| Division(s): N/A |
|---|

# AUDIT & GOVERNANCE COMMITTEE
# 5 January 2022

# Treasury Management Strategy Statement & Annual Investment Strategy for 2022/23

**Report by the Director of Finance**

## RECOMMENDATION

1. **The Audit & Governance Committee is RECOMMENDED to endorse the Treasury Management Strategy for 2022/23 as outlined in the report.**

## Executive Summary

2. The Treasury Management Strategy & Annual Investment Strategy for 2022/23 outlines the Council's strategic objectives in terms of its debt and investment management for the financial year 2022/23.

3. The forecast average cash balance for 2022/23 is £442m. The Council will maintain the investment in strategic pooled funds with a purchase value of £101m (23%), with the remaining £341m (77%) being managed internally with a mixture of short, medium and long-term deposits.

4. The Bank of England Base Rate is forecast to increase to 0.25% before the start of the financial year and rise again to 0.50% during the financial year.

5. UK Government Gilt yields are forecast to rise from 1.30% to 1.90% over the medium term.

6. Changes to the Treasury Management Strategy will be recommended to Council to be delegated to the Director of Finance in consultation with the Leader of the Council and Cabinet Member for Finance

**Changes from 2021/22 Strategy**

7. The long term lending limits are proposed to change as follows:

| | From | To |
|---|---|---|
| 2021/23 | £185m | £205m |
| 2023/24 | £185m | £175m |
| 2024/25 | £185m | £165m |
| 2025/26 | £185m | £165m |
| 2026/27 | n/a | £165m |

8. The introduction of a “Liability Benchmark” in paragraph 50 as set out in the updated Prudential Code for Capital Finance in Local Authorities that was issued on 20 December 2021.

## Background

9. The Local Government Act 2003 and supporting regulations require the Council to ‘have regard to’ the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council’s capital investment plans are affordable, prudent and sustainable.

10. The Act requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act). The Annual Investment Strategy sets out the Council’s policies for managing its investments and for giving priority to the security and liquidity of those investments.

11. Treasury management is defined as: “The management of the organisation’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.”

12. The proposed strategy for 2022/23 is based upon the views of the Council’s Treasury Management Strategy Team (TMST)[1], informed by market forecasts provided by the Council’s treasury advisor, Link Treasury Services.

13. It is proposed that any further changes required to the Annual Treasury Management Strategy & Annual Investment Strategy, continue to be delegated to the Director of Finance in consultation with the Leader of the Council and Cabinet Member for Finance.

## Treasury Limits for 2022/23 to 2025/26

14. The Authorised Borrowing Limit requires the Council to ensure that total capital investment remains within sustainable limits and that the impact upon future council tax levels is ‘acceptable’.

15. The capital investment relevant to this indicator to be considered for inclusion incorporates financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

[1]Comprising the Director of Finance, Service Manager (Pensions), Head of Financial Strategy and Treasury Manager.

## Forecast Treasury Portfolio Position

16. The Council's treasury forecast portfolio position for the 2022/23 financial year comprises:

| | Principal £m | Average Rate % |
|---|---|---|
| **Opening External Debt Balance** | | |
| PWLB | 263.383 | 4.533 |
| LOBO | 45.000 | 3.943 |
| Money Market Loans | 5.000 | 3.950 |
| **TOTAL EXTERNAL DEBT** | 335.383 | |
| 2022/23 Average Cash Balance | | |
| Average In-House Cash | 340.630 | |
| Average Externally Managed | 101.006 | |
| **TOTAL INVESTMENTS** | **442.230** | |

17. The average forecast cash balance for 2022/23 is comprised of the following:

| | Average Balance £m |
|---|---|
| Earmarked Reserves | 84.150 |
| Capital and Developer Contributions | 270.300 |
| General Balances | 30.900 |
| Cashflow and Working Capital Adjustments | 141.900 |
| Internal Borrowing | -99.444 |
| Provisions and Deferred Income | 13.424 |
| **TOTAL** | **442.230** |

## Treasury Management Advisors

18. Link Treasury Services Ltd provide treasury management advice to the Council.

## Prospects for Interest Rates

### *Economic Forecast – Provided by Link Treasury Services Ltd (10 November 2021)*

19. Link provided the following forecasts on 8 November 2021. These are forecasts for certainty rates, gilt yields plus 80 bps.

