Joint Audit and Governance Committee

Report of Head of Finance

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AGENDA ITEM

Wards affected: All

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To: Joint Audit and Governance Committee

Dates: 30 January 2024

Treasury management and investment Strategy 2024/25

Recommendations

That Joint Audit and Governance Committee approves each of the following key elements of this report and recommends these to Cabinet.

1. To approve the treasury management strategy 2024/5 set out in Appendix A to this report.

2. To approve the prudential indicators and limits for 2024/5 to 2026/7 as set out in Appendix A.

3. To approve the annual investment strategy 2024/5 set out in Appendix A, and the lending criteria detailed in table 6.

4. To approve the Environmental, Social and Governance (ESG) policy in Appendix E.

Purpose of report

1. This report presents the council's Treasury Management Strategy (TMS) for 2023/24. This sets out how the council's treasury service will support financing of capital investment decisions, and how treasury management operates day to day.

It sets out the limitations on treasury management activity informed by the prudential indicators, within which the council's treasury function must operate.

2. The strategy is included as appendix A to the report. This report includes the three elements required by legislation as follows:

   - The **prudential and Treasury indicators** required by the CIPFA Prudential Code 2021 for Capital Finance in Local Authorities and CIPFA TM code of Practice 2021;

   - The **annual investment strategy**. This sets out the council's criteria for selecting counterparties and limiting exposure to the risk of loss on its investments.

   - A statutory duty to approve a **minimum revenue provision** policy statement, (appendix A, paragraphs 15-20).

   The council's Section 151 officer is required by the CIPFA Code of Practice on Treasury Management 2021 to bring the treasury management strategy to full Council for approval on an annual basis.

Corporate objectives

3. Managing the finances of the authority in accordance with its treasury management strategies will help to ensure that resources are available to deliver services and meet the councils' strategic objectives.

Background

4. Treasury management is defined as: "The management of the local authority's borrowing, investments and cash flows, including its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

5. The primary function of the treasury management service is to manage cashflow and ensure cash is available when needed. Surplus monies are deposited with low-risk counterparties and financial instruments with adequate liquidity to fund expenditure commitments.

6. The funding of the council's capital expenditure is also a function of treasury management. The capital programme provides a guide to the funding needs of the council and informs long-term cash flow plans to ensure that the council can meet its capital spending obligations. All expenditure of a capital nature is managed through the council's capital programme and is not covered by this report.

7. The treasury management and annual investment strategy set out the council's policies for managing investments and confirms the council gives priority to the security and liquidity of those investments. It also includes the prudential indicators for the next three years; these demonstrate that the council's capital investment plans are affordable, prudent and sustainable.

8. The council's treasury management strategy 2024/25 is attached in appendix A. Whilst every attempt has been made to minimise the technical content of this report, it is, by its very nature and the need for compliance with associated guidance, technical in parts. A glossary of terms in appendix G should aid members understanding of some technical terms used in the report.

Recommended changes to the treasury management strategy

9. Council approved the 2023/24 treasury management strategy on 15 February 2023. Whilst there are no changes to the counterparty selection criteria in the proposed strategy for 2024/25 which cabinet is asked to recommend to council, a recommended change to the strategy this year is the inclusion of an Environmental, Social and Governance (ESG) statement. In adopting this statement, the council recognises that ESG issues, including climate change, can have significant future investment implications. The Council therefore seeks to be a responsible investor and consider ESG risks as an important overlay to the investment process, thereby improving future sustainability of investment, noting the council's requirement in treasury management guidance to prioritise security, liquidity and yield in that order. The full statement has been added to Treasury Management Practice 1 (TMP1 - Appendix E), in line with recommended practice.

Financial implications

10. This report and all associated policies and strategies set out clearly the parameters the council must work within. It is important that the council follows the approved treasury management strategy which is designed to help protect the council's finances by managing its risk exposure.

11. Link Treasury Services has provided a counterparty methodology, but given the council's balances, we have expanded on this methodology to include additional building societies to ensure a diversified portfolio.

12. Base rate is currently 5.5 per cent. The Bank of England maintained the rate from 2 November which had remained unchanged since August 2023 following fourteen consecutive rate hikes since December 2021.

13. Link Group's latest base rate forecast anticipates that the next bank base rate change will be a fall to 5.0 per cent I the second quarter of the 2024/25 financial year. Table 1 below gives an estimate of the investment income achievable for the council next five years. As a result of the anticipated downward trajectory of interest rates over the medium term, and the associated reduction in income available to support council activities, officers intend to conduct a review of current and potential longer-term holdings, based on an understanding of the council's cash flow needs over that period.

Table 1: Medium term investment income forecast	2024/25 £000's	2025/26 £000's	2026/27 £000's	2027/28 £000's	2028/29 £000's
Forecast as at December 2023	4,510	2,834	2,480	2,308	2,135

14. The 2024/25 budget setting report and medium-term financial plan will take into account the latest projections of anticipated investment income.

Legal implications

15. There are no significant legal implications as a result of the recommendations in this report. Compliance with the CIPFA Code of Practice for Treasury Management in the Public Services and the DLUHC Local Government Investment Guidance provides assurance that the council's investments are, and will continue to be, within its legal powers.

