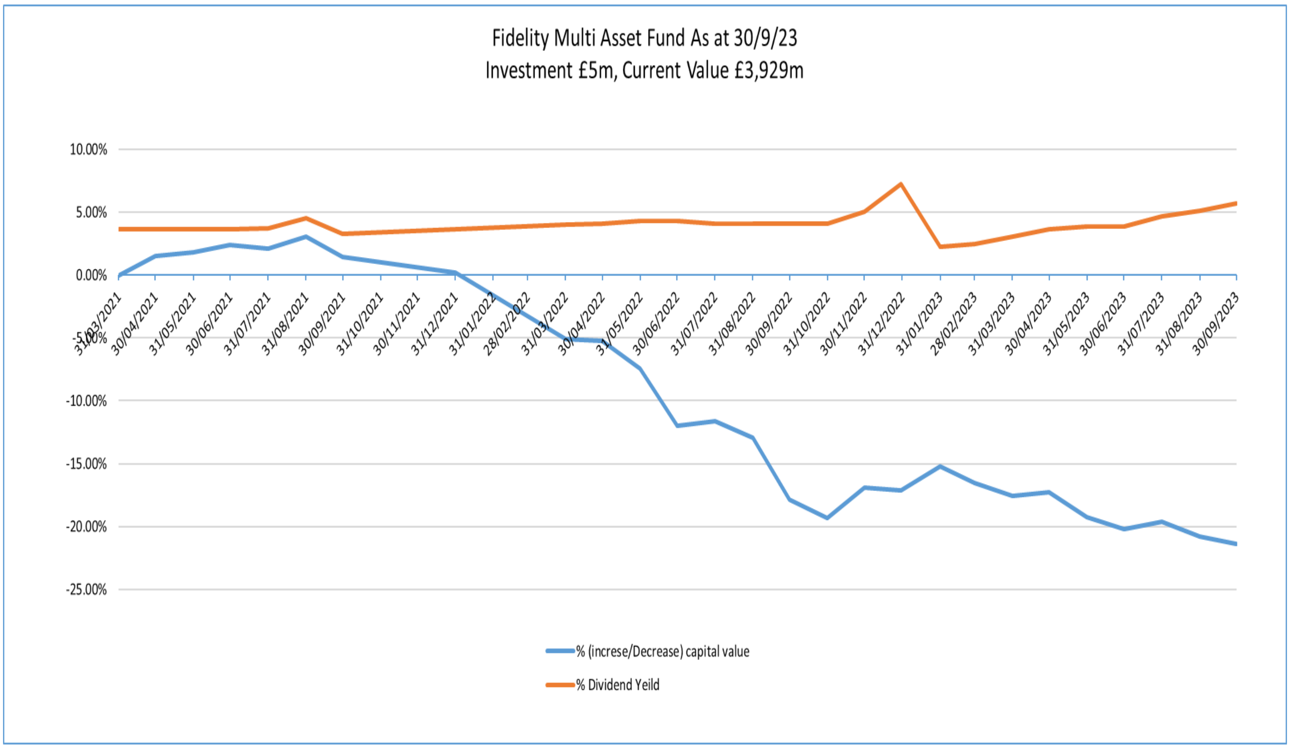


Fidelity Multi Asset Fund

34. In accordance with the 2020/21 budget, in line with the treasury strategy, £5m was invested into the Fidelity multi asset fund. Since inception the capital value has fallen to £3.998m equating in a fall of (21.4) % with an average monthly dividend payment of £16.9k giving an average percentage return of 4.07%.

35. The reasons behind the stock market falls are well-documented: inflation, rising interest rates, an energy crisis made worse by Russia's war in Ukraine.

