Report to:

Joint Audit & Governance Committee
Cabinet
Council

Report of Head of Finance **REPORT NO**

Author: Rhona Bellis

Telephone: 01235 422497

E-mail: Rhona.bellis@southandvale.gov.uk

Wards affected: all

Cabinet member responsible: Councillor Robert Sharp

Tel: 01367 710549

E-mail: Robert.sharp@whitehorsedc.gov.uk

To:	JOINT AUDIT & GOVERNANCE COMMITTEE on	23 January 2017
	CABINET on	3 February 2017
	COUNCIL on	15 February 2017

Treasury management and investment strategy 2017/18 to 2019/20

Recommendations

The committee recommends to cabinet and council:

1. To approve the treasury management strategy 2017/18 set out in appendix A to this report;

2. To approve the prudential indicators and limits for 2017/18 to 2019/20 as set out in table 2, appendix A;

3. To approve the annual investment strategy 2017/18 set out in appendix A (paragraphs 24-63) and the lending criteria detailed in table 5.

That cabinet:

Considers any comments from committee and recommends council to approve the report.

Purpose of report

1. This report presents the council's Treasury Management Strategy (TMS) for 2017/18 to 2019/20. This sets out how the council's treasury service will support capital investment decisions, and how the treasury management operates day to day. It sets out the limitations on treasury management activity governed by the prudential indicators, within which the council's treasury function must operate. The strategy is included as appendix A to the report. This report includes the three elements required by legislation as follows:

    - The **prudential indicators** required by the CIPFA Prudential Code for Capital Finance in Local Authorities;

    - The **annual investment strategy.** This sets out the council's criteria for selecting counterparties and limiting exposure to the risk of loss on its investments. This strategy is in accordance with the DCLG investment guidance and forms part of the treasury management strategy. (appendix A, paragraphs 24-65);

    - A statutory duty to approve a **minimum revenue provision** policy for 2017/18 (paragraphs 55-61).

    It is a requirement of the CIPFA Treasury Management Code 2011 that this report is approved by full Council on an annual basis.

Strategic objectives

2. Managing the finances of the authority in accordance with the treasury management strategy will help to ensure that resources are available to deliver its services and meet the council's other strategic objectives.

Background

3. 'Treasury management' is the planning of the council's 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.

4. The funding of the council's capital expenditure is also a function of treasury management. The capital programme provides a guide to the funding needs of the council and the long term cash flow plans to ensure that the council can meet its capital spending obligations.

5. The treasury management and annual investment strategy set out the council's policies for managing investments and confirms the council gives priority to the security and liquidity of those investments. It also includes the prudential indicators for the next three years; these demonstrate that the council's capital investment plans are affordable, prudent and sustainable.

6. The council's treasury management strategy 2017/18 to 2019/20 is attached in appendix A. Whilst every attempt has been made to minimise the technical content

of this report, it is, by its very nature and the need for compliance with associated guidance, technical in parts. A glossary of terms in annex 6 should aid with the understanding of some of the technical terms used in the report.

Recommended changes to the treasury management strategy

7. Council approved the 2016/17 treasury management strategy on 17 February 2016. The proposed strategy for 2017/18 includes the changes detailed below, which cabinet is asked to recommend to council:

Table 2 Prudential Indicators

- To change the limits on fixed interest rates to 100 per cent from £40 million.
- To raise the limits on variable interest rates to £50 million from £30 million.
- To raise the upper limit for principal sums invested for longer than 364 days to £40 million from £30 million.

Note that the Section 151 officer has already agreed that the limit on fixed interest rates can be increased from £40 million to £43 million in 2016/17. This followed a breach of the existing limit during December 2016.

Appendix A Minimum Revenue Provision

- To approve the change in the MRP policy that states that the council will use the "asset life method" to calculate MRP as a provision for repayment of borrowing if applicable.