16. The council must approve any amendment to the treasury management strategy and annual investment strategy in accordance with the Local Government Act 2003 (the Act), the CIPFA Code of Practice for Treasury Management in the Public Services and the DLUHC Local Government Investment Guidance under Section 15(1) (a) Local Government Act 2003 and CIPFA Prudential Code for Capital Finance.

Climate and ecological impact implications

17. There are no climate or ecological implications arising from this report, however the council can make significant impact via future investment opportunities and operational changes. Numerous changes have already been made to ensure that climate is a key consideration in key documents and processes (such as the procurement strategy), and this will become more evident in future decision making. As opportunities to support the climate ambitions of the council arise, they will be considered and appropriately weighted to include any climate or ecological impacts.

18. In order to comply with treasury management professional guidance, the council's investments must prioritise security, liquidity and yield in that order. Environmental, Social and Governance (ESG) factors represent a fourth consideration in the decision-making process and whilst this is something that the council is exploring it is in the context of the need to comply with the priorities outlined in the guidance. The council's ESG policy is shown in Appendix E.

Equalities implications

19. There are no equalities implications in this report.

Risks

20. The council operates within the treasury limits and prudential Indicators set out in its treasury management strategy. Security of capital remains the main objective.

Conclusion

21. This report introduces the treasury management strategy and the annual investment strategy for 2024/25 which are appended to this report, together with the prudential indicators for council approval. These documents provide the parameters within which the council's treasury management function will operate.

Background papers

- Chartered Institute of Public Finance and Accounting (CIPFA) code of practice for treasury management in the public sector.
- DCLG Local Government Investment Guidance
- Chartered Institute of Public Finance and Accounting (CIPFA) Prudential Code 2021

Appendices

Appendix A Treasury Management Strategy 2024/25
Appendix B Economic Background
Appendix C Risk and performance benchmarking
Appendix D Explanation of Prudential and Treasury Indicators
Appendix E TMP1 extract
Appendix F Extension to the responsibilities of the S151 officer
Appendix G Glossary of terms

Appendix A

Treasury Management Strategy 2024/25

Introduction

1. The primary function of the treasury management service is to ensure the council's cash flow is adequately managed, with cash being available when it is needed. Surplus monies are invested in low-risk counterparties or instruments commensurate with the council's low risk appetite, providing adequate liquidity initially before considering investment return. The second main function of the treasury management service is the funding of the council's capital plans.

2. Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day-to-day treasury management activities.

3. CIPFA defines treasury management as:

   "The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

4. Revised reporting was required for the 2019/20 reporting cycle due to revisions of the Department of Levelling Up, Housing and Communities (DLUHC) (formerly the Ministry of Housing, Communities & Local Government (MHCLG)) Investment Guidance, and Minimum Revenue Provision (MRP) Guidance, the Chartered Institute of Public Finance & Accountancy (CIPFA) Prudential Code and the CIPFA Treasury Management Code.
5. The primary reporting changes included the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is reported separately**.**

Treasury Management Reporting

6. The Council is currently required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals.

   a) Prudential and treasury indicators and treasury strategy (this report) - The first, and most important report is forward looking and covers:
      - the capital plans, (including prudential indicators);
      - a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time);
      - the treasury management strategy, (how the investments and borrowings are managed), including treasury indicators; and

- an investment strategy, (the parameters on how investments are to be managed).

b) A mid-year treasury management report – This is primarily a progress report and will update members on the mid-year treasury performance, amending prudential indicators as necessary, and whether any policies require revision.

c) An annual treasury report – This report reviews performance for the previous financial year and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny

7. The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Joint Audit and Governance Committee.

Quarterly reports

8. In addition to the three major reports detailed above, quarterly reporting to end of June and end of December is also required. However, these additional reports do not have to be reported to Full Council but do require to be adequately scrutinised.

Treasury Management Strategy for 2024/25

9. The strategy for 2024/25 covers the areas below:

Capital issues

- the capital expenditure plans and the associated prudential indicators;
- the minimum revenue provision (MRP) policy.

Treasury Management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- the policy on use of external service providers.

10. These elements cover the requirements of the Local Government Act 2003, (the Act) the CIPFA Prudential Code, DLUHC MRP Guidance, the CIPFA Treasury Management Code and DLUHC Investment Guidance.

Councillor and Officer Training

11. The CIPFA Code requires the Head of Finance to ensure that members with responsibility for treasury management receive adequate training in treasury

management. This especially applies to members responsible for scrutiny. The councils' Treasury Management advisors will provide training for the 2024/25 strategy. The training needs of treasury management officers and councillors will be reviewed, and further training will be arranged as required.

Treasury Management Consultants

12. The Council uses Link Group, Link Treasury Services Limited, as its external treasury management advisors.

13. The Council recognises that responsibility for treasury management decisions always remains with the organisation and will ensure that undue reliance is not placed upon the services of external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, treasury advisory services.

14. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills, knowledge and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented and subjected to regular review.

Capital Prudential Indicators

15. The Council's capital expenditure plans (as detailed in the council's capital programme) are a key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans are prudent, affordable and sustainable.

Minimum Revenue Provision (MRP) Policy Statement 2024/25

16. The council's current 2024/25 capital programme will primarily be financed from internal resources and external funding. If borrowing is undertaken, then the council will be required by statute to set aside funds in the annual revenue budget to amortise the principal element of any borrowing – this is the MRP. There will also be a requirement to set aside revenue budget for the interest payments on any borrowing raised. Loans will generally be taken over the life of the assets being financed and amortised accordingly.

