

To: Cabinet - 12 February 2020
Council - 13 February 2020

Report of: Head of Financial Services

Title of Report: Treasury Management Strategy 2020/21

| Summary and recommendations | |
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| Purpose of report: | To present the Council's Treasury Management Strategy for 2020/21 together with the Prudential Indicators for 2020/21 to 2024/25 |
| Key decision: | Yes |
| Cabinet Member: | Councillor Ed Turner, Deputy Leader and Cabinet Member for Finance and Asset Management |
| Corporate Priority: | None |
| Policy Framework: | The Treasury Management Strategy is a Policy Framework document |
| Recommendations: That Cabinet resolves to: | |
| Recommend that Council approves: | |
| <ol style="list-style-type: none"> 1. The Treasury Management Strategy 2020/21 as set out in paragraphs 18 to 64 and the Prudential Indicators for 2020/21 – 2024/25 as set out in Appendix 2; 2. The Borrowing Strategy at paragraphs 26 to 38; 3. The Minimum Revenue Provision (MRP) Statement at paragraphs 39 to 41 which sets out the Council's policy on charging borrowing to the revenue account; and 4. The Investment Strategy for 2020/21 and investment criteria as set out in paragraphs 42 to 63 and Appendix 1. | |

| Appendices | |
|-------------------|---|
| Appendix 1 | Credit and Counterparty Risk Management |
| Appendix 2 | Prudential Indicators 2020/21 – 2024/25 |

Summary

1. The Council's Treasury Management Strategy has been written in accordance with the revised CIPFA Prudential Code and the revised CIPFA Treasury Management Code of Practice.
2. The report presents the Council's prudential indicators for 2020/21 – 2024/2025. 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 2019 was £114.3m. The actual daily value fluctuated between £95.6m and £131.6m. This is an increase on the previous calendar year, when average balances were £102.2m and daily values ranged from £78.5m to £120.0m.
4. All external debt as at 31 March 2019 (£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 2024/25, including the loans to the Council's Housing Company (£76.1 million), the level of prudential borrowing will increase to over £511.5 million in 2024/25 from the projected £246.7 million at the end of 2019/20. 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 £419.5 million in 2024/25. The Housing Capital Programme is largely funded directly from council house rents.
6. The CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice were revised in late 2017 and have to be fully adopted from 2019/20 onwards. The codes include a requirement to produce a Capital Strategy (which the Council already did) and included additional requirements for this and also for non-Treasury Investments. In order to maintain the clarity between Treasury and non-Treasury Management Activity, all non Treasury Investments are covered by the Capital Strategy.
7. All Prudential Indicators continue to be covered together in the Treasury Strategy. This will allow the indicators to be seen as a whole and in the context of Treasury Management activity to which they are closely related. There are, however, some cross-overs to areas covered by the Capital Strategy.
8. The Prudential Indicators have been revised in line with the revised Codes of Practice. Additional disclosures are included to cover the Government's focus on "commercial activities" and non-financial investments such as loans to the Council's Companies and expenditure on investment properties. This focus has occurred due to some Councils (which have been featured in the press) incurring substantial expenditure buying investment properties to support their revenue budgets.
9. The MRP Statement has been reworked from the 2019/20 strategy in order to achieve more clarity over the policy and an additional MRP methodology added for where the borrowing relates to an income earning asset where the income is expected to increase over time.

10. The limit for non-specified investments is proposed to be increased to 30% of the previous year's total investment portfolio or £30 million, whichever is the greater, in order to allow capacity for occasional non-specified investments other than pooled investment funds such as investments with local authorities for longer than 364 days.

Loans to the Council's Companies

11. Over the life of the Council's Medium Term Financial Strategy to 2024/25 it is assumed that the Council will give loans to the Council's Housing Company to the value of around £76 million. Whereas these are not Treasury investments, there is however a positive impact on the Council's net investment income due to a markup being charged on the loans of around 2.2%. As at the end of December 2019 the Council had loans outstanding to Oxford West End Developments (OxWED) of £10.8 million and to the Housing Company of £10.37 million with interest due on these of around £1.06 million per annum.

