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OXFORD CITY COUNCIL

To: **City Executive Board**

Date: **11 February 2016**

Report of: **Head of Financial Services**

Title of Report: **Treasury Management Strategy 2016/17**

Summary and Recommendations

Purpose of report: To present the Council's Treasury Management Strategy for 2016/17 together with the Prudential Indicators for 2016/17 to 2018/19.

Key decision: Yes

Executive lead member: Councillor Ed Turner

Policy Framework: Sustaining Financial Stability

Recommendation(s): That the City Executive Board resolves to recommend that Council resolves to:

1. Approve the Treasury Management Strategy 2016/17, and adopt the Prudential Indicators for 2016/17 – 2018/19 as set out in paragraphs 7 to 41, and Appendix 2;
2. Approve the Investment Strategy for 2016/17 and investment criteria as set out in paragraphs 21 to 38 and Appendix 1; and
3. Approve the Minimum Revenue Provision (MRP) Statement at paragraphs 11 to 20 which sets out the Council's policy on debt repayment.

Appendices:
Appendix 1 – Credit and Counterparty Risk Management
Appendix 2 – Prudential Indicators
Appendix 3 – Risk Register

Executive Summary

1. The Council's Treasury Management Strategy has been written in accordance with the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice. The main changes to the Strategy are

    a. the introduction of Real Lettings as an investment instrument (which was approved by Council on 23 September 2015),
    b. provisions for assessing the Minimum Revenue Provision on loans to a Housing Company or other organisations in which the Council has an interest; and
    c. the proposal to reclassify loans to government bodies along with an increased duration of such investments.

2. The report presents the Council's prudential indicators for 2016/17 – 2018/19. Notable indicators include capital expenditure and borrowing limits as these are areas of significant activity.

3. Members are required to agree the Council's Minimum Revenue Provision (MRP) policy (set out at paragraphs 11 to 20), which is the annual charge to revenue for the repayment of debt.

4. The average value of investments during the financial year to date is £71.7m, ranging from £58.4m to £88.2m at any one time; an increase on the previous year, when average balances were £69.4m and ranged from £63.7m to £76.1m; this rise is primarily due to slippage in the Council's Capital Programme.

    During 2015/16 the Council will repay the residual balance of its General Fund debt (£0.895m). All external debt as at 31 March 2016 (£198.5m) will relate solely to the Housing Revenue Account self-financing debt taken out in 2012 which is held at fixed rates with varying fixed periods to maturity.

5. The Council's General Fund Capital Programme over the next four years continues to be funded from a combination of government grants, capital receipts, revenue resources and Community Infrastructure Levy but with an increase in the amount funded from prudential borrowing of £15.3 million over the next four years. This relates to an investment in the National Homelessness Property Fund the purchase of homes for homeless families and the purchase of investment interests in properties. This borrowing is likely to be undertaken from internal resources in order to restrict the cost of carrying external debt.

6. Whilst the majority of the Housing Capital Programme continues to be funded directly from Council House rents the Council's budget also allows for increased borrowing (around £20 million) to fund a package of housing investments over the next four year period

Treasury Management Strategy
Borrowing and Debt Strategy 2016/17

7. Under the Prudential Code, individual authorities are responsible for deciding the level of their borrowing. The system is designed to allow authorities with an affordable borrowing requirement, to borrow in order to pay for capital investment.

8. The arrangements also facilitate 'invest to save' schemes where they are affordable, prudent and sustainable.

9. The parameters for determining the level of prudential borrowing are:

    - A balanced revenue budget that includes the revenue consequences of any capital financing i.e. interest, debt repayment and running costs of any new project;
    - That the impact of the authorised borrowing limit on Council Tax or Council rents is reasonable.

10. The draft Capital Programme which appears elsewhere on the Agenda; includes:
    - £20 million of HRA borrowing, to fund the HRA Capital Programme over the next four years.
    - £5 million for investment in the National Homelessness Property Fund;
    - £8.4 million for investment in the regeneration of Oxpens to be undertaken in 2015/16; and
    - £10.3 million for investment in property that will generate additional revenue income

Minimum Revenue Provision (MRP) Statement 2016/17

11. Prudential borrowing increases the Council's Capital Financing Requirement (CFR) or underlying need to borrow. Whether the Council actually borrows to finance capital expenditure is a treasury management decision unconnected to the capital financing decision. In practice, the Council is likely to use a combination of internal and external borrowing in the medium term to fund the Capital Programme. The amount of external borrowing, if any, will depend on the borrowing requirement compared to the level of cash balances. The Council is required to make a prudent charge to its revenue account for borrowing. This charge is known as Minimum Revenue Provision (MRP) and reflects the repayment of principal borrowed. In some circumstances there is no need to charge a MRP; these circumstances are identified in paragraph 12 below.