| Link Group Interest Rate View 8.11.21 | Dec-21 | Mar-22 | Jun-22 | Sep-22 | Dec-22 | Mar-23 | Jun-23 | Sep-23 | Dec-23 | Mar-24 | Jun-24 | Sep-24 | Dec-24 | Mar-25 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| BANK RATE | 0.25 | 0.25 | 0.50 | 0.50 | 0.50 | 0.75 | 0.75 | 0.75 | 0.75 | 1.00 | 1.00 | 1.00 | 1.00 | 1.25 |
| 3 month ave earnings | 0.30 | 0.40 | 0.50 | 0.50 | 0.50 | 0.60 | 0.80 | 0.90 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| 6 month ave earnings | 0.40 | 0.50 | 0.60 | 0.60 | 0.70 | 0.80 | 0.90 | 1.00 | 1.10 | 1.10 | 1.10 | 1.10 | 1.10 | 1.10 |
| 12 month ave earnings | 0.50 | 0.60 | 0.70 | 0.70 | 0.80 | 0.90 | 1.00 | 1.10 | 1.20 | 1.20 | 1.20 | 1.20 | 1.20 | 1.20 |
| 5 yr PWLB | 1.50 | 1.50 | 1.60 | 1.60 | 1.70 | 1.70 | 1.70 | 1.80 | 1.80 | 1.80 | 1.90 | 1.90 | 2.00 | 2.00 |
| 10 yr PWLB | 1.80 | 1.90 | 1.90 | 2.00 | 2.00 | 2.10 | 2.10 | 2.20 | 2.20 | 2.20 | 2.30 | 2.30 | 2.30 | 2.40 |
| 25 yr PWLB | 2.10 | 2.20 | 2.30 | 2.40 | 2.40 | 2.40 | 2.50 | 2.50 | 2.60 | 2.60 | 2.60 | 2.60 | 2.70 | 2.70 |
| 50 yr PWLB | 1.90 | 2.00 | 2.10 | 2.20 | 2.20 | 2.20 | 2.30 | 2.30 | 2.40 | 2.40 | 2.40 | 2.40 | 2.50 | 2.50 |

*Additional notes by Link on this forecast table: -*

- *LIBOR and LIBID rates will cease from the end of 2021. Work is currently progressing to replace LIBOR with a rate based on SONIA (Sterling Overnight Index Average). In the meantime, our forecasts are based on expected average earnings by local authorities for 3 to 12 months.*
- *Our forecasts for average earnings are averages i.e., rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short term cash at any one point in time.*

20. The coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings.

21. As shown in the forecast table above, the forecast for Bank Rate now includes five increases, one in December 2021 to 0.25%, then quarter 2 of 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and, finally, one in quarter 1 of 2025 to 1.25%.

22. Link views the following as risks to the economic forecast:

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity.

- **Mutations** of the virus render current vaccines ineffective, and development of vaccines to combat these mutations takes time, resulting in further national lockdowns or severe regional restrictions.

- **The Monetary Policy Committee** raises the Bank Rate to quickly or too far over the next three years and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

- **UK / EU trade arrangements** – complications or lack of co-operation in resolving significant remaining issues could cause a major impact on trade flows and financial services.

- **Longer term US treasury yields** rise strongly and pull gilt yields up higher than forecast

- **Major stock markets** e.g., in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the "moral hazard" risks of having to buy shares and corporate bonds to reduce the impact of major financial market selloffs on the general economy

- **Geopolitical risks,** for example in Iran, North Korea, but also in Europe and Middle Eastern countries; on-going global power influence struggles between Russia/China/US. These could lead to increasing safe-haven flows

### *Forecast for Bank Rate*

23. It is not expected that Bank Rate will increase quickly after the initial rate rise as the underlying supply potential of the economy is not likely to have taken a major hit during the pandemic: it should, therefore, be able to cope well with meeting demand after supply shortages subside over the next year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the Monetary Policy Committee's 2% target after the spike up to around 5% in 2022. The forecast includes five increases in Bank Rate over the three-year forecast period to March 2025, ending at 1.25%.

### *Forecasts for PWLB rates and gilt and treasury yields*

24. As the interest forecast table for PWLB certainty rates above shows, there is likely to be a steady rise over the forecast period, with some degree of uplift due to rising treasury yields in the US

### *Treasury Management Strategy Team's View*

25. The Council's TMST, taking into account the advice from Link Treasury Services, market implications and the current economic outlook, have determined the rates to be included in the Strategic Measures budget for 2022/23 and over the medium term. TMST forecast a rise to 0.25% before the start of the financial year, another rise to 0.50% during the financial year. Another rise to 0.75% s forecast during 2023/24.

26. The TMST team has agreed that based on the current portfolio of deposits and market rates, the target in-house rate of return as set out below. These rates have been incorporated into the strategic measures budget estimates:

- 2022/23 0.35%
- 2023/24 0.75%
- 2024/25 -2026/27 1.00%

## Borrowing Strategy

27. Borrowing rates are forecast to be between 1.40 – 2.60% in the short to medium term. Whilst there will be a "cost of carry[2]" associated with the long-term borrowing compared to temporary investment, it is smaller compared to recent years.