17. The council is required by regulation to approve an annual MRP policy before the start of the year to which it relates. Any in-year changes must also be submitted to the council for approval.

18. A variety of options are provided to councils for the calculation of MRP. The council has chosen the "asset life method" as being most appropriate. Using this method MRP will be based on the estimated life of the asset, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction). Repayments included in annual PFI or finance leases are applied as MRP.

19. Currently, the council's MRP liability is nil. This will remain the case unless capital expenditure is financed by external or internal borrowing. The Head of Finance will determine the most appropriate repayment method, term of borrowing and duration of borrowing. The Capital Financing Requirement (CFR) estimate for the council is £12 million from 2026/27 onwards.

Table 2: Example MRP and interest calculation		
Loan Amount	£12,000,000	
Loan Duration	50 Years	
PWLB Interest	4.725%	
2023/24 Tax Base	58,104	
	£	£ per Band D
MRP Element	£240,000	4.13
Annual Interest Cost	£567,000	9.76
Total	**£807,000**	**13.89**

Prospects for Interest Rates

20. The council has appointed Link Group as its treasury advisor and part of their service is to assist the council to formulate a view on interest rates. Link provided the following forecasts in November 2023. These are forecasts for Bank Rate, average earnings and PWLB certainty rates, gilt yields plus 80 bps.

Table 2: Interest Rate Forecasts

Link Group Interest Rate View 07.11.23	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	3.25	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.30	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.40	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.50	3.30	3.30	3.30	3.30	3.30
5 yr PWLB	5.00	4.90	4.80	4.70	4.40	4.20	4.00	3.80	3.70	3.60	3.50	3.50	3.50
10 yr PWLB	5.10	5.00	4.80	4.70	4.40	4.20	4.00	3.80	3.70	3.70	3.60	3.60	3.50
25 yr PWLB	5.50	5.30	5.10	4.90	4.70	4.50	4.30	4.20	4.10	4.10	4.00	4.00	4.00
50 yr PWLB	5.30	5.10	4.90	4.70	4.50	4.30	4.10	4.00	3.90	3.90	3.80	3.80	3.80

Economic Background – Provided by Link

"Our central forecast for interest rates was previously updated on 25 September and reflected a view that the MPC would be keen to further demonstrate its anti-inflation credentials by keeping Bank Rate at 5.25% until at least Q2 2024. We expect rate cuts to start when both the CPI inflation and wage/employment data are supportive of such a move, and that there is a likelihood of the overall economy enduring at least a mild recession over the coming months, although most recent GDP releases have surprised with their on-going robustness.

Naturally, timing on this matter will remain one of fine judgement; cut too soon and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

In the upcoming months, our forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but also international factors such as policy development in the US and Europe, the provision of fresh support packages to support the faltering recovery in China as well as the on-going conflict between Russia and Ukraine, and Gaza and Israel.

On the positive side, consumers are still anticipated to be sitting on some excess savings left over from the pandemic, which could cushion some of the impact of the above challenges and may be the reason why the economy is performing somewhat better at this stage of the economic cycle than may have been expected. However, as noted previously, most of those excess savings are held by more affluent households whereas lower income families already spend nearly all their income on essentials such as food, energy and rent/mortgage payments.

PWLB RATES

- Gilt yield curve movements have broadened of late. The short part of the curve has not moved far but the longer-end continues to reflect inflation concerns. At the time of writing there is a 60 basis point difference between the 5 and 50 year parts of the curve.

The balance of risks to the UK economy: -

- The overall balance of risks to economic growth in the UK is to the downside.

Downside risks to current forecasts for UK gilt yields and PWLB rates include:

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, rising gilt yields).

- **The Bank of England** has increased Bank Rate too fast and too far over recent months, and subsequently brings about a deeper and longer UK recession than we currently anticipate.

- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.

- **Geopolitical risks,** for example in Ukraine/Russia, the Middle East, China/Taiwan/US, Iran and North Korea, which could lead to increasing safe-haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates: -

- Despite the recent tightening to 5.25%, the **Bank of England proves too timid** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly and for a longer period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project.

- **The pound weakens** because of a lack of confidence in the UK Government's pre-election fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.

- Longer term **US treasury yields** rise strongly if inflation remains more stubborn there than the market currently anticipates, consequently pulling gilt yields up higher. (We saw some movement of this type through October although generally reversed in the last week or so.).

- Projected **gilt issuance, inclusive of natural maturities and QT,** could be too much for the markets to comfortably digest without higher yields compensating.

LINK GROUP FORECASTS

We now expect the MPC will keep Bank Rate at 5.25% for the remainder of 2023 and the first half of 2024 to combat on-going inflationary and wage pressures. We do not think that the MPC will increase Bank Rate above 5.25%, but it is possible.

Gilt yields and PWLB rates

The overall longer-run trend is for gilt yields and PWLB rates to fall back over the timeline of our forecasts, as inflation starts to fall through the remainder of 2023 and into 2024."

Treasury Limits for 2023/24 to 2026/27

21. It is a statutory duty, under Section 3 of the Act and supporting regulations for the council to determine and keep under review how much it can afford to borrow. The amount so determined is called the "Affordable Borrowing Limit". The Authorised Limit is the legislative limit specified in the Act.

