www.oxford.gov.uk

OXFORD CITY COUNCIL

To:	**City Executive Board**
Date:	**13 February 2018**
Report of:	**Head of Financial Services**
Title of Report:	**Treasury Management Strategy 2018/19**

Summary and recommendations	
Purpose of report:	To present the Council's Treasury Management Strategy for 2018/19 together with the Prudential Indicators for 2018/19 to 2021/22
Key decision:	Yes
Executive Board Member:	Councillor Ed Turner, (Deputy Leader) Finance, Asset Management and Public Health
Corporate Priority:	None
Policy Framework:	
Recommendation(s):	**That the City Executive Board resolves to:**

Recommend that Council approves:

1. The Treasury Management Strategy 2018/19 as set out in paragraphs 7 to 43 and the Prudential Indicators for 2018/19 – 2021/22 as set out in Appendix 2;
2. The Borrowing Strategy at paragraphs 12 to 22;
3. The Minimum Revenue Provision (MRP) Statement at paragraphs 23 to 24 which sets out the Council's policy on charging borrowing to the revenue account; and
4. The Investment Strategy for 2018/19 and investment criteria as set out in paragraphs 25 to 39 and Appendix 1.

Appendices	
Appendix 1	Credit and Counterparty Risk Management
Appendix 2	Prudential Indicators 2018/19 – 2021/22
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.

2. The report presents the Council's prudential indicators for 2018/19 – 2021/2022. Notable indicators include capital expenditure and borrowing limits as these are areas of significant activity.

3. The average value of investments during the calendar year to 31st December 2017 was £93.7m. The actual daily value fluctuated between £72.9m to £106.2m. This is an increase on the previous calendar year, when average balances were £82.8m and daily values ranged from £62.9m to £98.8m.

4. All external debt as at 31 March 2018 (£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.

5. The Council's General Fund Capital Programme over the next four years is funded from a combination of government grants, capital receipts, revenue, Community Infrastructure Levy and prudential borrowing. However, due to the scale of investment over the period to 2021/22, particularly the loans to the Council's Housing Company (£68.7m), the level of prudential borrowing will increase to over £342.6 million in 2021/22 from the projected £238.6 million at the end of 2017/18. Borrowing from internal resources will be maximised, however much of the borrowing will need to be from external resources with anticipated external borrowing increasing from £198.5 million to £270.5 million in 2021/22. The Housing Capital Programme is funded directly from council house rents.

6. Proposed changes to the 2018/19 Strategy include:
   - A change in the methodology for measuring levels of investment balances to assess counterparty investment levels. The period over which they are now measured is the prior calendar year i.e. 1st January 2017 to 31st December 2017
   - Some changes are included due to changes in CIPFA's Treasury Management Code of Practice:
     - A summary of how the Council will manage the risks associated with loans to the Council's subsidiary Companies.
     - The inclusion of a Statement on Investments that are not part of the treasury management activity (see Appendix 1)
     - A statement on the Council's position in respect of Markets in Financial Instruments Directive II (MiFID II) (see paragraphs 8 to 11 below)

Treasury Management Strategy

Treasury Advisor

7. Treasury advice and market information is provided by Link Asset Services, formerly known as Capita Asset Services. The contract for Treasury Advisors was extended for two years in September 2016 and is due for retendering in September 2018. The information provided by Link Asset Services that is used for making investment decisions is outlined further on in this report and in associated appendices.

Markets in Financial Instruments Directive II (MiFID II)

8. Under an EU directive, MiFID II, the Financial Conduct Authority (FCA) has introduced new regulations effective from January 2018, requiring all clients, such as the City Council, currently classified as professional under the Markets in Financial Instruments Directive to opt up to professional status under MiFID II which has more stringent measures for classifying organisations. Not opting up to professional status would mean that the organisation would revert to retail status, restricting the types of investment vehicles available.