28. The external borrowing of the Council is set to fall well below the Capital Financing Requirement due to increased capital expenditure and £88m of debt repayments by 2027/28.

29. The Council needs to borrow to finance prudential borrowing schemes. The Council's Capital Programme Financing Principles applies capital grants, developer contributions, capital receipts and revenue contributions to fund capital expenditure before using prudential borrowing.

30. Financing the Council's borrowing requirement internally would reduce the cost of carry in the short term but there is a risk that the internal borrowing would need to be refinanced with external borrowing at a time when PWLB (or its successor) and market rates exceed those currently available.

31. The Council's TMST have agreed that they should maintain the option to fund new or replacement borrowing through internal borrowing. Internal borrowing will have the effect of reducing some of the "cost of carry" of funding. Internal borrowing will also be used to finance prudential schemes. The limit of internal borrowing will be combined with the long term lending limit, and will not exceed £300m.

32. The TMST will monitor the borrowing rates during the 2022/23 financial year. If changes in interest rate forecasts mean the policy to borrow internally is no longer in the short term or long-term interests of the Council, the TMST may take out new or replacement borrowing to give the Council certain of cost over the long term, and to reduce Interest Rate Risk and Refinancing Risk in the short to medium term. Any borrowing will be reported to Cabinet.

33. As the Accountable Body for OxLEP ltd, the Council will be required to prudentially borrow £41m on their behalf for project funding from 2021/22 onwards. The borrowing will be included in the Council's overall borrowing requirement, using internal or external borrowing as appropriate. The loans will be repaid through the retained business rates of the Enterprise Zone 1.

34. If the PWLB offer any further lending rounds of the Local Infrastructure Rate, it is likely to be at a discounted interest rate of gilts + 60 basis points. The borrowing on behalf of OxLEP may be eligible as the schemes are all major infrastructure schemes.

---

[2] The difference between the interest payable on borrowing on debt and the interest receivable from investing surplus cash.

35. The Council’s chief objective when borrowing money is to strike an appropriate balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Authority’s long-term plans change is a secondary objective.

36. The approved sources of long-term and short-term borrowing are:
- Public Works Loan Board and any successor body
- UK local authorities
- any institution approved for investments (see below)
- any other bank or building society authorised by the Prudential Regulation Authority to operate in the UK
- UK public and private sector pension funds
- capital market bond investors
- special purpose companies created to enable joint local authority bond issues.

*Borrowing for the Capital Financing Requirement*

37. The Council’s Capital Financing Requirement (CFR) represents the Council’s underlying need to finance capital expenditure by borrowing. The Council’s CFR is currently forecast to increase over the medium-term financial plan. This is a result of the requirement to borrow on behalf of the OxLEP discussed in paragraph 32 and increased investment in the Council’s Capital Programme, and the previously agreed infrastructure investment.

38. The Council’s external debt is also forecast to increase over the medium-term financial plan as new external borrowing required for OxLEP projects and the infrastructure investment is forecast to exceed the rate at which existing long term debt is repaid upon maturity.

*Borrowing Instruments*

39. The main source of borrowing for the Council is the PWLB. The borrowing rate from the PWLB is directly linked to UK Government Gilt yield. There are three rates offered by the PWLB; the standard rate, the certainty rate and local infrastructure rate, which are 100, 80 and 60 basis points over gilts, respectively.

40. The Council will apply to qualify for the certainty rate each year. If the PWLB announce further infrastructure rate programmes, the Council will apply for it if appropriate.

41. The TMST forecast for available rates from the PWLB over the medium term are as follows:

- 1.50 – 2.70% for the Certainty rate
- 1.30 – 2.50% for the Infrastructure rate

42. The Council has historically set a maximum limit of 20% of the debt portfolio to be borrowed in the form of Lender's Option Borrower's Option (LOBOs). It is recommended that this remain as the limit for 2022/23. As at 30 November 2021 LOBOs represent 14.4% of the total external debt.

43. The Council has five £5m LOBO's with call options in 2022/23, three of which have two call options in year, whilst two have a single call option in year. At each call date, the lender may choose to exercise their option to change the interest rate payable on the loan. If the lender chooses to do so, the Council will evaluate alternative financing options before deciding whether or not to exercise the borrower's option to repay the loan or to accept the new rate offered. It is likely that if the rate is changed the debt will be repaid. The TMST will explore early repayment of LOBO's if there were to arise and where there is a financial benefit to do so.