Annex 2 Liquidity

- To simplify the performance measurement in terms of investment liquidity in Annex 2 paragraphs 3 and 4 to focus on maintaining minimum levels of working capital in short term vehicles

8. The Section 151 officer is content that there is no current need to review practices following the TUPE transfer of staff to Capita in August 2016 whilst the service is provided on a "business as usual" basis. However when there are changes to this provision then practices will be reviewed.

Financial implications and risk assessment

9. This report and all associated policies and strategies set out clearly the parameters the council must work within. It is important that the council follows the approved treasury management strategy which is designed to safeguard the council's finances by managing its risk exposure.

10. In the last few years investment income has fallen due to lower interest rates. In the medium term interest rates are expected to remain low. According to latest forecasts from Capita Asset Services, the council's treasury advisors, a rise in interest rates is not expected until June 2019 and any rises in rates are expected to be slow and gradual given the continued uncertainty in the economy. The table below gives an estimate of the investment income achievable for the next five years.

Table 1: Medium term investment income forecast					
	2017/18	2018/19	2019/20	2020/21	2021/22
	£000	£000	£000	£000	£000
Forecast as at January 2017	464	390	434	491	517

11. The 2017/18 budget setting report and medium term financial plan will take into account the latest projections of anticipated investment income.

Legal implications

12. There are no significant legal implications as a result of the recommendations in this report. Compliance with the CIPFA Code of Practice for Treasury Management in the Public Services, the CLG Local Government Investment Guidance provides assurance that the council's investments are, and will continue to be, within its legal powers.

13. The council must approve any amendment to the treasury management strategy and annual investment strategy in accordance with the Local Government Act 2003 (the Act), the CIPFA Code of Practice for Treasury Management in the Public Services and the CLG Local Government Investment Guidance under Section 15(1) (a) Local Government Act 2003 and CIPFA Prudential Code for Capital Finance.

Conclusion

14. This report provides details of the proposed changes to the treasury management strategy and the annual investment strategy for 2017/18 which are appended to this report, together with the prudential indicators for approval to council. These documents provide the parameters within which the council's treasury management function will operate.

Background papers

- CIPFA Treasury Management in the Public Services Code of Practice and Cross Sectoral Guidance Notes (revised 2011)
- CLG Local Government Investment Guidance under Section 15(1) (a) Local Government Act 2003 and CIPFA Prudential Code for Capital Finance.
- Treasury Management Investment Strategy 2016/17 (cabinet 5 February 2016, council 17 February 2016)

Appendices

Appendix A Treasury Management Strategy 2017/18 – 2019/20 - incorporating the following:

Annex 1	Economic conditions
Annex 2	Risk and performance benchmarking
Annex 3	Property investment policy
Annex 4	Explanation of prudential indicators
Annex 5	TMP1 extract
Annex 6	Glossary of terms

Appendix A

Treasury Management Strategy 2017/18- 2019/20

Introduction

1. The Local Government Act 2003 and supporting regulations require the council to 'have regard to' the CIPFA Prudential Code and to set Prudential Indicators for the next three years to ensure that the council's capital investment plans are affordable, prudent and sustainable.
2. The Act requires the council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act). This sets out the council's policies for managing its investments and for giving priority to the security and liquidity of those investments.
3. The strategy in respect of the following aspects of the treasury management function is based on treasury officers' views on interest rates, supplemented with market forecasts provided by the council's treasury advisor, Capita Asset Services. The strategy covers:
    - Prudential and treasury indicators in force that will limit the treasury risk and activities of the council;
    - Current treasury position
    - Prospects for interest rates;
    - Borrowing strategy
    - Policy on borrowing in advance of need;
    - Investment strategy;
    - Counterparty selection and limits;
    - Policy on use of external service providers;
    - Minimum revenue provision (MRP) statement;
    - Treasury management scheme of delegation and Section 151 role.
4. It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each year to include the revenue costs that flow from capital financing decisions. This means that increases in capital expenditure must be limited to a level where any increases in charges to revenue are from:
    - Increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
    - Any increases in running costs from new capital projects are identified and limited to a level which is affordable.

