

To: City Executive Board
Date: 9 February 2017
Report of: Head of Financial Services
Title of Report: Treasury Management Strategy 2017/18

Summary and recommendations	
Purpose of report:	To present the Council's Treasury Management Strategy for 2017/18 together with the Prudential Indicators for 2017/18 to 2019/20.
Key decision:	Yes
Executive Board Member:	Cllr Ed Turner, Finance, Asset Management and Public Health
Corporate Priority:	None
Policy Framework:	Treasury Management Strategy
Recommendation: That the City Executive Board resolves to:	
<ol style="list-style-type: none"> 1. Recommend that Council approve the Treasury Management Strategy 2017/18, and adopt the Prudential Indicators for 2017/18 – 2019/20 as set out in paragraphs 7 to 37, and Appendix 2; 2. Recommend that Council approve the Borrowing Strategy at paragraphs 7 to 18; 3. Recommend that Council approve the Minimum Revenue Provision (MRP) Statement at paragraphs 19 to 22 which sets out the Council's policy on charging borrowing to the revenue account; and 4. Recommend that Council approve the Investment Strategy for 2017/18 and investment criteria as set out in paragraphs 23 to 37 and Appendix 1. 	

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

Executive Summary

1. This is the start of the body of your report. You must include at least one paragraph introducing the subject and setting out the background.
2. 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 proposed to the Strategy are:
 - a. The introduction of a monetary limit to non-specified investments in addition to the percentage limit to enable the continuation of investments in Property Funds
 - b. An updated Borrowing Strategy and policy on borrowing in advance of need
3. The report presents the Council's prudential indicators for 2017/18 – 2019/20. Notable indicators include capital expenditure and borrowing limits as these are areas of significant activity.
4. The average value of investments during the financial year to 30th November 2016 is £82.1m. The actual daily value has fluctuated between £69.1m to £94.0m. This is an increase on the previous year, when average balances were £71.4m and daily values ranged from £55.7m to £86.2m.
5. All external debt as at 31 March 2017 (£198.5m) relates to the Housing Revenue Account self-financing debt taken out in 2012 which is held at fixed rates with varying fixed periods to maturity.
6. The Council's General Fund Capital Programme over the next four years is funded from a combination of government grants, capital receipts, revenue resources, Community Infrastructure Levy and prudential borrowing. However, due to the scale of investment over the period, particularly the loans to the Council's Housing Company (£60 million), the level of prudential borrowing has increased to £80.9 million. Borrowing from internal resources will be maximised, however much of the borrowing will need to be from external resources.
7. The Housing Capital Programme is funded directly from council house rents.

Treasury Management Strategy Borrowing and Debt Strategy 2017/18

8. Under the Prudential Code, individual authorities are responsible for deciding their level of borrowing. The system is designed to allow authorities with an affordable borrowing requirement, to borrow in order to pay for capital investment.
9. The arrangements also facilitate 'invest to save' schemes where they are affordable, prudent and sustainable.
10. 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.
11. The draft Capital Programme, which appears elsewhere on the Agenda; includes the following expenditure which is currently planned to be financed by borrowing:
- £4.2 million loan to Oxford West End Development Limited for investment in the regeneration of Oxpens;
 - £60 million loan to the Housing Company, primarily to finance the purchase of New Build homes for Affordable Housing at Barton and other housing;
 - £9.7 million for the acquisition of Investment Properties that will generate additional revenue income; and
 - £10 million for the purchase of properties to be used for homeless accommodation
12. The S151 officer has delegated authority to determine the need for external 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.
13. 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;
 - 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.
14. 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.
15. The Council currently has £198.5m of external debt held at fixed rates with varying maturity terms up to 2057. This debt relates to the Council's housing stock within its HRA. The first repayment is due in 2020/21.
16. 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 by borrowing from a

financial institution or the Public Works Loans Board (PWLB) – see also paragraph 16.

Borrowing Strategy 2017/18

17. The Council currently has £22 million of internal borrowing. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary funding source. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.
18. The Head of Financial Services will continue to monitor interest rates and adopt a pragmatic approach to changing circumstances:
 - if it is felt that there is a likelihood of a significant fall in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowing will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
 - Alternately if it is felt that there is a significant risk of a sharp increase in long and short term rates than currently forecast, then external borrowing is likely to be taken earlier.