36. Capital values should improve when interest rates start to fall.



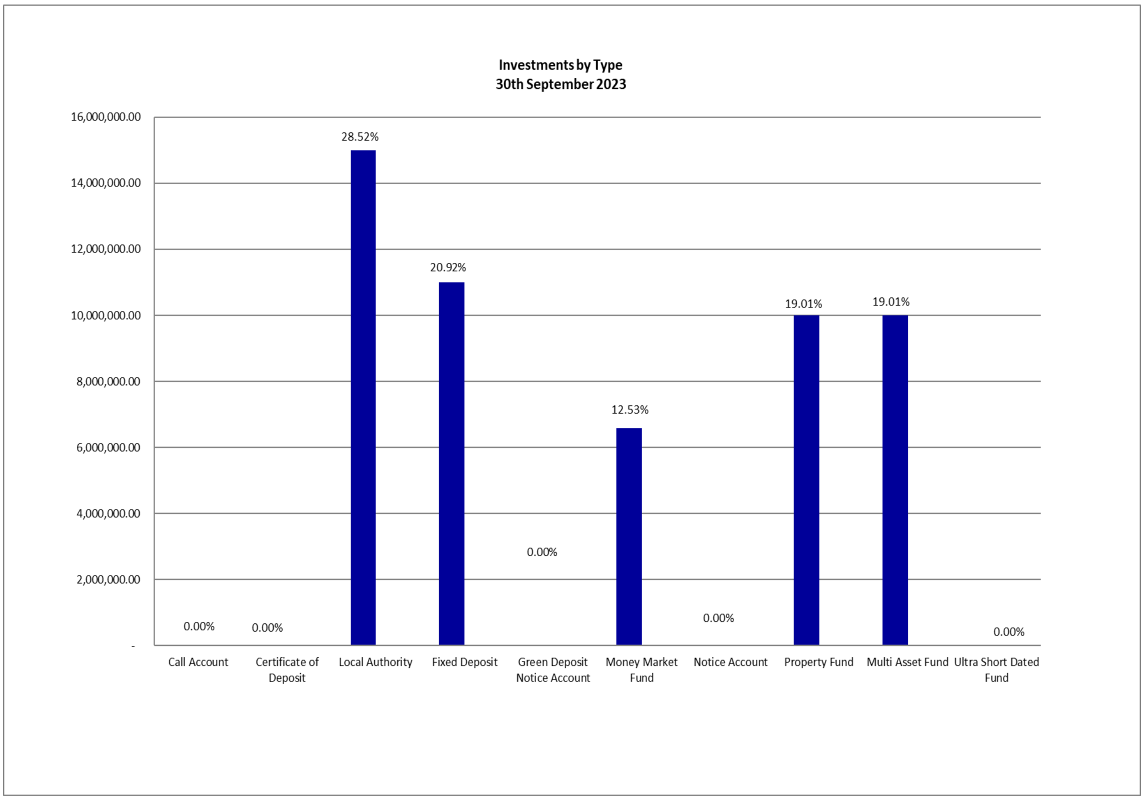
Funds Overall position

37. Although the capital value of the multi asset funds and the property funds has seen a downturn over the past six months. These investments add diversity to the overall investment portfolio. Although the values may fluctuate in the short term the funds are seen as long term investments that provide a good return.

Investment Portfolio

38. As at 30th September 2023, the Council's total investment portfolio amounted to £52.6 million, with £10 million of this being held in property funds, £10 million in Multi asset funds and £6.6 million being held in instant access cash facilities, in order to manage day to day cash flow requirements, with the balance being held in banks and loaned to local authorities. A breakdown of these investments is shown at Appendix 1.

39. The graphs below illustrate how the Council's investment portfolio is distributed, both in terms of the type of investment and counterparty category:



40. Fixed deposits and certificates of deposits both have an agreed start and end date which are arranged where possible, to suit the cash flow requirements. However, as mentioned previously, it is also important to keep a proportion in instant access funds.

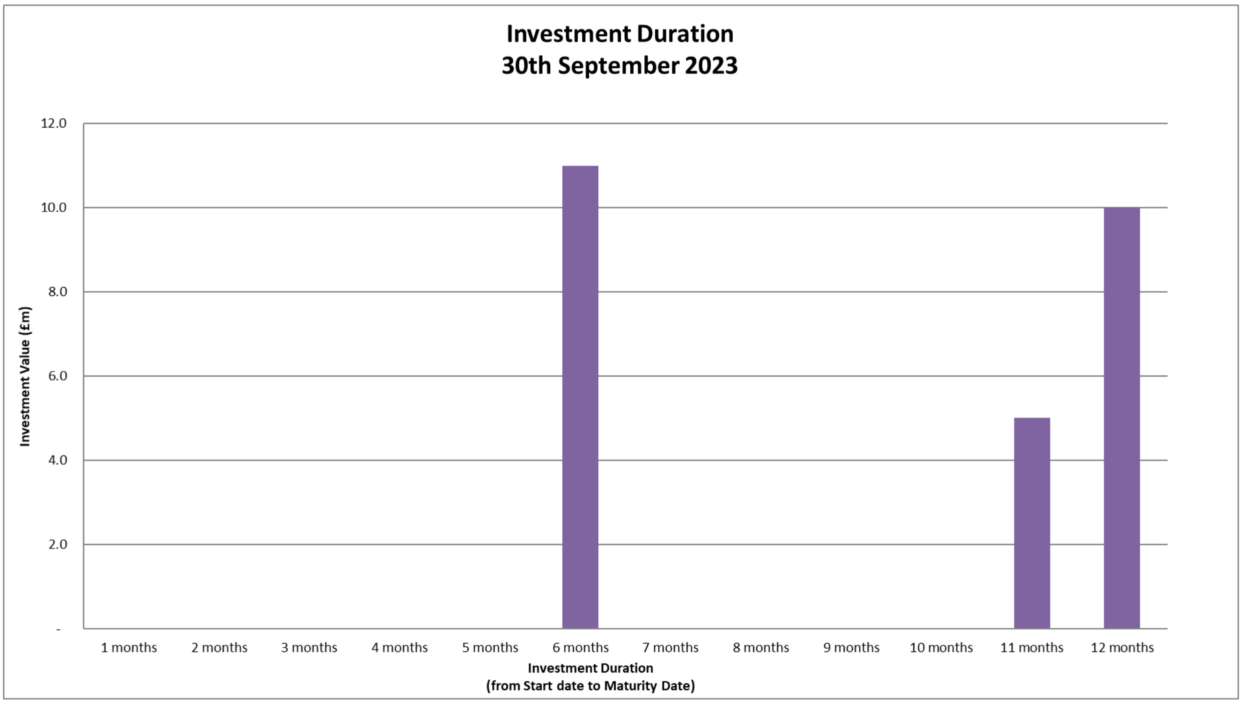
41. The Council's Treasury Management Strategy limits non-specified investments to 25% of the previous year's average investment portfolio or £25m whichever is greater. This limit is reviewed each year when setting the Strategy in order to ensure a balanced and diversified portfolio of investments. Property funds and investments in excess of 364 days are classified as non-specified due to the