    A key requirement of this report is to explain the risks, and the management of those risks, associated with providing the treasury service. Legislation requires that as a minimum two further treasury reports are provided: a mid-year monitoring report and an outturn report after the year-end that reports on actual activity for the year.

Treasury Limits for 2017/18 to 2019/20

5. It is a statutory duty, under Section 3 of the Act and supporting regulations for the council to determine and keep under review how much it can afford to borrow. The

amount so determined is called the "Affordable Borrowing Limit". The Authorised Limit is the legislative limit specified in the Act.

6. The council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital expenditure remains within sustainable limits and in particular, that the impact upon its future council tax is 'acceptable'.

7. The Authorised Limit is set on a rolling basis, for the forthcoming financial year and two successive financial years.

8. The following indicators set the parameters within which we manage the overall capital investment and treasury management functions. There are specific treasury activity limits, which aim to contain the activity of the treasury function in order to manage risk and reduce the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. The limits are set out in table 2 below.

Cabinet is asked to recommend council to approve the limits:

Table 2: Prudential indicators

	2016/17	2017/18	2018/19	2019/20
Debt	**£m**	**£m**	**£m**	**£m**
Authorised limit for external debt				
Borrowing	30	30	30	30
Other long term liabilities	5	5	5	5
	35	**35**	**35**	**35**
Operational boundary for external debt				
Borrowing	25	25	25	25
Other long term liabilities	0	5	5	5
	25	**30**	**30**	**30**
Interest rate exposures				
Maximum fixed rate borrowing	100%	100%	100%	100%
Maximum variable rate borrowing	100%	100%	100%	100%
Investments	**£m**	**£m**	**£m**	**£m**
Interest rate exposures				
Limits on fixed interest rates	40	100%	100%	100%
Limits on variable interest rates[1]	30	50	50	50
Principal sums invested > 364 days				
Upper limit for principal sums invested >364 days	30	40	40	40

[1] The council has an investment in CCLA – property fund which pays dividends and is not included in this limit.