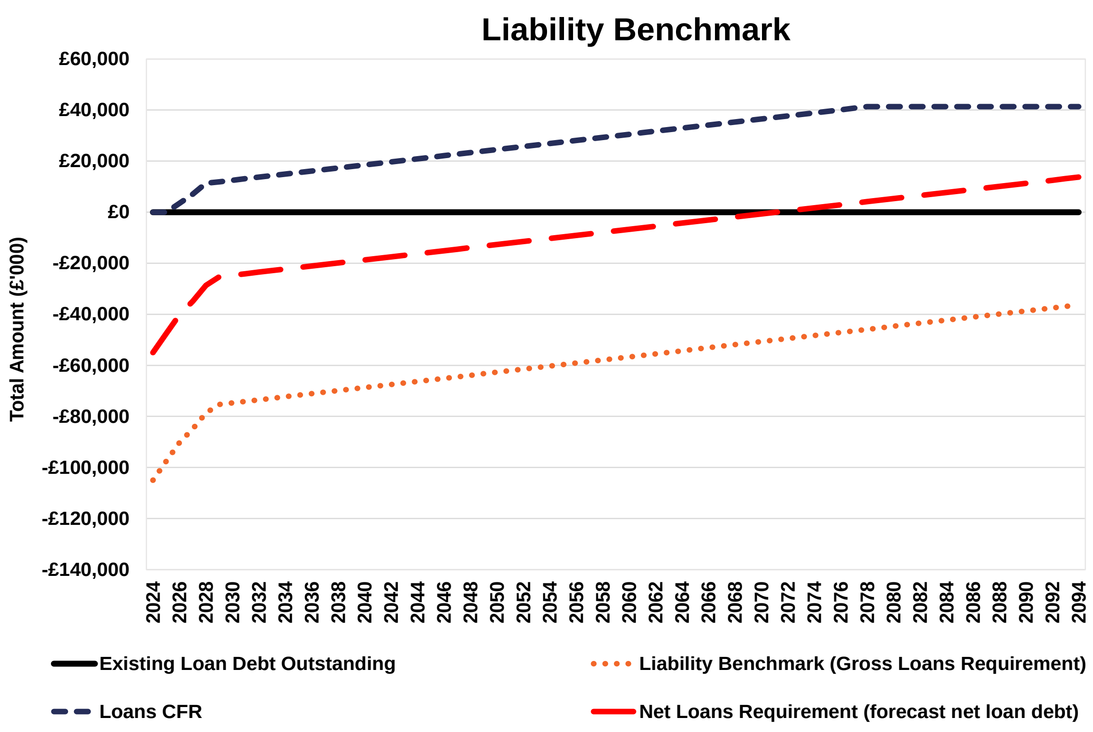
22. The council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital expenditure remains within sustainable limits and that the impact upon its future council tax is 'acceptable'. The Authorised Limit is set on a rolling basis, for the forthcoming financial year and two successive financial years.

24 The following indicators set the parameters within which we manage the overall capital investment and treasury management functions. There are specific treasury activity limits, which aim to contain the activity of the treasury function in order to manage risk and reduce the impact of an adverse movement in interest rates. However, if these are set to be too restrictive, they will impair the opportunities to reduce costs/improve performance.

25 The limits are set out in table 3 below. **Cabinet is asked to recommend council to approve the limits:**

Table 3: Prudential indicators	**2023/24 Approved £m**	**2024/25 Estimate £m**	**2025/26 Estimate £m**	**2026/27 Estimate £m**
Debt				
Authorised limit for external debt				
Borrowing	30	30	30	30
Other long-term liabilities	5	10	10	10
	35	**40**	**40**	**40**
Operational boundary for external debt				
Borrowing	25	25	25	25
Other long-term liabilities	5	10	10	10
	30	**35**	**35**	**35**
Interest rate exposures				
Maximum fixed rate borrowing	100%	100%	100%	100%
Maximum variable rate borrowing	100%	100%	100%	100%
Investments				
Interest rate exposures				
Limits on fixed interest rates	100%	100%	100%	100%
Limits on variable interest rates	100	100	100	100
Principal sums invested > 364 days				
Upper limit for principal sums invested >364 days	50	50	50	50

Liability Benchmark



Current position

26 The maturity structure of the council's investments at 31 December 2023 was as follows:

Table 4: maturity structure of investments:	Total £000's	% Holding
Call and notice accounts	0	0%
Money Market Funds	11,800	7%
Less than 6 months	84,000	52%
6 months to 1 year	46,500	29%
1 year +	18,000	11%
CCLA - Property Fund	2,000	1%
Total Investments	**162,300**	**100%**

Note: £162 million does not represent uncommitted resource the council has at its disposal. This amount includes council tax receipts held prior to forwarding to Oxfordshire County Council and the Police and Crime Commissioner for the Thames Valley, business rate receipts prior to payment to the government and committed capital and revenue balances. Details of the council's uncommitted balances are provided in the annual budget and council tax setting report.

27 At 31 December 2023, the council held as above, 99 per cent of its treasury management investments in the form of cash deposits, 92 per cent was invested with fixed terms and 7 per cent in liquid accounts with variable returns. 1 per cent of the portfolio was held in a non-cash externally managed fund.

28 The council's primary investment considerations will remain security, liquidity, and yield – in that order. Officers undertaking Treasury Management will work towards the optimum profile distribution.