44. Other sources of funding be available to the Council include the money market, other Local Authorities and the Municipal Bond Fund. The TMST will consider all available funding sources when entering into any new borrowing arrangements.

45. As at November 2021, the average borrowing rate across the whole portfolio taking account all of the sources of funding was 4.44%. The rate for new debt is estimated at 1.9%. If the council takes out new debt at that rate it will reduce the average borrowing rate across the portfolio.

### *Link Treasury Services View on borrowing rates*

46. Link Treasury Services have forecast gilt yields and borrowing rates over the medium term to be as follows:

| Duration | Gilt Yield % | PWLB Infrastructure Rate % | PWLB Certainty Rate % |
|---|---|---|---|
| 50 year | 1.10 – 1.70 | 1.70 – 2.30 | 1.90 – 2.50 |
| 25 year | 1.30 – 1.90 | 1.90 – 2.50 | 2.10 – 2.70 |
| 10 year | 1.00 – 1.69 | 1.60 – 2.20 | 1.80 – 2.40 |
| 5 year | 0.70 – 1.20 | 1.30 – 1.80 | 1.50 – 2.00 |

**Treasury Management Prudential Indicators for Debt**

**Gross and Net Debt**

47. This indicator is intended to identify where an authority may be borrowing in advance of need.

| Upper Limit of net debt: | 2020/21 | 2022/23 | 2022/23 | 2023/24 | 2024/25 |
|---|---|---|---|---|---|
| Net Debt / Gross Debt | 70% | 70% | 70% | 70% | 70% |

**Upper and lower limits to maturity structure of fixed rate borrowing**

48. This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

49. It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

50. LOBOs are classified as maturing on the next call date, this being the earliest date that the lender can require repayment.

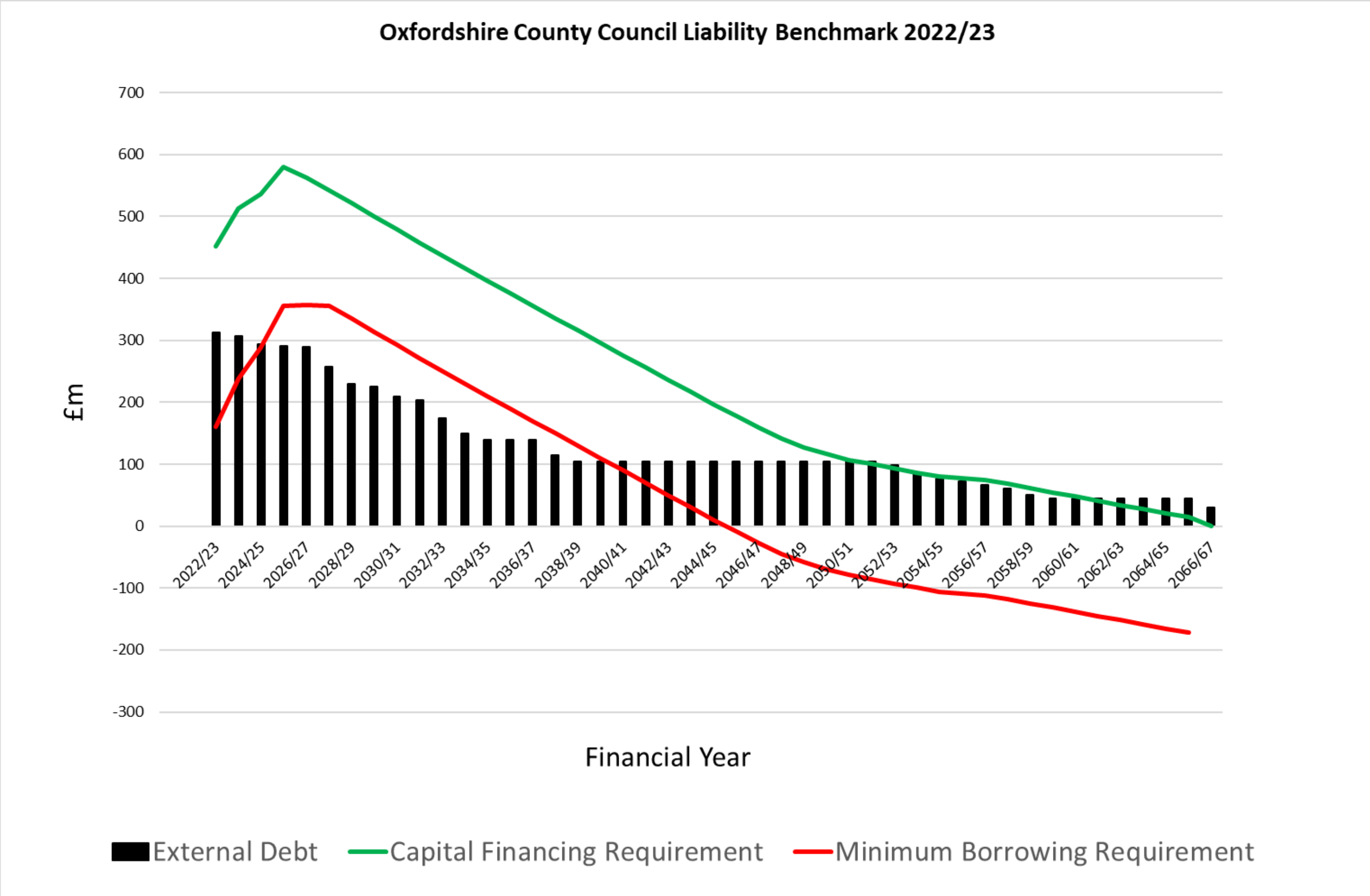
| **Maturity structure of fixed rate borrowing during 2022/23** | **Lower Limit %** | **Upper Limit %** |
|---|---|---|
| Under 12 months | 0 | 20 |
| 12 months and within 24 months | 0 | 25 |
| 24 months and within 5 years | 0 | 35 |
| 5 years and within 10 years | 5 | 40 |
| 10 years and above | 40 | 95 |