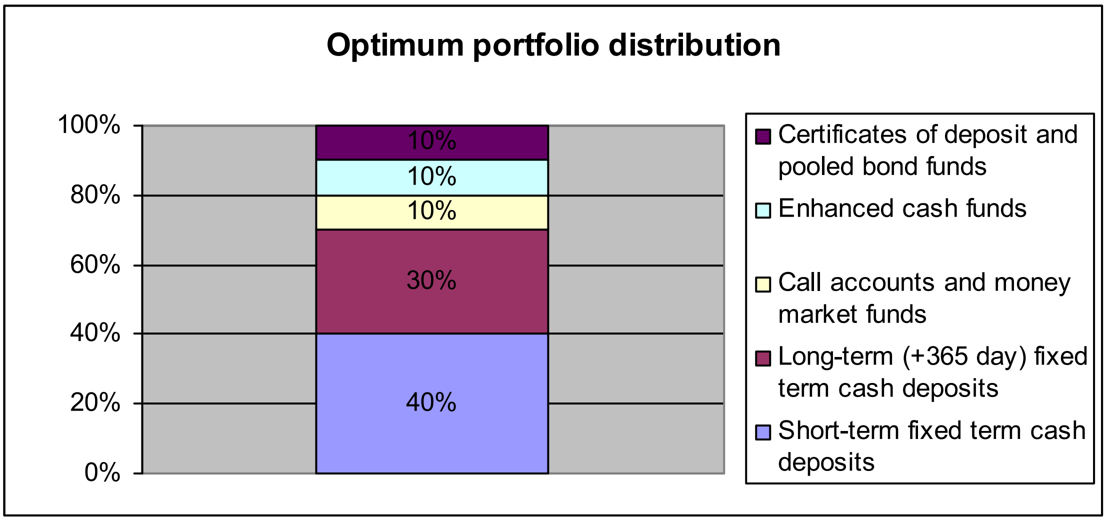
Current position

9. The maturity structure of the council's investments at 31 December 2016 was as follows:

Table 3: Maturity structure of investments:				
	Classification of investment at deal date		Classification as at 31/12/2016	
	£'000		£'000	
Call	100	0%	100	0%
Money market fund	9,090	17%	9,090	17%
Less than 6 months	9,000	17%	27,000	51%
6 months to 1 year	25,000	47%	9,000	17%
1 year +	8,000	15%	6,000	11%
CCLA - property fund	2,000	4%	2,000	4%
Total investments	**53,190**		**53,190**	

10. The council currently holds all of its investments in the form of either cash deposits or a managed property fund (£2 million with CCLA), the majority of which have been placed for fixed terms with a fixed investment return.

11. The council's considerations for investment will remain security, liquidity and yield – in that order. Within this framework an optimum portfolio distribution of cash investments could be considered as follows:



This represents officer interpretations of a diversified portfolio and from time to time actual holdings will vary from this significantly. Should interest rates increase then consideration would be given to increasing the proportion held for the long term.

Investment performance for the year to 31 December 2016.

12. The council's budgeted investment return for 2016/17 is £0.411 million, and the actual interest received to date is shown as follows:

Table 4: Investment interest earned to date and outturn estimate				
		Interest Earned		
Investment type	Annual Budget 2016/17 £000's	Actual to date 2016/17 £000's	Annual Forecast 2016/17 £000's	Forecast Variation 2016/17 £000's
Position at end December 2016	411	444	570	159
Total interest	**411**	**444**	**570**	**159**

Borrowing Strategy 2017/18 – 2019/20

13. The annual treasury management strategy has to set out details of the council's borrowing requirement, any maturing debt which will need to be re-financed, and the effect this will have on the treasury position over the next three years. This council currently has no external debt and external borrowing may only prove necessary to fund the future capital programme.

14. The council will continue to take a prudent approach to its debt strategy. In general, the council will borrow for one of two purposes:

- to support cash flow in the short-term;
- To fund capital investment over the medium to long term.

Any borrowing undertaken will be within the scope of the boundaries given in the prudential indicators shown in Table 2.

15. The prudential indicators provide the scope and flexibility for the council to borrow up to a maximum of £30 million, if such a need arose. This also allows short-term borrowing for the cash flow management activities of the authority, for the achievement of its service objectives.

16. The existing capital programme can be financed from internal resources. Additional expenditure committed as part of the 2017/18 budget setting process can be financed from internal resources (either by use of reserves or internal borrowing) or externally (through prudential borrowing). Any decision on borrowing will be taken by the Head of Finance based on the optimum cost to the council.

17. Currently, the council is debt free. There is no financial advantage to the council of maintaining a debt free status, other than it avoids the revenue cost of servicing any borrowing it assumes. Any borrowing undertaken will be within the framework of the prudential indicators included in this report.

18. The latest projection from the council's treasury advisors, Capita Asset Services, is for the Bank of England base rate to remain unchanged at 0.25 per cent until June 2019.

19. The treasury management strategy for the forthcoming year aims to efficiently manage the investment portfolio by reducing the amount of funds held extremely short-term for cash flow purposes and operating with an adequate but not excessive level of working capital. This optimum level is dictated by the accuracy of cash flow forecasts and,

although unlikely, it is prudent to set a minimum level for the use of short-term borrowing arrangements or overdraft facilities if the cash flow forecasts prove inaccurate at any point in the year.

20. This strategy allows the Head of Finance to take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above.

21. Any borrowing for capital financing purposes will be assessed by the Head of Finance to be prudent, sustainable and affordable

22. This strategy allows the Head of Finance to determine the most suitable repayment terms of any borrowing to demonstrate affordability and sustainability in the medium term financial plan. As a general rule, the term of any borrowing will not be longer than the expected life of the capital asset being created.