Investment performance for the year to 30 September 2023.

29 The council's budgeted investment return for 2023/24 is £3.3 million, and the actual interest received for the first half of the year is shown as follows:

Table 5: Investment interest earned by investment type		Interest Earned		
Investment type	Annual Budget £000's	Actual to date £000's	Annual Forecast £000's	Forecast Variation £000's
Fixed term and call cash	3264	2515	5307	2043
CCLA	65	63	123	58
Total interest	**3329**	**2578**	**5430**	**2101**

Borrowing Strategy 2024/25

30 The annual treasury management strategy has to set out details of the council's borrowing requirement, any maturing debt which will need to be re-financed, and the effect this will have on the treasury position over the next three years. This council currently has no external debt and in general, the council will borrow for one of two purposes;

- to support cash flow in the short-term;
- to fund capital investment over the medium to long term.

31 Any borrowing undertaken will be within the scope of the boundaries given in the prudential indicators shown in Table 2, which allow for the council to borrow up to a maximum of £30 million, if such a need arose. This also allows short-term borrowing for the cash flow management activities of the authority.

32 The council's current 2024/25 capital programme will primarily be financed from internal resources and external funding. If borrowing is undertaken, then the council will be required by statute to set aside funds in the annual revenue budget to amortise the principal element of any borrowing – this is the MRP. There will also be a requirement to set aside revenue budget for the interest payments on any borrowing raised. Loans will generally be taken over the life of the assets being financed and amortised accordingly.

33 Currently the PWLB Certainty rate is set at gilts + 80 basis points. However, consideration may still need to be given to sourcing funding from other sources for the following reasons:

- Local authorities (primarily shorter dated maturities out to 3 years or so – are generally still cheaper than the Certainty Rate)
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a "cost of carry").

34 Link Group will advise the council on the relative merits of alternative funding sources. These may include but are not limited to, PWLB, UK Municipal Bond Agency, Local Authorities, Banks, Pension Funds, Insurance Companies, UK Infrastructure Bank, Market loans, Overdrafts, Internal Borrowing, Finance Leases

35 Any borrowing for capital financing purposes will be assessed by the Head of Finance to be prudent, sustainable and affordable.

36 This strategy allows the Head of Finance to determine the most suitable source and repayment terms of any borrowing to demonstrate affordability and sustainability in the medium-term financial plan if required. As a general rule, the term of any borrowing will not be longer than the expected life of the capital asset being created.

Policy on borrowing in advance of need

37 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

38 Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

Annual investment strategy 2024/25

39 The Department of Levelling Up, Housing and Communities (DLUHC – this was formerly the Ministry of Housing, Communities and Local Government (MHCLG)) and CIPFA have extended their definition of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, (a separate report).

40 The Council's investment policy has regard to the following: -

- DLUHC's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2021 ("the Code")
- CIPFA Treasury Management Guidance Notes 2021

41 The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return). The council will aim to achieve, the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with regard to the council's risk appetite.

42 In the current economic climate, it is considered appropriate to maintain a degree of liquidity to cover cash flow needs but to also consider "laddering" investments for periods up to twelve months with high credit rated financial institutions, whilst investment rates remain elevated.

43 The above guidance from DLUHC and CIPFA places a high priority on the management of risk. This council has adopted a prudent approach to managing risk and defines its risk appetite by the following means:-

1. Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short-term and long-term ratings.

2. Other Information: ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the council will engage with its advisors to

maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

3. Other information sources used will include the financial press, share price and other such information pertaining to the financial sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4. Deposits will only be placed with counterparties from countries that meet the minimum sovereign rating criteria.

5. The council will set a limit for its investments which are invested for more than 365 days.

44 The council's Head of Finance will ensure a counterparty list (a list of named institutions) is maintained in compliance with the recommended credit rating criteria (table 6) and will revise the criteria and submit any changes to the credit rating criteria to council for approval as necessary.

Investment types

45 The types of investment that the council can use are summarised below. These are split under the headings of 'specified' and 'non-specified' in accordance with the statutory guidance.

Specified investment instruments

46 These are high credit quality, sterling investments of not more than one-year maturity, or those where the council has the right to be repaid within 12 months if it wishes. These would include sterling investments with:

- UK government Debt Management Agency Deposit Facility (DMADF)
- UK government – treasury bills and Gilts with less than one year to maturity
- Deposits with UK local authorities
- Pooled investment vehicles (AAA rated)
- Deposits with banks and building societies (minimum F1/A- rated)

Non-specified investment instruments

47 These are any other type of investment (i.e. investments not defined as specified, above). Examples of non-specified investments include any sterling investments with:

- Supranational bonds of 1 to 10 years to maturity
- UK treasury stock (Gilts) with a maturity of 1 to 10 years
- Unrated building societies (minimum asset value £1 billion)
- Bank and building society cash deposits up to 5 years (minimum F1/A- rated)
- Deposits with UK local authorities up to 5 years to maturity
- Corporate bonds, Sovereign bonds, and covered bonds
- Pooled property, pooled bond funds and UK pooled equity funds

- Diversified Income Funds
- Multi-Asset Funds
- Ultra-Dated/Short dated bond Funds
- Non-UCITS Retail Schemes (NURS)

Approach to investing

48 The council holds core cash balances which are available to invest for more than one year. This is expected to reduce over the medium term as the approved capital expenditure is incurred and to fund the revenue budget shortfall.