**Liability Benchmark**

51. Changes to the Prudential Code for Capital Finance in Local Authorities were consulted on in 2021. The Liability Benchmark (ie. the real need to borrow) is an additional prudential indicator introduced in the updated code. This identifies the minimum future borrowing needs, compared to the capital financing requirement and the actual level of external debt.

52. The gap between the capital financing requirement and the minimum borrowing requirement[3] represents the maximum amount of financing that can be temporarily funded through internal borrowing. Based on the assessment below the council would need to internally borrow up to £292m in 2022/23.

[3] The minimum borrowing requirement is calculated by taking the capital financing requirement, netting off usable reserves and working capital, and adding on a liquidity allowance.




## Annual Investment Strategy

53. The Council complies with all relevant treasury management regulations, codes of practice and guidance. The Council's investment priorities are: -

- The security of capital and
- The liquidity of its investments

54. The Council also aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The borrowing of monies purely to invest or on-lend and make a return is unlawful and the Council will not engage in such activity.

55. The Treasury Management Code of Practice requires the Council to approve a Treasury Management Policy Statement. Good practice requires that this statement is regularly reviewed and revised as appropriate. Council approved the statement in February 2019.The statement has been reviewed and there are no revisions proposed at present. The new CIPFA Code of Practice will be fully adopted in for 2023/24 and a new policy statement will be brought for approval before adoption.

## *Investment Instruments*

56. Investment instruments identified for use in the 2022/23 financial year are set out in the Specified and Non-Specified instrument tables below

57. 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 phrase as they form a normal part of day to day treasury management.

58. Money market funds (MMFs) will be utilised, but good treasury management practice prevails and whilst MMFs provide good diversification the council will also seek to diversify any exposure by using more than one MMF where practical. It should be noted that while exposure will be limited, the use of MMFs does give the council exposure to institutions that may not be included on the approved lending list for direct deposits. This is deemed to be an acceptable risk due to the benefits of diversification. The Treasury team use an online portal to provide details of underlying holdings in MMFs. This enables more effective and regular monitoring of full counterparty risk.

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

| Specified Investment Instrument | Minimum Credit Criteria | Use |
|---|---|---|
| Term Deposits – UK Government | N/A | In-house |
| Term Deposits – other Local Authorities | N/A | In-house |
| Debt Management Agency Deposit Facility | N/A | In-house and Fund Managers |
| Treasury Bills | N/A | In-house and Fund Managers |
| UK Government Gilts | N/A | In-house on a buy and hold basis and Fund Managers |
| Term Deposits – Banks and Building Societies | Short-term F1, Long-term BBB+,<br>Minimum Sovereign Rating AA+ | In-house and Fund Managers |
| Certificates of Deposit issued by Banks and Building Societies | A1 or P1 | In-house on a buy and hold basis and Fund Managers |
| Money Market Funds | AAA | In-house and Fund Managers |
| Other Money Market Funds and Collective Investment Schemes[4] | Minimum equivalent credit rating of A+. These funds do not have short-term or support ratings. | In-house and Fund Managers |
| Reverse Repurchase Agreements - maturity under 1 year from arrangement and counterparty is of high credit quality (not collateral) | Long Term Counterparty Rating A- | In-house and Fund Managers |
| Covered Bonds – maturity under 1 year from arrangement | Minimum issue rating of A- | In-house and Fund Managers |

60. Non-specified investment products are those which take on greater risk. They are subject to greater scrutiny and should therefore be subject to more rigorous justification and agreement of their use in the Annual Investment Strategy; this applies regardless of whether they are under one-year investments and have high credit ratings.