12. Regulations require Full Council to approve the Council's MRP policy on an annual basis. The following statement is recommended for 2016/17:

a) For capital expenditure incurred before 1 April 2008 or which in the future will be supported capital expenditure[1], existing practice, outlined in the former Department for Communities and Local Government (DCLG) regulations will apply.

b) For capital expenditure that relates to the assets transferred from the Housing Revenue Account (HRA) to the General Fund (GF) MRP will be based on the estimated useful life of the assets, taking into account the number of years the assets have been in existence, and previous funding allocated to them.

c) For all unsupported borrowing[2] incurred after 1 April 2008 the MRP policy will be the Asset Life Method (with the exception of d below), i.e. the MRP will be based on the estimated life of the asset and borrowing will be charged to the revenue account in equal instalments over the life of the asset.

d) In respect of the Council's investments in a Directly Managed Property Fund or loans to other organisations such as a company in which the Council has an interest, under s25(b)/s25(d) of The Local Authorities Capital Finance and Accounting (England) Regulations 2003 the Council will make no MRP provision as it is anticipated the investment will be repaid in full. The investment and CFR position will be reviewed on at least an annual basis and if there is a likelihood of capital loss, a prudent MRP provision will then be made.

13. The HRA is not required to make a MRP but is required to make a depreciation charge. Regulations allow the Major Repairs Allowance (MRA) to be used as a proxy for depreciation for the first five years of the HRA self-financing scheme. Depreciation on HRA properties is estimated at £6 million per annum and the MRA received is in line with this. After the five year period (which ends in 2016/17), no offsetting will be available and depreciation will be a real charge impacting the bottom line.

14. The S151 officer has delegated authority to determine the need for any future borrowing taking into account prevailing interest rates and associated risks. A combination of long-term and short-term fixed and variable rate borrowing may be considered. This may include borrowing in advance of future years' requirements.

15. Borrowing may be undertaken to fund the approved Capital Programme or to fund future debt maturities. The S151 officer will adopt a cautious approach and take into account the following factors:

- The on-going revenue liabilities created, and the implications for the future plans and budgets;

[1] Supported Capital Expenditure means the total amount of capital expenditure which a local authority has been notified by Government will be given as part of the grant payment
[2] Unsupported borrowing is any borrowing not covered by Government grants.

- The economic and market factors that might influence the manner and timing of any decision to borrow;
- The pros and cons of alternative forms of funding including internal borrowing;
- The impact of borrowing in advance on cash balances and the consequent increase in counterparty risk.

16. Council officers, in conjunction with our treasury advisors, Capita Asset Services - Treasury Solutions, monitor both prevailing interest rates and market forecasts, thereby allowing the Council to respond to any changes that may impact on the timing and manner of borrowing decisions, to ensure these are optimised.

17. The Council had £199.4m of external debt as at 1 April 2015, all of which was held at fixed rates with varying maturity terms up to 2057. This debt is primarily related to housing although £0.895 million related to the General Fund, all of which has been repaid during 2015/16.

18. Therefore, as at 31 March 2016, all external debt relates solely to the Housing Revenue Account and totals £198.5m

19. The Council's Capital Financing Requirement is an indication of the Council's underlying need to borrow to fund its capital investments; this borrowing can be undertaken internally using available resources or externally.

20. The Council's draft capital programme assumes the ongoing need to borrow.

Investment Strategy 2016/17
Interest rates

21. Average cash balances are currently £71.7m, having fluctuated between £58.7m to £88.2m during the year to date.

22. Interest rates remain at an all-time low, with the Base Rate having been held at 0.50% since March 2009. The Council's treasury advisors expect rates to begin to rise slowly during 2016 peaking at around 1.5% by the end of 2017 (calendar year).

23. Most existing investment deal terms are less than 364 days. The Strategy allows for investments beyond 364 days with high quality counterparties; however prevailing interest rates have not been attractive enough to outweigh the additional risk that a longer term investment brings. The exceptions to this are investments in property funds, investments with Local, Fire and Police Authorities and the investment in the National Homelessness Property Fund in which the Council has agreed to invest £5m for a period of 7 to 9 years at an estimated return of 3.5% after the acquisition period.

24. Investments are made in accordance with the Council's Treasury Management Strategy such that returns are balanced against security of investment, liquidity of cash to ensure funding of day to day cash flows and yield. Consequently, procedures are in place to determine the maximum periods that funds may be invested for, as well as the nature of those investments.

25. The Council works to achieve the optimum rate of return on its investments commensurate with proper levels of security and liquidity.

26. Investment instruments identified for use are listed in Appendix 1 under the specified and non-specified investment categories. Counterparty limits are set in accordance with the Council's Treasury Management Practices (TMPs).

27. The Council utilises the creditworthiness services provided by Capita Asset Services – Treasury Solutions. The model combines the credit ratings, credit watches and credit outlooks provided by the credit rating agencies - Fitch, Moody's and Standard and Poor's in a weighted scoring system which is then combined with an overlay of Credit Default Swap[3] (CDS) spreads and sovereign ratings for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the duration of investments.