Policy on borrowing in advance of need

23. 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 approved Capital Financing Requirement estimates, and will be considered carefully to ensure value for money can be demonstrated and that the council can ensure the security of such funds. In determining if any borrowing will be undertaken in advance of need, the council will:

    - consider the impact of borrowing in advance on investment cash balances and the exposure to counterparty risk. Any risk associated with any borrowing in advance of activity will be subject to prior appraisal and subsequent reporting through the mid year or annual reporting process.

    - consider the optimum point to borrow in advance of need to obtain the most beneficial rates on any loan raised to minimise the cost of borrowing over the duration of the loan.

Annual investment strategy

24. The primary aim of the council's investment strategy is to maintain the security and liquidity of its investments; yield or return on the investment will be a secondary consideration, subject to prudent security and liquidity. The council will ensure:

    - It has sufficient liquidity in its investments to cover cash flow. For this purpose it has set out parameters for determining the maximum periods for which funds may prudently be committed.

    - It maintains a policy covering the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security.

25. The strategy aims to provide a high degree of flexibility to take appropriate lending decisions, with a view to producing a portfolio with an even spread of maturity periods as and when institutional security and market confidence returns. This aim is to provide a more even and predictable investment return in the medium term.

26. The council's Head of Finance will ensure a counterparty list (a list of named institutions) is maintained in compliance with the recommended credit rating criteria (table 5) and will revise the criteria and submit any changes to the credit rating criteria to council for approval as necessary.

Investment types

27. The types of investment that the council can use are summarised below. These are split under the headings of 'specified' and 'non-specified' in accordance with the statutory guidance.

Specified investment instruments

28. These are sterling investments of not more than one year maturity, or those where the council has the right to be repaid within 12 months if it wishes. These would include sterling investments with:

- UK government Debt Management Agency Deposit Facility (DMADF)
- UK government – treasury stock (Gilts) with less than one year to maturity
- Supranational bonds of less than one year's duration
- Deposits with UK local authorities
- Pooled investment vehicles such as Money Market Funds (MMF) (AAA rated)
- Deposits with banks and building societies (minimum F1/A- rated)
- Certificates of deposits issued by banks and building societies (minimum rating as above)

Non-specified investment instruments

29. These are any other type of investment (i.e. investments not defined as specified, above). Non-specified investments would include any sterling investments with:

- Supranational bonds of 1 to 10 years to maturity
- UK treasury stock (Gilts) with a maturity of 1 to 10 years
- Unrated building societies (minimum asset value £1 billion)
- Bank and building society cash deposits up to 5 years (minimum F1/A- rated)
- Deposits with UK local authorities up to 25 years to maturity
- Corporate bonds
- Pooled property, pooled bond funds and UK pooled equity funds
- Direct property investment

Other Non-specified investment instruments

30. Other non-specified investment instruments include:

- Fixed term deposits with variable rate and variable maturities

Approach to investing

31. The council holds approximately £14 million core cash balances which are available to invest for more than one year. This is expected to reduce over the medium term as the approved capital expenditure is incurred and not replenished by capital receipts. In

addition the council has funds that are available on a temporary basis to invest. These are held pending payment over to another body such as precept payments and council tax. The amount can vary between £5 million and £15 million throughout the year and should only be invested short term (under one year). Investments will be made with reference to known cash flow requirements (liquidity).

32. Whilst the current market uncertainties remain the council will aim to keep investments relatively short term, but will continue to look for opportunities to fix lending in the medium term with highly rated institutions when possible for core cash balances. The aim is to increase the weighted average maturity of the portfolio in order to reduce maturity risk.

33. Officers will continue to implement an operational strategy which provides tight controls on the investments placed. Where possible, opportunities to spread the investment risk over different types of instruments will be considered.