Interest and Economic Outlook

12. The below forecasts have been based on an assumption that there is an agreed deal on the exit from the EU, including agreement on the terms of trade between the UK and EU, at some point in time. The view of the market is that the result of the general election has removed much uncertainty around this major assumption, however, it does not remove uncertainty around whether agreement can be reached with the EU on a trade deal within the short time to December 2020 as the prime minister has pledged.

| Link Asset Services Interest Rate View | | | | | | | | | | | | | | |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 | Jun-22 | Sep-22 | Dec-22 | Mar-23 |
| Bank Rate View | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.25 | 1.25 | 1.25 | 1.25 |
| 3 Month LIBID | 0.70 | 0.70 | 0.70 | 0.80 | 0.90 | 1.00 | 1.00 | 1.00 | 1.10 | 1.20 | 1.30 | 1.30 | 1.30 | 1.30 |
| 6 Month LIBID | 0.80 | 0.80 | 0.80 | 0.90 | 1.00 | 1.10 | 1.10 | 1.20 | 1.30 | 1.40 | 1.50 | 1.50 | 1.50 | 1.50 |
| 12 Month LIBID | 1.00 | 1.00 | 1.00 | 1.10 | 1.20 | 1.30 | 1.30 | 1.40 | 1.50 | 1.60 | 1.70 | 1.70 | 1.70 | 1.70 |
| 5yr PWLB Rate | 2.30 | 2.40 | 2.40 | 2.50 | 2.50 | 2.60 | 2.70 | 2.80 | 2.90 | 2.90 | 3.00 | 3.10 | 3.20 | 3.20 |
| 10yr PWLB Rate | 2.60 | 2.70 | 2.70 | 2.70 | 2.80 | 2.90 | 3.00 | 3.10 | 3.20 | 3.20 | 3.30 | 3.30 | 3.40 | 3.50 |
| 25yr PWLB Rate | 3.20 | 3.30 | 3.40 | 3.40 | 3.50 | 3.60 | 3.70 | 3.70 | 3.80 | 3.90 | 4.00 | 4.00 | 4.10 | 4.10 |
| 50yr PWLB Rate | 3.10 | 3.20 | 3.30 | 3.30 | 3.40 | 3.50 | 3.60 | 3.60 | 3.70 | 3.80 | 3.90 | 3.90 | 4.00 | 4.00 |

13. The Monetary Policy Committee (MPC) of the Bank of England has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over the EU exit and the outcome of the general election. Uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. There is still some residual risk that the MPC could cut Bank Rate as the UK economy is projected to only grow weakly in 2020 due to continuing uncertainty over whether there is time to get a trade deal in place by December 2020. Until that major uncertainty is removed, or the period for agreeing a deal is extended, it is unlikely that the MPC would raise Bank Rate.
14. Many interest rates are linked in some way to the bond market. There are heightened expectations that the US could be heading for a recession, and there is a general background of a downturn in world economic growth. This, together with inflation generally at low levels in most countries and expected to remain subdued,

means that bond yields are expected to fall and some bond yields in the Eurozone have already gone negative. Inflation has remained low due to the effect of interest rate setting by the major central banks and the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending and inflation. This has had the effect of reducing the overall level of interest rates and bond yields in financial markets. An additional effect of the unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), has led to increased consumer borrowing meaning that it is more difficult for central banks to raise interest rates.

15. During the first half of 2019/20 to 30 September, gilt yields reduced dramatically and caused a near halving of longer term PWLB rates, since PWLB rates are directly linked to bond yields, to completely unprecedented historic low levels. PWLB rates are subject to ad hoc decisions by H.M. Treasury to change the margin over gilt yields charged in PWLB rates. There was an additional 1% margin added to PWLB rates on 9th October 2019. The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise. It is not clear whether, if gilt yields were to rise back up again by over 1% within the next year or so, H M Treasury would remove this additional margin.
16. Investment returns are likely to remain low during 2020/21 with little increase in the following two years. However, if major progress was made with an agreed deal with the EU, then there is potential for additional interest earnings.
17. Economic and interest rate forecasting remains difficult with so many influences weighing on UK gilt yields and PWLB rates. The forecasts and MPC decisions will be liable to amendment depending on economic data and developments in financial markets over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

Treasury Management Strategy Statement

Background

18. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.
19. The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.
20. The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.
21. Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, arising usually from capital expenditure, and are separate from the day to day treasury management activities.
22. CIPFA defines treasury management as:
"The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."
23. Revised reporting is required for the 2019/20 reporting cycle onwards due to revisions of the MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The reporting changes include the introduction of the requirement to approve a capital strategy (which the Council produced in a slightly different form previously), to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is being reported separately and includes the additional requirements introduced with these changes.