9. Each financial institution has its own methods for determining whether a client is eligible to opt up but regardless of how the financial institution assesses applications, clients must fulfil both qualitative and quantitative criteria which stipulate that professional clients will only be classified as such if they have an investment portfolio of over £10 million and they have completed a minimum of 10 transactions per quarter over the last 4 quarters. Additionally officers completing such transactions must be suitably qualified and experienced.

10. Since not opting up to Professional status would restrict the types of investment into which the Council may enter, the Council has applied to all relevant institutions and been granted professional status with all organisations applied to.

11. It is important to note that professional status under the new legislation requires the Council to assume more direct responsibility for its investment decisions but these are essentially encompassed in the due diligence the Council already applies to all investments.

Borrowing and Debt Strategy 2018/19

12. 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.

13. The arrangements also facilitate ‘invest to save’ schemes where they are affordable, prudent and sustainable.

14. 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; and
    - That the impact of the Authorised Borrowing Limit on Council Tax or council rents is reasonable.

15. The draft Capital Programme for 2018/19 to 2021/22, which appears elsewhere on the Agenda; includes the following expenditure which is currently planned to be financed by borrowing:
    - £68.7 million loans to the Housing Company, primarily to finance the purchase of New Build homes for Affordable Housing at Barton and other housing of which £57 million is available for drawdown;
    - £13.2 million for the acquisition or refurbishment of Investment Properties that will generate additional revenue income; and
    - £23.0 million to finance HRA capital expenditure.

16. The S151 officer has delegated authority to determine the need for external borrowing taking into account prevailing interest rates and associated risks. Borrowing may be undertaken to fund the approved Capital Programme or to fund future debt maturities and a combination of long-term and short-term fixed and variable rate borrowing may be considered which may include borrowing in advance of future years' requirements. In using the delegated authority, the S151 Officer will 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.

17. Council officers, in conjunction with the Council's treasury advisors, Link Asset Services, monitor 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.

18. 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. It is currently anticipated that debt to the same value will be taken out in order to replace the debt repaid.

19. The Council's Capital Financing Requirement (CFR) 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). The estimated level of CFR for each year can be found in the Prudential Indicators in Appendix 2.

Borrowing Strategy 2018/19

20. The Council currently has £25.1 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.

21. The Head of Financial Services will continue to monitor interest rates and adopt a pragmatic approach to changing circumstances:
    - If it is considered that there is a likelihood of a significant fall in long and short term rates (e.g. due to a marked increase of risks in respect of recession or deflation), then long term borrowing will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
    - Alternatively, 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

22. 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. Due to the amount of Prudential Borrowing in the Capital Programme, the potential benefits of borrowing in advance will be closely monitored.

Minimum Revenue Provision (MRP) Statement 2018/19

23. 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.

24. Regulations require the Council to approve an MRP policy on an annual basis. The following statement is recommended for 2018/19:

    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.

---

[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

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.

Investment Strategy 2018/19

Interest rates

25. Average cash balances for the year to 31st December 2017 were £93.7m, having fluctuated between £72.9m to £106.2m.

26. In November 2017, base rate increased to 0.5% from 0.25% where it had been since August 2016. It is yet to be seen whether the latest rise is the beginning of a gradual rate rise over the coming year. Economic forecasts suggest that base rate will rise to 0.75% around June 2018 and that it will continue to increase thereafter, but the Council's advisers believe that base rate will not rise again until late 2019; the situation will therefore be closely monitored. The Council's target average interest rate return is 0.6% above base rate which is estimated at 1.1% for 2018/19.

27. As with the previous financial year, most existing investment deal terms are for 6 months. However, the Council does have some longer-term investments up to one year and durations of future loans are likely to increase in line with the criteria set out by the Council's Treasury advisers.

28. Investments are made in accordance with the Council's Treasury Management Strategy such that returns are balanced against security of investment and 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. The Council works to achieve the optimum rate of return on its investments commensurate with proper levels of security and liquidity.

29. 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).

30. The Council utilises the creditworthiness services provided by Link Asset Services. 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

---

[2] Unsupported borrowing is any borrowing not covered by Government grants.

weighted scoring system which is then combined with an overlay of Credit Default Swap[3] (CDS) spreads and sovereign ratings. 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.