associated risk; property funds by nature are high risk due to the volatility of the market. There are several factors that deem longer term investments to be more risky in nature including the risk of interest rate rises and the commitment of cash for longer periods.

42. In addition to the above the Council has £10 million invested in the National Homelessness Property Fund which has property in Milton Keynes, Bristol and Oxford. Resonance developed the Property Fund with leading homelessness charity St Mungo's. It is the largest impact investment fund in the UK and closed at nearly £57m. The Fund design was developed in response to the lack of private rented accommodation accessible to rising numbers of people living in temporary accommodation or otherwise at risk of homelessness in London. There is also £4 million invested in a second National Homelessness Property Fund which widens the area covered by the funds. These are classified as service investments undertaken using service delivery powers rather than treasury powers under Section 12 of the Local Government Act 2003. This means the counterparty limit for the £14 million loaned to the National Homelessness Property Funds is not taken into account when assessing the residual headroom available for investment in non-specified investments.

43. The Strategy defines a specified investment as one that is in sterling, less than one year in duration or, if it is a year or more, can be repaid earlier on request and with counterparties that meet the Council's credit rating criteria. Additionally, once the duration of a non-specified investment falls below 365 days, it also falls into the Specified category. The maturity profile for the Council's specified investments (equating to £58.5m when excluding the instant access cash) is illustrated below.

44. The graph below illustrates the same investments by duration period in order to demonstrate duration periods. It is not surprising that the majority of investments have a duration period of six months as this is the limit for most of the banks and building societies with whom the Council may invest. When the opportunity arises, longer investments are arranged to allow for a greater yield.



Borrowing

45. The Council has not taken on any additional long term debt during the year to date and so the balance of its external borrowing remains at approximately £198.5 million. This figure relates to funds borrowed from the PWLB to buy out the Housing Revenue Account (HRA) from the subsidy system and relates wholly to Housing with interest repayment being met by the HRA. The Council does not consider that debt restructuring and/or premature repayment would be practical at this time as due to the differential in interest rates, the Council would incur a large premium from the PWLB for doing so. The Council continues to monitor borrowing interest rates and forecasts on a regular basis and will continue to review its position on debt restructuring.

46. The Council is currently managing the capital financing requirements through internal cash resources and short term treasury activity. However external borrowing will be necessary in the future to meet its capital expenditure requirements, including loans to the Housing Company, and this is likely to occur later in 2023/24 or early in 2024/25.

Treasury and Prudential Limits for 2023/24

47. The Council has operated all of its Treasury Management activity within the parameters set by the Treasury and Prudential indicators in the Treasury Management Strategy for 2023/24.

Other Key Updates

Changes in Risk Appetite

48. The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy should be brought to members' attention in treasury management update reports. The Council has not made any significant changes to its investment approach at this time. The risk will continue to be managed by understanding the individual investment vehicles and also by considering the appropriate percentage of non-specified investments that can be held in the overall portfolio.

Treasury Advisor

49. Treasury advice and market information is provided by Link Asset Services. A recent procurement process reappointed Link Asset Services as the Council's treasury advisors for the next 3 years with the ability to extend by two further periods of 2 years each. Information provided by Link Asset Services is used to advise council officers when making investment decisions.

Financial Implications

50. Any financial implications are contained within the body of this report.

Legal Issues

51. The Council is required by regulations issued under the Local Government Act 2003 to produce and consider this treasury management monitoring report. This

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

52. There are no risks in connection with the report's recommendations. A risk register covering Treasury Management activity is included at Appendix 2. One key risk going forward is around uncertainty caused by interest rate rises from the Bank of England and the effect this will have on the economy. These rises are being driven by the overall economic position both at the national and the global level. Equally it is uncertain how long interest rates will remain high before coming back down. This gives uncertainty around both investment and borrowing decisions. There are also risks that there will be failings in investment counterparties although this risk is reduced through the use of counterparty lists. 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

53. 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