Treasury Management Advisors

24. Treasury advice and market information is provided by Link Asset Services, formerly known as Capita Asset Services. A procurement exercise was undertaken during 2018 and the contract was awarded to Link Asset Services in September 2018 for 3 years with an option to extend for a further 2 years. 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.
25. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

Borrowing and Debt

26. 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.
27. The arrangements also facilitate 'invest to save' schemes where they are affordable, prudent and sustainable.
28. 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.
29. The draft Capital Programme for 2020/21 to 2024/25, which appears elsewhere on the Agenda; includes the following expenditure which is currently planned to be financed by borrowing:
 - £76.1 million loans to the Housing Company, primarily to finance the purchase of New Build homes for Affordable Housing at Barton and other housing;
 - £67.0 million to purchase commercial property
 - £3.7 million for the East Oxford Community Centre
 - £1.4 million on car parking
 - £12.4 million on Depot Rationalisation
 - £108.5 million to finance HRA capital expenditure.
30. 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.
31. 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.
 32. 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, of £20 million, 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. The first repayment of the remaining debt, in the sum of £20 million, will now take place in 2025-26.
 33. 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.
 34. In October 2018, a policy change of the abolition of the HRA debt cap was announced. The Chancellor announced in the Budget that the date the debt cap was to be removed was 29th October 2018. The Council can now undertake further borrowing to finance HRA capital expenditure, provided it is both affordable and prudent to do so, in line with the CIPFA Prudential Borrowing Code. The Council is using these new borrowing powers to increase housing supply by buying properties from the Housing Company.

Borrowing Strategy 2020/21

35. The Council currently has £22 million internal borrowing as at 1st April 2019. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt since 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.
36. The Head of Financial Services will continue to monitor interest rates and take a pragmatic approach to changing circumstances. Due to the risks within the economic forecast, caution will be adopted with the 2020/21 treasury operations. The increase in PWLB rates has led to increased potential competitiveness in the borrowing market from other lenders and therefore the Council will need to consider borrowing from sources other than PWLB. Additionally the Council will consider carefully when to take out borrowing, balancing the need for cash to fund treasury and non-treasury investments (such as the purchasing of new investment property) and the cost of borrowing.:

- 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

37. The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.
38. 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 2020/21

39. Prudential borrowing increases the Council's Capital Financing Requirement (CFR) or underlying need to borrow. Whether the Council actually borrows externally to finance capital expenditure is a treasury management decision which is not directly linked 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, whether that borrowing is financed internally or externally. This charge is known as the Minimum Revenue Provision (MRP) and reflects the repayment cost of principal borrowed.
40. Regulations require the Council to approve an MRP policy on an annual basis and to calculate in each financial year an amount of MRP that it considers to be prudent. In doing this, the Council has to pay regard to governmental statutory guidance on MRP. MRP is not charged until the year after the expenditure has been incurred. The following statement has been reworked from the 2019/20 strategy in order to achieve more clarity over the policy and an additional MRP methodology added for where the borrowing relates to an income earning asset where the income is expected to increase over time (included in method d) below). A statement has also been included to cover the methodology that is applied for finance leases which aligns with existing practice (method e) below).

41. It is recommended that this MRP methodologies be adopted for 2020/21:

- a) For borrowing incurred before 1 April 2008 the practice of making a 4% annual charge on the reducing balance, outlined in the former Department for Communities and Local Government (DCLG) regulations, will apply.
- b) For borrowing 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) There will be no annual MRP charge made for the following items where they are deemed to be capital under s25(b)/s25(d) of The Local Authorities Capital Finance and Accounting (England) Regulations 2003 and where it is anticipated the investment will be repaid in full:
 - i. The Council's investments in a Directly Managed Property Fund;
 - ii. Loans to other organisations, such as a company in which the Council has an interest;
 - iii. Treasury management investments undertaken in accordance with section 12 of the Local Government Act 2003;
 - iv. Borrowing related to capital expenditure incurred on assets which are to be leased to one of the Council's companies; and
 - v. Other borrowing related to expenditure where it is anticipated the investment will be repaid in full.

The repayment to the Council for these will be a capital receipt of which the Council will set aside the amount for which borrowing was used in order to repay that borrowing. Each item where there is no annual MRP charge 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.

- d) For all borrowing incurred after 1 April 2008 relating to expenditure other than that which is covered in c) above, the MRP will be charged using the Asset Life Method. The default methodology under this option is that MRP will be based on the estimated life of the asset and will be charged to the revenue account in equal instalments over the life of the asset. Where the Head of Financial Services, in their capacity of section 151 officer, is comfortable that the asset or the income arising from that asset is appreciating over time, MRP will be based on an annuity charge over the estimated life of the asset. Applying the annuity method results in an annual charge to revenue which takes account of the time value of money. The charges made through the annuity method thus results in a consistent charge over an asset's life, taking into account the real value of the annual charges when they fall due.
- e) For finance leases the council will charge MRP to its General Fund each year dependant on the life of the underlying asset.