34. Should market conditions deteriorate suddenly to the extent that the council is unable to place money with institutions with the necessary credit rating, it will make use of the UK Government deposit account (DMADF).

35. The council has the authority to lend to other local authorities at market rates. Current investments include £4 million of lending to Kingston upon Hull City Council, which matures in 2020/21. Whilst investments with other local authorities are considered to be supported by central government, officers will consider the financial viability and sustainability of the individual local authority before any funds are advanced.

36. The property investment holdings will be kept under review to identify if further investments should be placed in these categories. Property funds will also be looked at in more detail for consideration. In 2013/14 the council invested £2 million in the Churches Charities and Local Authorities pooled property investment fund (CCLA). Further details on the property investment policy are contained in annex 3.

37. Money market funds are mainly used for liquidity; they also provide security and spread portfolio risk. Officers will always monitor the council's exposure to these funds in order to manage our security risk.

38. Currently the council does not make use of an external fund manager. Whilst there are presently no plans for this situation to change, this will continue to be kept under review.

39. Bond funds can be used to diversify the portfolio, whilst maintaining an element of liquidity and security. These will be considered and reviewed as an investment possibility to spread portfolio risk.

40. One option to offer diversification in the council's investment portfolio would be to make use of enhanced cash funds. Possible use of such funds would be intended for longer term investments than with traditional money market funds (i.e. for possible investment durations of three – six months). Investments placed with enhanced cash funds are callable and so offer the option to be withdrawn before maturity, although this is likely to have an adverse impact on the return on the investment.

41. Unlike money market funds, enhanced cash funds have a variable net asset value (VNAV). This means the assets are 'marked to market' (re-valued to current market value) on a daily basis and the fund unit price adjusted accordingly. Under this calculation basis the unit price fluctuates and could, therefore, be higher or lower than the original investment when it is redeemed. Any use of enhanced cash funds would be restricted to the high quality counterparty credit criteria as set out in Table 5 below.

42. The council does not currently make use of certificates of deposit. Consideration will be given to their use to assist diversification of the investment portfolio. Certificates of deposit have the same level of ranking and security as ordinary fixed term deposits but have the option of being traded before maturity. Certificates of deposit are bought and sold on the stock market and their price can go up or down prior to their redemption date. If held to maturity the investment will return their issue value. The council would only normally look to enter into such investments on a held to maturity basis.

Counterparty selection

43. Treasury management risk is the risk of loss of capital to the council. To minimise this risk, the council uses credit rating information when considering who to lend to. Capita Asset Services provide the council with credit rating updates from all three ratings agencies – Standard & Poors, Fitch and Moodys.

44. The council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies in evaluating investment opportunity. This is because adopting this approach could leave the council with too few counterparties for the strategy to be workable. Instead, counterparty investment limits will be set by reference to all of the assigned ratings.

45. Credit rating information is supplied by Capita Asset Services, our treasury consultants. Any counterparty failing to meet the minimum required criteria (Table 5 below) would be omitted from the counterparty list. Any rating changes and rating watches (notification of a rating change) are provided to officers almost immediately after they occur and this information is considered before any deal is entered into. Extreme market movements may result in a downgrade of an institution or removal from the council's lending list.

46. Additional requirements under the CIPFA Treasury Management Code require the council to supplement the credit rating data with operational market information such as credit default swaps (CDS), negative watches and outlooks, which are considered when assessing the security of counterparties. This additional information is used so that the council does not rely solely on the current credit ratings of counterparties.

47. Where it is felt the council would benefit from utilising government guarantees provided by countries with an AAA rating, the council may lend to institutions covered by such guarantees. Any decision to lend in this way will be subject to consultation with and the agreement of the cabinet member responsible for finance.

Country and sector considerations

48. The council has determined that it will only use approved counterparties outside the UK from countries with a minimum sovereign credit rating of AAA from Fitch Ratings.