Borrowing in Advance of Need

19. Any decision to borrow in advance will be within approved Capital Financing Requirement estimates, and demonstrate value for money. Prior to borrowing in advance the risks and benefits of undertaking the borrowing will be considered. Actual borrowing will be subsequently reported through either the mid-year performance report or annual report as appropriate.

Minimum Revenue Provision (MRP) Statement 2017/18

20. 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 undertaken will depend on the borrowing requirement compared to the projected level of cash balances. The Council is required to make a prudent charge to its revenue account for borrowing. This charge is known as the 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 24 and item (d) below.
21. Regulations require the Council to approve an MRP policy on an annual basis. The following statement is recommended for 2017/18:

- a) For capital expenditure incurred before 1 April 2008 or which in the future will be supported capital expenditure¹, 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 borrowing² 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.
22. The HRA is not required to make a MRP but is required to make a depreciation charge. Regulations allowed the Major Repairs Allowance (MRA) to be used as a proxy for depreciation for the first five years of the HRA self-financing scheme, from the 1st April 2017 this is no longer possible and depreciation will be a real cost to the HRA. Depreciation on HRA properties is estimated at @ £6 million per annum over the period.

Investment Strategy 2017/18

Interest rates

- 23. Average cash balances for the year to 30th November 2016 were £82.1m, having fluctuated between £69.1m to £94.0m.
- 24. Interest rates are at an all-time low, with the Bank of England's Monetary Policy Committee having cut the base rate in August 2016 to 0.25%. The Council's treasury advisors expect rates to remain at this level throughout 2017 and 2018 before rising back to 0.5% in second quarter of 2019.
- 25. Most existing investment deal terms are for 6 months, a reduction from last year's 12 month's duration. This is in line with the Council's Treasury advisors counterparty guidelines and reflects market/economic uncertainty arising following the vote to leave the European Union. The Strategy allows for investments beyond 6 months with high quality counterparties; e.g. property funds, Local, Fire and

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.

Police Authorities, other local authorities and the National Homelessness Property Fund.

26. 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.
27. The Council works to achieve the optimum rate of return on its investments commensurate with proper levels of security and liquidity.
28. 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).
29. 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 Swap³ (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.
30. 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 was extended for two years in September 2016.

31. 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.
32. 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:

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

- No more than 20% of the previous year's average investment balance with any one counterparty or group (currently £14.13m) or £15m, whichever is the greater
 - Maximum of 10% of total investments to be with institutions in other countries that meet the required criteria.
33. 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.
34. 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

35. 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 shown in more detail in Appendix 1.
36. 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. Additionally, once the duration of a non-specified investment falls below 365 days, it also falls into the specified category.
37. 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 or £15 million, whichever is the greater is placed in such investments.
38. 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 are 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.

Loans to companies in which the Council has an interest

39. A loan for capital purposes to a company in which the Council has an interest will be categorised as capital expenditure by the Council. This ensures that the Council can take out external borrowing to fund these loans as necessary. The Council could fund this capital expenditure from any capital resource however the majority will be funded from external borrowing. The MRP provisions in respect of

any loans to a Company are covered in paragraph 23 d). The Council will undertake these loans under powers other than its investment powers.

Ethical Investment Policy

40. Council adopted an ethical investment policy in 2015/16, which is set out below. No changes are proposed to this policy for 2017/18.

41. 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:

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

42. In November 2016 Lloyds Bank launched a Community Lending Report Deposit which specifically invests in local businesses at a rate equivalent to an ordinary deposit. An account has been opened and is ready to accept new investments when an opportunity arises. The Council has also opened an account with Royal London Asset Management which operates its investments using ethical principles; the Council currently has £8 million invested in this account.

Prudential Indicators

43. 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 2017/18 – 2019/20, and will be monitored and reported on an annual basis.

Other implications

44. Environmental Impact – 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.

Financial implications

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

Legal issues

46. 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.

47. 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.

48. 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.

Level of risk

49. The risk register is attached at Appendix 3.

Equalities impact

50. There are no equalities impacts relating to this report.

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Background Papers: None

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