61. A maximum of 50% of internal investments, and 100% of external investments will be held in non-specified investments.

[4] I.e., credit rated funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.

| Non-Specified Investment Instrument | Minimum Credit Criteria | Use | Max Maturity Period |
|---|---|---|---|
| Term Deposits – other Local Authorities (maturities in excess of 1 year) | N/A | In-house | 5 years |
| UK Government Gilts with maturities in excess of 1 year | N/A | In-house and Fund Managers | 5 years in-house, 10 years fund managers |
| Collective Investment Schemes[5] but which are not credit rated | N/A | In-house and Fund Managers | Pooled Funds do not have a defined maturity date |
| Registered Providers | As agreed by TMST in consultation with the Leader and the Cabinet Member for Finance | In-house | 5 years |
| OxLEP Ltd | As agreed by TMST in consultation with the Leader and the Cabinet Member for Finance | In-house | 5 years |
| Term Deposits – Banks and Building Societies (maturities in excess of 1 year) | Short-term F1+, Long-term AA- | In-house and Fund Managers | 3 years |
| Structured Products (e.g. Callable deposits, range accruals, snowballs, escalators etc.) | Short-term F1+, Long-term AA- | In-house and Fund Managers | 3 years |
| Bonds issued by Multilateral Development Banks | AAA | In-house and Fund Managers | 25 years |
| Bonds issued by a financial institution which is guaranteed by the UK Government | AA | In-house and Fund Managers | 5 years in-house |

[5] Pooled funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.

| Non-Specified Investment Instrument | Minimum Credit Criteria | Use | Max Maturity Period |
|---|---|---|---|
| Sovereign Bond Issues | AAA | In-house on a buy and hold basis. Fund Managers | 5 year in-house, 30 years fund managers |
| Reverse Repurchase Agreements - maturity in excess of 1 year, or/and counterparty not of high credit quality. | Minimum long term rating of A- | In-house and Fund Managers | 3 years |
| Covered Bonds | AAA | In-house and Fund Managers | 20 years |

### *Changes to Instruments*

62. There are no proposed changes to instruments

### *Credit Quality*

63. The CIPFA Code of Practice on Treasury Management (2021) recommends that Councils have regard to the ratings issued by the three major credit rating agencies (Fitch, Moody's and Standard & Poor's) and to make decisions based on all ratings. Whilst the Council will have regard to the ratings provided by all three ratings agencies, the Council uses Fitch ratings as the basis by which to set its minimum credit criteria for deposits and to derive its maximum counterparty limits. Counterparty limits and maturity limits are derived from the credit rating matrix as set out in the tables at paragraphs 73 and 74 respectively.

64. The TMST may further reduce the derived limits due to the ratings provided by Moody's and Standard & Poor's or as a result of monitoring additional indicators such as Credit Default Swap rates, share prices, Ratings Watch & Outlook notices from credit rating agencies and quality Financial Media sources.

65. Notification of any rating changes (or ratings watch and outlook notifications) by all three ratings agencies are monitored daily by a member of the Treasury Management Team. Updates are also provided by the Council's Treasury Management advisors Arlingclose and reported to TMST. Appropriate action will be taken for any change in rating.

66. Where a change in the Fitch credit rating places a counterparty on the approved lending list outside the credit matrix (as set out in tables at paragraphs 73 and 74), that counterparty will be immediately removed from the lending list.

67. The Authority defines “high credit quality” organisations as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher with the Fitch ratings agency.

### *Liquidity Management*

68. The Council forecasts its cash flow to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council’s medium term financial plan and cash flow forecast. The Council uses instant access bank deposit accounts and money market funds for balances forecast to be required at short notice to meet commitments due. The TMST will continue to monitor options available to maintain the required liquidity and will open new accounts with approved counterparties as appropriate.

### *Lending Limits*

69. In addition to the limits determined by the credit quality of institutions, the TMST apply further limits to mitigate risk by diversification. These include:

    - Limiting the amount lent to banks in any one country (excluding the UK) to a maximum of 20% of the investment portfolio.
    - Limiting the amount lent to any bank, or banks within the same group structure to 10% of the investment portfolio.
    - Actively seeking to reduce exposure to banks with bail in risk

70. Where the Council has deposits on instant access, this balance may temporarily exceed the 10% bank or group limit. However, the limits as set out in paragraphs 72 and 73 will still apply.