Counterparty limits

49. In the normal course of the council's cash flow operations it is expected that both specified and non-specified investments will be used for the control of liquidity as both categories allow for short term investments. The use of longer term instruments (greater than one year from inception to repayment) will fall in the non-specified investment category. These instruments will be used where the council's liquidity requirements are safeguarded. The council will lend to institutions that meet the following criteria:

Table 5: Counterparty limits

Counterparty	Minimum Fitch Rating (or equivalent)	Counterparty Limit £m	Max. maturity period	Maximum % of total investments
Routinely used counterparties				
Banks - house bank	n/a	£5.0m	3 months	20%
Banks - part nationalised UK	UK sovereign	£15.0m	3 years	100%
Building societies - assets > £1,000m	n/a	£3.0m	12 months	50%
Building societies - assets > £3,000m	n/a	£3.5m	12 months	60%
Building societies - assets > £5,000m	n/a	£5.0m	12 months	70%
Institutions with a minimum rating:	F1 / A-	£7.5m	2 years	80%
Local authorities; parish councils	n/a	£20.0m	25 years	20%
Money Market funds (CNAV)	AAA	£20.0m	liquid	100%
Pooled property funds - CCLA	n/a	£3.0m	variable	10%
Other counterparties				
Corporate Bonds	AA-	£5.0m	variable	40%
Direct property investment	n/a	n/a	unlimited	80%
Enhanced cash funds (VNAV)	AAA / V1	£15.0m	variable	50%
Institutions with a minimum rating:	F1+ / AA-	£10.0m	5 years	100%
Institutions with a minimum rating:	F2/BBB	£5.0m	1 year	70%
Managed Bond Funds	n/a	£15.0m	variable	40%
Share capital / Equities	n/a	£3.0m	variable	20%
Supranationals	AAA	£10.0m	10 years	50%
UK Government - DMADF	UK sovereign	Unlimited	6 months	100%
UK Government - gilts	UK sovereign	Unlimited	25 years	20%
UK Government - treasury bills	UK sovereign	Unlimited	12 months	50%

50. The criteria for choosing counterparties provides a sound approach to investment. Whilst councillors are asked to approve the criteria in table 5, under exceptional market conditions the head of finance may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval.

Fund managers

51. The council does not currently employ any external fund managers. However in the event of such an appointment, appointees will comply with this and subsequent treasury strategies. This strategy empowers the Section 151 officer to appoint such an external manager to manage a proportion of the council's investment portfolio if this is advantageous. Situations in which this might be advantageous include benchmarking the performance of the internal treasury team; benefiting from the often extensive

credit risk and economic modelling resources of external fund managers and resources necessary to hold liquid instruments for trading.

Risk and performance benchmarks

52. A requirement of the Code is that security and liquidity benchmarks are considered and approved. This is in addition to yield benchmarks which are used to assess performance. The benchmarks are guidelines (not limits) so may be breached depending on the movement in interest rates and counterparty criteria. Their purpose is to allow officers to monitor the current trend position and amend the operational strategy depending on any changes. Any breach of the benchmarks will be reported, with an explanation in the mid year or annual report to audit and corporate governance committee. Detailed information for the assessment of risk is shown in annex 2.

53. Performance indicators are set to assess the adequacy of the treasury function over the year. These are distinct historic performance indicators, as opposed to the predominantly forward looking prudential indicators. The indicators used to assess the performance of the treasury function are:

- Cash investments - 3 month LIBID rate.
- Property related investments – IPD Balance Property Unit Trust Index.

54. The results of these indicators will be reported in both the annual mid-year and year-end treasury reports.

Policy on the use of treasury management advisors

55. The council has a joint contract for treasury management advisors with South Oxfordshire District Council. Capita Asset Services, a subsidiary of the Capita Group Plc provides a range of services which include:

    - technical support on treasury matters, capital finance issues, statutory reports;
    - economic forecasts and interest rate analysis;
    - credit ratings / market information service involving the three main credit rating agencies;
    - strategic advice including a review of the investment and borrowing strategies and policy documents.