Annual Investment Strategy 2020/21

Management of Risk

42. The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy which is presented in a separate report.

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

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018

The Council's investment priorities will be security first, portfolio liquidity second and then yield (return).

44. The guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

- a) Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
- b) **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "**credit default swaps**" and overlay that information on top of the credit ratings.
- c) **Other information sources** used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
- d) This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in appendix 1 under the categories of 'specified' and 'non-specified' investments.
 - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
 - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

45. As a result of the change in accounting standards for 2018/19 under IFRS 9, the Council will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. In November 2018, the Ministry of Housing, Communities and Local Government concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1st April 2018.

Interest rates

46. Average cash balances for the year to 31st December 2019 were £114.3m, having fluctuated between £95.6m and £131.6m.
47. In August 2018, base rate increased to 0.75% and has remained at that level for 2019 following a previous rise in November 2017. The Council's target average interest rate return is 0.6% above base rate. Investment returns are likely to remain low during 2020/21 but to be on a gently rising trend over the next few years.
48. In the event of an orderly non-agreement exit from the EU, it is possible that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall. If there was a disorderly exit, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

Investment Durations

49. 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.
50. 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.

Creditworthiness

51. 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).
52. 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 weighted scoring system which is then combined with an overlay of Credit Default Swap (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.

53. 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.
54. 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.
55. 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.
56. 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.
57. 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

58. 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.
59. 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 366 days, it also falls into the Specified category.
60. Non-specified investments are any other type of investment including pooled investment 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 30% (currently £34.3 million) of the previous full year's average

monthly investment balance to 31st December, or £30 million, whichever is the greater. The Council currently has £10 million of property investments; £7 million with Lothbury property fund and £3 million with CCLA Investment Management Ltd property fund. A further investment of £10 million is currently planned in a multi asset fund.

61. 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 364 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.

Ethical Investment Policy

62. 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)
63. The Council has been able to take advantage of some green deposit notice accounts offered by Barclays Bank who are working in association with Sustainalytics, a leading global provider of environmental, social and corporate governance research and ratings, to achieve a positive environmental impact. Their green framework covers the following environmental areas:
- Energy efficiency projects and renewable energy
 - Sustainable food agriculture and forestry
 - Waste management
 - Greenhouse gas emission reduction
 - Sustainable water

The balance of these investments as at 31st December 2019 was £7.5 million.

Prudential Indicators

64. 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 2019/20 – 2024/25, and will be monitored and reported on an annual basis.

Other implications

65. 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

66. All financial issues are addressed in the body and appendices of the report. The Council's assumptions for net investment interest for the General Fund for 2020/21 to 2024/25 are as follows:

| | 2020/21 | 2021/22 | 2022/23 | 2023/24 |
|---|---------------|---------------|---------------|---------------|
| | £000's | £000's | £000's | £000's |
| Interest Payable | 8,294 | 10,618 | 12,933 | 15,639 |
| Interest from companies on borrowing | -2,506 | -4,267 | -4,992 | -6,101 |
| Transfer from HRA | -7,702 | -8,042 | -9,622 | -11,565 |
| Treasury management investment interest | -1,222 | -1,044 | -1,063 | -1,058 |
| Net investment interest | -3,136 | -2,735 | -2,744 | -3,085 |

67. This includes the cost of borrowing, interest from companies and interest from external investments.

Legal issues

68. 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.

69. 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.

70. 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

71. Risks are managed as set out in this report and appendices. The Council is intending to invest a further £10 million in pooled investment funds during 2019/20. The use of these instruments can be deemed capital expenditure, and as such can require the use of capital resources. This Authority will seek guidance on the status of any fund it may consider using. Appropriate due diligence will also be undertaken before investment of this type is undertaken.
72. The value of property funds is reliant on the value of the property held by the funds and property values can go down as well as up. It will be ensured that the Fund(s) that the Council uses will hold a broad property portfolio which will mitigate the risk of specific sectors suffering a loss in property values. The regular returns from Property Funds are from property rentals so as long as the properties remain tenanted there will be a return. The risk of holding property is also affected by the uncertainty over the exit from the EU and changes in the market such as retail.
73. Increases and decreases in the value of property funds now have to be charged to the revenue account, although there is a statutory mitigation from Government that allows these impacts to be reversed out for five years.

Equalities impact

74. The Council has adopted an ethical investment policy to help reduce the environmental, health and wellbeing impacts that could potentially arise from investments. There are no other equalities impacts relating to this report.

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Background Papers: None

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