49 In addition, the council has funds that are available to deposit on a temporary basis. These sums are held pending payment over to another body, for example precept payments and council tax. As the balances fluctuate on a daily basis, instant access and notice accounts, money market funds and short-dated deposits are normally utilised for these funds, to ensure funds are available to meet cash flow commitments.

50 Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates. Greater returns are usually obtainable by investing for longer periods. While most cash balances are required to manage cash flow, where funds can be invested for longer periods, options will be carefully assessed.

51 If it is anticipated that Bank Rate is likely to rise significantly consideration will be given to keeping new deposits short term or variable. Conversely, if it is thought that Bank Rate is likely to fall within an investment time horizon, consideration will be given to locking in higher rates currently obtainable, for longer periods.

52 Officers will continue to provide tight controls on the investments placed. Where possible, opportunities to spread the investment risk over different types of instruments will be considered.

53 Should market conditions deteriorate suddenly to the extent that the council is unable to place money with institutions with the necessary credit rating, it may make use of the UK Government deposit account (DMADF).

54 The council has the authority to lend to other local authorities at market rates. Whilst investments with other local authorities are considered to be supported by central government, officers will consider the financial viability and sustainability of the individual local authority.

Counterparty selection

55 Treasury management risk is the risk of loss of capital to the council. To minimise this risk, the council uses credit rating information when considering who to lend to. Link Group provide the council with credit rating updates from all three ratings agencies – Standard & Poors, Fitch and Moodys.

56 The council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies in evaluating investment opportunity. This is because adopting this approach could leave the council with too few

counterparties for the strategy to be workable. Instead, whilst the council will have regard to the ratings provided by all three rating agencies, Fitch ratings will be used as the basis for setting minimum credit criteria and deriving counterparty investment limits.

57 Where counterparties fail to meet the minimum required criteria (Table 6 below) they will be omitted from the counterparty list. Any rating changes and rating watches (notification of a rating change under consideration) are provided to officers almost immediately after they occur, and this information is considered before any deal is entered into. Market movements may result in a downgrade of an institution or removal from the council's lending list.

58 Additional requirements under the CIPFA Treasury Management Code require the council to supplement the credit rating data with operational market information such as credit default swaps (CDS), negative watches and outlooks, which are considered when assessing the security of counterparties. This additional information is used so that the council does not rely solely on current credit ratings of counterparties.

59 Where it is felt the council would benefit from utilising government guarantees provided by countries with an AAA rating, the council may lend to institutions covered by such guarantees. Any decision to lend in this way will be subject to consultation with the agreement of the cabinet member responsible for finance.

Country and sector considerations

60 The council has determined that it will only use approved counterparties outside the UK from countries with a minimum sovereign credit rating of AA- from Fitch Ratings. This is in line with the current Fitch Sovereign rating for the UK. This is to enable deposits to be placed with foreign financial institutions with higher, or equivalent credit ratings to UK banks on the approved counterparty list.

61 The three major credit rating agencies have placed the UK Sovereign rating on Stable or Negative Outlook, it is possible that the UK Sovereign rating could be downgraded during the period covered by this strategy. When setting minimum Sovereign debt ratings, the council will not set a minimum rating for the UK.

Counterparty limits

62 In the normal course of the council's cash flow operations, it is expected that both specified and non-specified investments will be used for the control of liquidity. Guidance states that specified investments are those requiring "minimal procedural formalities". The placing of cash on deposit with banks and building societies 'awarded high credit ratings by a credit rating agency', the use of Money Market Funds (MMFs) and investments with the UK Government and local authorities qualify as falling under this category and form a normal part of day to day treasury management activity.

63 All specified investments will be sterling denominated, with maturities up to a maximum of 1 year, meeting the 'high' credit rating criteria where applicable.

64 Non-specified investments which would be specified investments apart from originally being for a period longer than 12 months, will be classified as being specified once the remaining period to maturity falls to under 12 months.

65 Non-specified investment products are those which take on greater risk. They are subject to greater scrutiny and include all longer-term instruments (greater than one year from inception to repayment). The council will lend to institutions that meet the criteria outlined in table 6 below:

66 If the council's banking services contract is held with a bank that fails to meet the minimum credit criteria for banks in the specified or non-specified investment categories, the house bank limit will apply. In this instance balances will be minimised as far as possible. Standard bank limits will apply where the house bank meets the minimum credit rating criteria.

67 The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The council may use such building societies but will restrict their use to within the non-specified investments category limit for non-rated building societies. Where a building society has a credit rating, the minimum credit rating criteria for rated financial institutions will apply.

68 The counterparty limits apply at the time investments are arranged. Where the council has deposits on instant access, this limit may temporarily be exceeded by the accrual and application of interest or dividends into accounts such as call accounts, money market funds, or notice accounts. Where the application of interest causes the balance with a counterparty to exceed the agreed limits, the balance will be reduced when appropriate, dependent upon the terms and conditions of the account and the cashflow position.

69 The counterparty limits apply to the net cash value of units purchased and sold at the time of investment, or disinvestment, in pooled and managed funds. The limits will not apply to the value of accumulated or reinvested investment returns.