71. Counterparty limits as set out in paragraphs 73 and 74, may be temporarily exceeded by the accrual and application of interest amounts onto 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 cashflow forecast.

72. Any changes to the approved lending list will be reported to Cabinet as part of the Business Management and Monitoring Report.

73. The Council also manages its credit risk by setting counterparty limits. The matrix below sets out the maximum proposed limits for 2022/23. The TMST may further restrict lending limits dependent upon prevailing market conditions. BBB+ to BBB- ratings is included for overnight balances with the Council’s bank, currently Lloyds Bank Plc. This is for practical purposes should the bank be downgraded.

| LENDING LIMITS - Fitch Rating | Short Term Rating | |
|---|---|---|
| Long Term Rating | F1+ | F1 |
| AAA | £30m | £20m |
| AA+ | £30m | £20m |
| AA | £25m | £15m |
| AA- | £25m | £15m |
| A+ | £20m | £15m |
| A | £20m | £15m |
| A- | £15m | £10m |
| BBB+, BBB, BBB- (bank with which the Council has its bank account) | £20m | £20m |

74. The Council also manages its counterparty risk by setting maturity limits on deposits, restricting longer term lending to the very highest rated counterparties. The table below sets out the maximum approved limits. The TMST may further restrict lending criteria in response to changing market conditions.

| MATURITY LIMITS – Fitch Rating | Short Term Rating | |
|---|---|---|
| Long Term Rating | F1+ | F1 |
| AAA | 3 years | 364 days |
| AA+ | 2 years | 364 days |
| AA | 2 years | 9 months |
| AA- | 2 years | 9 months |
| A+ | 364 days | 9 months |
| A | 9 months | 6 months |
| A- | 6 months | 3 months |
| BBB+, BBB, BBB- (bank with which the Council has its bank account) | Overnight | Overnight |

*Other institutions included on the councils lending list - Structured Products*

75. As at 30 November 2021, the Council had no structured products within its investment portfolio. Structured products involve varying degrees of additional risk over fixed rate deposits, with the potential for higher returns. It is recommended that the authority maintain the option to use structured products up to a maximum of 10% of the investment portfolio. The Council will continue to monitor structured products and consider restructuring opportunities as appropriate.

## External Funds

76. The Council uses external fund managers and pooled funds to diversify the investment portfolio through the use of different investment instruments,

investment in different markets, and exposure to a range of counterparties. It is expected that these funds should outperform the Council's in-house investment performance over a rolling three-year period. The Council will have no more than 50% of the total portfolio invested with external fund managers and pooled funds (excluding MMFs). This allows the Council to achieve diversification while limiting the exposure to funds with a variable net asset value. And, in order to ensure appropriate diversification within externally managed and pooled funds these should be diversified between a minimum of two asset classes.

77. As at 30 November 2021, the Council had £104m (original purchase value of £101m) invested in external funds (excluding MMFs), representing 18% of the Council's total investment portfolio. As the pandemic continues, there is likely to be continued short term volatility in the value of the funds, however they are held with a long term view, and there is no intention to divest from any of the funds at present.

78. The external funds have a higher targeted income return than in house deposits of 3.75% which has been incorporated into the medium-term financial plan.

79. The performance of the pooled funds is monitored by the TMST throughout the year against the funds' benchmarks and the in-house investment returns. The TMST will keep the external fund investments under review and consider alternative instruments and fund structures, to manage overall portfolio risk. It is recommended that authority to withdraw, or advance additional funds to/from external fund managers, continue to be delegated to the TMST.

## Investment Approach

80. The TMST will aim to maintain the balance between medium and long-term deposits with local authorities and short-term secured and unsecured deposits with high credit quality financial institutions. Money Market Funds will continue to be utilised for instant access cash. This approach will maintain a degree of certainty about the investment returns for a proportion of the portfolio, while also enabling the Treasury Management team to respond to any increases or decreases in interest rates in the short-term.

## Treasury Management Indicators for Investments

### Upper limit to total of principal sums invested longer than 364 days

81. The purpose of this limit is to contain exposure to the risk of loss that may arise as a result of the Authority having to seek early repayment of the sums invested.