28. The Council is alerted to changes to ratings by Capita Asset Services - Treasury solutions' creditworthiness service and takes the following action in respect of this update:

    - If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, it is withdrawn immediately from further use
    - If a counterparty's credit rating is placed on negative watch or negative outlook, officers carry out a review to determine whether the institution is still worthy of inclusion on the counterparty list. If there is any doubt, the counterparty is temporarily suspended pending the credit rating agency's full review.

    The contract for Treasury Advisors is due for renewal in September 2016.

29. As part of the creditworthiness methodology a minimum sovereign rating of AA- from Fitch (or equivalent from other agencies if Fitch does not provide) has been determined.

[3] A financial swap agreement that the seller of the CDS will compensate the buyer in the event of default

30. In addition to the recommendations from Capita Asset Services, the S151 Officer and Treasury Management team have agreed to limit the amounts invested with any one country (excluding the UK) or sector as follows:
    - No more than 20% of the previous year's average monthly investment balance with any one counterparty or group (currently £15.8m)
    - Maximum of 10% of total investments to be with institutions in other countries that meet the required criteria.

31. To ensure that the Strategy is not breached and to also be aware of any new opportunities, the Council's counterparty list is reviewed on a daily basis taking into account market information and changes to the methodology used. The list is maintained by the Treasury Management Team, and reported to the S151 Officer on a regular basis.

32. The Investment Strategy provides delegated authority for the S151 Officer to determine the most appropriate form of investment dependant on prevailing interest rates and counterparty risk at the time.

Specified and Non-Specified investments

33. In approving the Investment Strategy, Members are approving the types of investments the Council can undertake. Investments are classified as either specified or non-specified and are show in more detail in Appendix 1.

34. Currently, the Strategy defines a specified investment as one that is in sterling, no more than one year in duration or, if in excess of one year can be repaid earlier on request and with counterparties that meet the Council's credit rating criteria. However, once the duration of an investment falls below 365 days, investments previously classified as non-specified (due to a longer duration period) also fall into the specified category.

35. Non-specified investments are any other type of investment including property funds. Whilst generally these investments will earn a higher rate of return they are inherently more risky in nature and a maximum level of 25% of the previous year's average monthly investment balance is placed on such investments.

36. Investments may be arranged in advance and there has been a significant rise in "forward deals" in recent times. Trades arranged up to four weeks in advance of the start date will still be classified as specified investments, provided the duration of the investment from the start date to the maturity are no longer than 364 days. Trade dates should be factored into the duration of the investment if arranged in advance by more than this period because there is an increased risk due to funds being contractually committed.

37. For 2016/17, it is also recommended that loans to government bodies such as Local Authorities, Fire and Police authorities are exempt from the non-specified category regardless of the duration of the investment; as these counterparties are essentially risk free because they are Government-backed. Therefore, the only risk associated with lending longer term is interest rate risk and the potential for rates to rise whilst a fixed deposit is in place. It is also proposed that lending to government bodies is permitted for a maximum period of 3 years as longer-term interest rates are proportionately more favourable than those achievable over shorter periods.

Loans to companies in which the Council has an interest

38. A loan for capital purposes to a company in which the Council has an interest would be categorised as capital expenditure by the Council. The Council could fund that capital expenditure from any capital resource. For the purposes of this Strategy no loans have been assumed in the Prudential Indicators. Amendments to the Strategy may be needed in respect of any future proposed loans. The MRP provisions in respect of any loans to a Company are covered in paragraph 12 d).

Ethical Investment Policy

39. Council adopted an ethical investment policy in 2015/16, which is set out below. No changes are proposed to this policy for 2016/17.

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

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

Prudential Indicators

41. The Council is required to set out a number of indicators, relating to the affordability and prudence of its Treasury Strategy. These indicators are detailed in Appendix 2 for the period 2016/17 – 2018/19, and will be monitored and reported on an annual basis.

Legal implications

42. This report fulfils four key requirements:

    - The reporting of the Prudential Indicators setting out the Council's expected capital activities (as required by the CIPFA Prudential Code for Capital Finance in Local Authorities).
    - Agreeing the Council's Minimum Revenue Provision (MRP) Policy, which sets out how the Council will pay for capital assets

through revenue each year (as required by guidance under the Local Government and Public Involvement in Health Act 2007).

- Agreeing the Treasury Management Strategy, which links day to day Treasury Management to the Capital Programme and the Treasury Management Prudential Indicators. The key indicator is the Authorised Limit, the maximum amount of debt the Council could afford in the short term, but which would not be sustainable in the longer term. This is the Affordable Borrowing limit required by S3 of the Local Government Act 2003.
- Agreeing the Investment Strategy, this sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss.

43. The Local Government Act 2003 and supporting regulations require the Council to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set prudential and treasury indicators to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

44. The Constitution requires the Strategy to be reported to the City Executive Board and Full Council outlining the expected treasury activity for the forthcoming four years on an annual basis.

Financial Issues

45. All financial issues have been addressed in the body of the report.

Environmental Impact

46. Following the inclusion of the Ethical Investment Policy, this ensures that through our investments we will not knowingly, directly invest in businesses that undertake harmful environmental activities.

Equalities Impact

47. There is no equalities impact relating to this report.

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