Table 6: Counterparty Limits	Minimum Fitch Short term Rating (or	Minimum Fitch Long term Rating (or	Individual Counterparty Limit	Maximum maturity period	Maximum % of total investment
Specified Instruments					
Term Deposits - UK Government		N/A		1 year	100%
UK Debt Management Agency Deposit Facility					
UK Government Treasury Bills					
UK Government Gilts					
Term Deposits - Other UK Local Authorities	N/A	N/A	£20m		
Term Deposits - Banks and Building Societies	F1	A-	£15m		
Covered Bonds	N/A	A-	£5m		
Money Market Funds (CNAV)	Fund Rating AAA		£30m	Liquid	
Ultra Short Dated Bond Funds			£20m	Liquid	
Non-Specified Instruments					
Term Deposits 1yr + - UK Government	N/A	N/A	N/A	5 years	100%
Term Deposits 1yr + - Other UK Local Authorities	N/A	N/A	£20m	5 years	100%
Banks - part nationalised UK	N/A	N/A	£15m	3 years	100%
Institutions with a minimum rating:	F1+	AA-	£15m	5 years	80%
Institutions with a minimum rating:	F1	A-	£10m	2 years	80%
Institutions with a minimum rating:	F2	BBB	£5m	1 year	70%
Building Societies	F2	BBB+	£7m	1 year	70%
Building societies assets >£2bn	N/A	N/A	£6m	1 year	50%
Banks - house bank	N/A	N/A	£5m	3 months	20%
Managed Funds					
Money Market funds (LVNAV & VNAV)	Fund Rating AAA		£30m	Liquid	70%
Bond Funds	Use of these instruments can be deemed capital expenditure. The council will seek guidance on the status of any fund it may consider using. Appropriate due diligence will also be undertaken before investment of this type is undertaken.		£15m	Variable	70%
Pooled property funds			£10m	Variable	15%
Non-UCITS Retail Scheme (NURS)			£3m	Variable	50%
Diversified Income Funds			£3m	Variable	10%
Multi - Asset Funds			£3m	Variable	10%
Equity Funds			£3m	Variable	10%
Tradable Instruments					
UK Government Gilts with maturities over 1yr		UK sovereign	No limit	25 years	20%
Supranationals		AAA	£10m	10 years	50%
Corporate Bonds		AA-	£5m	5 years	40%
Covered Bonds maturities over 1yr		AA-	£5m	5 years	40%
Bonds issued by Multilateral Development banks		AA-	£5m	5 years	40%
Sovereign Bond Issues		AA-	£5m	5 years	40%

70 The criteria for choosing counterparties provides a sound approach to investment. Whilst councillors are asked to approve the criteria in table 6, the Head of Finance may temporarily amend the operational criteria to further restrict investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval/or reduce maximum maturity limits.

71 Delegation 2.7 of the council constitutions allows the Head of Finance, in consultation with the cabinet member for finance, to raise counterparty limits by £3,000,000 within a financial year.

Fund managers

72 The council does not currently employ any discretionary external fund managers. However, in the event of such an appointment, appointees will comply with this and subsequent treasury strategies. This strategy empowers the Section 151 officer to appoint such an external manager to manage a proportion of the council's investment portfolio if this is advantageous.

Risk and Performance Benchmarks

73 A requirement of the Code is that security and liquidity benchmarks are considered and approved. This is in addition to yield benchmarks which are used to assess performance. The benchmarks are guidelines (not limits) so may be breached depending on the movement in interest rates and counterparty criteria. Their purpose is to allow officers to monitor the current trend position and amend the operational strategy depending on any changes. Any breach of the benchmarks will be reported, with an explanation in the mid-year or annual report to audit and governance committee. Detailed information for the assessment of risk is shown in appendix C.

74 Performance indicators are set to assess the adequacy of the treasury function over the year. These are distinct historic performance indicators, as opposed to the predominantly forward-looking prudential indicators. The indicators used to assess the performance of the treasury function are:

- Cash investments – 3-month compounded SONIA rate.
- Property related investments – IPD Balance Property Unit Trust Index.

75 The results of these indicators will be reported in both the annual mid-year and year-end treasury reports.

Policy on the use of treasury management advisors

76 The council has a joint contract with South Oxfordshire District Council for treasury management advice, which is currently supplied by Link Asset Services. A range of services are provided and include:

- technical support on treasury matters, capital finance issues, statutory reports;
- economic forecasts and interest rate analysis;
- credit ratings / market information service involving the three-main credit rating agencies;
- strategic advice including a review of the investment and borrowing strategies and policy documents;
- treasury management training.

77 The council recognises that responsibility for treasury management decisions always remains with the organisation and will ensure that undue reliance is not placed upon external service providers. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills, resources and up to date market information.

Treasury management scheme of delegation and the role of the Section 151 officer

78 **Council**

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

79 **Joint Audit and Governance Committee/ Cabinet**

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- Ensuring effective scrutiny of the treasury management function

80 **Section 151 Officer/Head of Finance**

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- preparing and submitting regular treasury management reports including an annual strategy for approval by Council;
- submitting budgets and budget variations;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- Approving the selection of external service providers and agreeing terms of appointment.

81 The above list of specific responsibilities of the S151 officer in the 2021 Treasury Management Code has not changed. However, implicit in the changes in both codes, is a major extension of the functions of this role, especially in respect of non-financial investments, (which CIPFA has defined as being part of treasury management), (See Appendix G).