31. The Council is alerted to changes to ratings by Link Asset Services' creditworthiness service and takes the following action in respect of updates:
    - 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.

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

33. In addition to the recommendations from Link 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 investment balance (to 31st December) with any one counterparty or group or £15 million, whichever is the greater
    - Maximum of 10% of total investments to be with institutions in other countries that meet the required criteria.

34. 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.

35. 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

36. 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.

37. 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

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

the duration of a Non-specified Investment falls below 366 days, it also falls into the Specified category.

38. 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 therefore limited to either a maximum of 25% (currently £23.4 million) of the previous full year's average monthly investment balance to 31st December, or £24 million, whichever is the greater.

39. 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 are still classified as Specified Investments provided the duration of the investment from the start date to the maturity is no longer than 365 days. Trade dates are factored into the duration of the investment if arranged more than four weeks in advance because there is an increased risk due to funds being contractually committed.

Loans to companies in which the Council has an interest

40. Any loan for capital purposes to a company in which the Council has an interest is categorised as capital expenditure by the Council. This means that the Council can take out external borrowing to fund the loans as necessary. The Council could fund such loans from many sources; however, the majority will be funded from internal and external borrowing. The Council will not make any MRP provision in respect of loans to a Company in which it has an interest on the basis that the loan will be repaid in full on the agreed terms (see paragraph 24d). The Council will undertake these loans under powers other than its investment powers.

41. Interest rates charged on the loans will be set with reference to:
    - The level of collateral;
    - An assessment of the credit worthiness of the company; and
    - State Aid rules

42. Loan agreements will be put in place for any loans to Companies in which it has an interest. The agreements will detail:
    - The general terms under which the loan is advanced;
    - Loan repayment requirements;
    - What security there is on the loan with reference to collateral; and
    - Any loan covenants that must be adhered to.

43. The Council's Section 151 Officer will monitor the financial performance of the Companies on a regular basis and use this information to assess any risks of loan default. Where a risk of default becomes apparent, the Section 151 Officer will assess any MRP that may be required in respect of the loan.

Banking and Treasury Management Arrangements in relation to the Companies

44. Subject to approval by the Company Boards it is proposed that the bank accounts relating to the Council's wholly owned companies are grouped with the Council's bank accounts for the purposes of cash flow management and investment. In order to put this into place, the Boards of the Companies would have to adopt Treasury

Management principles in line with the Council’s Treasury Management Strategy. This has the following advantages:

- The cashflows of the companies could be managed within the Council’s current arrangements for treasury management
- Overdrafts would not need to be arranged and paid for either for the Companies’ bank accounts
- Working capital draw down could be minimised based on actual cashflow required to balance the accounts to nil (calculated on a notional basis with no need for cash transfers)
- Assuming adoption of the Council’s Treasury Management principles, the Companies could earn interest on any positive balances in line with that achieved by the Council (excluding investments in property funds)
- There would be no need for the Companies to comply separately with MiFID II to undertake investments which, due to the lack of treasury management history and an investment portfolio that does not meet the minimum levels, would not be able to be achieved, thus limiting their investment options
- The Council would not need to apply for FCA registration and therefore would not need to incur the additional costs of doing so. Additional costs would be chargeable to the Companies, but is an unnecessary additional expense providing agreement is reached on Treasury Management principles and processes.

Ethical Investment Policy

45. The Council adopted an ethical investment policy in 2015/16. No changes are proposed to the policy which is set out below:

    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

46. 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 2018/19 – 2021/22, and will be monitored and reported on an annual basis.

Other implications

47. 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

48. All financial issues are addressed in the body and appendices of the report.

Legal issues

49. 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.
50. 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.

51. The Council's 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

52. The risk register is attached at Appendix 3.

Equalities impact

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

Report author	Bill Lewis
Job title	Financial Accounting Manager
Service area or department	Financial Services
Telephone	01865 252607
e-mail	blewis@oxford.gov.uk

Background Papers: None