82. The long term lending limit is based on 50% of the forecast average cash balance. Based on forecast balances reducing to £330m over the medium term, the proposed limits for investments longer than 364 day is set out below:

| | 2022/23 £m | 2023/24 £m | 2024/25 £m | 2025/26 £m | 2026/27 £m |
|---|---|---|---|---|---|
| Upper limit on principal sums invested longer than 364 days | 205 | 175 | 165 | 165 | 165 |

## Other Treasury Management Prudential Indicators

### Upper limits on fixed and variable rate interest exposures

83. These indicators allow the Authority to manage the extent to which it is exposed to changes in interest rates.

Fixed interest rate exposure

84. Limits in the table below have been set to reflect the current low interest rate environment. The limits set out offer the Council protection in an uncertain interest rate environment by allowing the majority of the debt portfolio to be held at fixed interest rates, thus not subjecting the Council to rising debt interest.

| Upper limit for fixed interest rate exposure | 2022/23 | 2022/23 | 2023/24 | 2024/25 | 2025/26 | 2026/27 |
|---|---|---|---|---|---|---|
| Net principal re fixed rate borrowing / investments | £350m | £350m | £350m | £350m | £350m | £350m |

85. Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

Variable interest rate exposure

The council will maintain a zero (or negative) net variable interest rate exposure. This is maintained by insuring the Council's variable rate debt is lower than variable rate investments

86. Prudential Indicators are reported to and monitored by the TMST on a regular basis and will be reported to the Audit & Governance Committee and Cabinet in the quarterly Treasury Management reports and the Treasury Management Annual Performance Report.

## Policy on Use of Financial Derivatives

87. The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks

presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

88. Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

89. It is the view of the TMST that the use of standalone financial derivatives will not be required for Treasury Management purposes during 2022/23. The Council will only use derivatives after seeking expertise, a legal opinion and ensuring officers have the appropriate training for their use.

## Performance Monitoring

90. The Council will monitor its Treasury Management performance against other authorities through its membership of the CIPFA Treasury Management benchmarking club.

91. Arlingclose benchmark the performance of their clients against each other on a quarterly basis, looking at a variety of indicators including investment risk and returns.

92. Latest performance figures will be reported to the Audit & Governance Committee and Cabinet in the quarterly Treasury Management reports and the Treasury Management Annual Performance Report.

## Investment Training

93. All members of the Treasury Management Strategy Team are members of CIPFA or other professional accounting body. In addition, key Treasury Management officers receive in-house and externally provided training as deemed appropriate and training needs are regularly reviewed, including as part of the staff appraisal process.

94. The Council has opted up to ‘professional client’ categorisation with under the second Markets in Financial Instruments Directive (MiFID II). In order to achieve this, evidence was required that the person(s) authorised to make investment decisions on behalf of the authority have at least one year’s relevant professional experience and the expertise and knowledge to make investment decisions and understand the risks involved. Members of the TMST currently meet these criteria and training needs will be regularly monitored and reviewed to ensure continued compliance.

## Financial Implications

95. Interest payable and receivable in relation to Treasury Management activities are included within the overall Strategic Measures budget. In house interest receivable for 2022/23 is budgeted to be £1.49m.

96. Dividends payable from external funds in 2022/23 are budgeted to be £3.81m.

97. Interest payable on external debt in 2022/23 is budgeted to be £14.39m.

Comments checked by:

Lorna Baxter, Director of Finance, lorna.baxter@oxfordshire.gov.uk

## Legal Implications

98. There are no direct legal implications arising from this report save for the need for ongoing collaborative working between the S151 Officer and the Monitoring Office. CIPFA guidance promotes the need for consultative working and collaboration between these respective roles to promote good organisational governance.

Comments checked by:

Sukdave Ghuman, Deputy Monitoring Officer,
Sukdave.ghuman@oxfordshire.gov.uk

## Sustainability Implications

99. This report is not expected to have any negative impact with regards to the Council's zero carbon emissions commitment by 2030.

100. The Treasury Management Strategy Team (TMST) will consider investments that may make a positive contribution to the Council's carbon commitment when appropriate opportunities become available. The TMST will continue to explore Ethical, Sustainable and good Governance investment practices.

101. The Council's Treasury Management Practices will be updated during 2022/23 to set out the Council's policy and practices relating to environmental, social and governance investment considerations.

102. Where the Council has investments in externally managed funds, each of the fund managers is a signatory to the United Nations Principal for Responsible Investment.

103. The Council is undertaking a review of all of its Treasury Management investments to produce a report on how it is performing with regards to Ethical, Social and Governance (ESG) criteria.

104. Furthermore, the Council will not knowingly invest directly in organisations whose activities include practices which are inconsistent with the values of the Council or the Council's zero carbon emissions commitment by 2030.

105. The Treasury Management function is now completely paperless, and remote working is likely to remain normal for the foreseeable future.


**LORNA BAXTER**
Director of Finance

Contact officer: Tim Chapple – Treasury Manager
Contact number: 07917 262935

December 2021