Summary

82 Prior to the beginning of each financial year the council must approve the treasury management strategy. The strategy sets the parameters within which officers can manage the council's cash flows and invest any surplus fund.

83 This strategy provides a commentary on the current financial climate and sets out the council's lending strategy in response to this.

Appendix B

ECONOMIC BACKGROUND – <u>Provided by Link Group</u>

“ The first half of 2023/24 saw:

- Interest rates rise by a further 100bps, taking Bank Rate from 4.25% to 5.25% and, possibly, the peak in the tightening cycle.
- Short, medium and long-dated gilts remain elevated as inflation continually surprised to the upside.
- CPI inflation falling from 8.7% in April to 6.7% in September, its lowest rate since February 2022, but still the highest in the G7.
- Core CPI inflation declining to 6.1% in September from 7.1% in April and May, a then 31 years high.
- A cooling in labour market conditions, but no evidence yet that it has led to an easing in wage growth (as the 3myy growth of average earnings rose by 7.8% for the period June to August, excluding bonuses).
-

The registering of 0% GDP for Q3 suggests that underlying growth has lost momentum since earlier in the year. Some of the weakness in July was due to there being almost twice as many working days lost to strikes in July (281,000) than in June (160,000). But with output falling in 10 out of the 17 sectors, there is an air of underlying weakness.

The fall in the composite Purchasing Managers Index from 48.6 in August to 46.7 in September left it at its lowest level since COVID-19 lockdowns reduced activity in January 2021. At face value, it is consistent with the 0% q/q rise in real GDP in the period July to September, being followed by a contraction in the next couple of quarters.

The 0.4% m/m rebound in retail sales volumes in August is not as good as it looks as it partly reflected a pickup in sales after the unusually wet weather in July. Sales volumes in August were 0.2% below their level in May, suggesting much of the resilience in retail activity in the first half of the year has faded.

As the growing drag from higher interest rates intensifies over the next six months, we think the economy will continue to lose momentum and soon fall into a mild recession. Strong labour demand, fast wage growth and government handouts have all supported household incomes over the past year. And with CPI inflation past its peak and expected to decline further, the economy has got through the cost-of-living crisis without recession. But even though the worst of the falls in real household disposable incomes are behind us, the phasing out of financial support packages provided by the government during the energy crisis means real incomes are unlikely to grow strongly. Higher interest rates will soon bite harder too. We expect the Bank of England to keep interest rates at the probable peak of 5.25% until the second half of 2024. Mortgage rates are likely to stay above 5.0% for around a year.

The tightness of the labour market continued to ease, with employment in the three months to July falling by 207,000. The further decline in the number of job vacancies from 1.017m in July to 0.989m in August suggests that the labour market has loosened a bit further since July. That is the first time it has fallen below 1m since July 2021. At 3.0% in July, and likely to have fallen to 2.9% in August, the job vacancy rate is getting closer to 2.5%, which would be consistent with slower wage growth.

Meanwhile, the 48,000 decline in the supply of workers in the three months to July offset some of the loosening in the tightness of the labour market. That was due to a 63,000 increase in inactivity in the three months to July as more people left the labour market due to long term sickness or to enter education. The supply of labour is still 0.3% below its pre-pandemic February 2020 level.

But the cooling in labour market conditions still has not fed through to an easing in wage growth. The headline 3myy rate rose 7.8% for the period June to August, which meant UK wage growth remains much faster than in the US and in the Euro-zone. Moreover, while the Bank of England's closely watched measure of regular annual average total pay growth for the private sector was 7.1% in June to August 2023, for the public sector this was 12.5% and is the highest total pay annual growth rate since comparable records began in 2001. However, this is affected by the NHS and civil service one-off non-consolidated payments made in June, July and August 2023. The Bank of England's prediction was for private sector wage growth to fall to 6.9% in September.

CPI inflation declined from 6.8% in July to 6.7% in August and September, the lowest rate since February 2022. The biggest positive surprise was the drop in core CPI inflation, which declined from 6.9% to 6.1%. That reverses all the rise since March.

In its latest monetary policy meeting on 06 November, the Bank of England left interest rates unchanged at 5.25%. The vote to keep rates on hold was a split vote, 6-3. It is clear that some members of the MPC are still concerned about the stickiness of inflation.

Like the US Fed, the Bank of England wants the markets to believe in the higher for longer narrative. In terms of messaging, the Bank once again said that "further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures", citing the rise in global bond yields and the upside risks to inflation from "energy prices given events in the Middle East". So, like the Fed, the Bank is keeping the door open to the possibility of further rate hikes.

However, it also repeated the phrase that policy will be "sufficiently restrictive for sufficiently long" and that the "MPC's projections indicate that monetary policy is likely to need to be restrictive for an extended period of time". Indeed, Governor Bailey was at pains in his press conference to drum home to markets that the Bank means business in squeezing inflation out of the economy.

This narrative makes sense as the Bank of England does not want the markets to decide that a peak in rates will be soon followed by rate cuts, which would loosen financial conditions and undermine its attempts to quash inflation. The language also gives the Bank of England the flexibility to respond to new developments. A rebound in services inflation, another surge in wage growth and/or a further leap in oil prices could conceivably force it to raise rates in the future.

In the table below, the rise in gilt yields across the curve as a whole in 2023/24, and therein PWLB rates, is clear to see.