56. 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 our external service providers. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills, resources and up to date market information.

Minimum Revenue Provision (MRP) policy statement 2017/18

57. MRP is the amount out of revenues set aside each year as a provision for debt i.e. the provision in respect of capital expenditure financed by borrowing.

58. The council is required by regulation to approve an annual MRP policy before the start of the year to which it relates. Any in-year changes must also be submitted to the council for approval.

59. A variety of options are provided to councils for the calculation of MRP. The council has chosen the "asset life method" as being most appropriate. Using this method MRP will be based on the estimated life of the asset, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction). Repayments included in annual PFI or finance leases are applied as MRP.

60. Currently, the council's MRP liability is nil. This will remain the case unless capital expenditure is financed by external borrowing.

61. In the event that borrowing is required to fund the council's capital programme the Head of Finance will determine the most appropriate repayment method, term of borrowing and duration of borrowing.

Councillor and officer training

62. The requirement for increased councillor consideration of treasury management matters and the need to ensure officers dealing with treasury management are trained and kept up to date requires a suitable training process for councillors and officers. In compliance with the revised CIPFA Code, the council provided treasury management training to councillors in January 2017. Further training can be provided if required or requested.

Treasury management scheme of delegation and the role of the Section 151 officer

63. The treasury management scheme of delegation and the role of the Section 151 officer is as follows:

I. **Council**
   - Receiving and approval of reports on treasury management policies, practices, outturn and activities;
   - Approval of annual strategy

II. **Joint Audit and Governance Committee / Cabinet**
   - Approval of amendments to the organisations, adopted clauses, treasury management policy statements and treasury management practices;
   - Receiving and reviewing monitoring reports and acting on recommendations;
   - Ensuring effective scrutiny of the treasury management function

III. **Section 151 Officer / Head of Finance**
   - Recommending clauses, treasury management policies/practices for approval, review and monitoring compliance;
   - Submitting regular treasury management information reports;
   - Submitting budgets and budget variations;
   - Reviewing the performance of the treasury management function;
   - Ensuring adequacy of treasury management resources and skills and the effective division of responsibilities within the treasury management function;
   - Ensuring the adequacy of internal audit and liaising with external audit;
   - Approving the selection of external service providers and agreeing terms of appointment.

Summary

64. Prior to the beginning of each financial year the council must approve the treasury management strategy. The strategy sets the parameters within which officers can manage the council's cash flows and invest any surplus funds.

65. This strategy provides a commentary on the current financial climate and sets out the council's lending strategy in response to this.

Economic conditions and interest rate forecasts

1. In order to put the investment strategy into context it is necessary to consider the strength of the UK economy, external factors in the financial markets and their impact on interest rate forecasts.

UK economy

2. Since the second quarter of 2013 the UK has reported rising levels of GDP. However, following the result of the EU referendum, growth has become volatile. Indicators suggest we will still see growth thanks to low unemployment and household spending, but the rate of growth will be slower than previously forecast.

3. Levels of unemployment currently stand at 4.9 per cent, lower than the initial threshold of seven per cent previously flagged by the MPC as the point before which it would not consider any increase in bank rate. The MPC broadened its forward guidance by looking at a much wider range of economic indicators in order to form a view on spare capacity in the domestic economy.

4. Consumer Price Inflation currently stands at 0.6 per cent. Forward indications are that rates of inflation will rise due to the weakness in sterling and the impact this is having on import prices.

5. The latest projection from Capita Asset Services is for a first increase in interest rates to occur around June 2019.

Eurozone economy

6. Growth has slowed in the Eurozone. Consumer confidence is falling, especially in Germany, which is pulling growth lower. The Euro has strengthened since the Brexit vote in June, and if it remains strong, it will result in inflation in the bloc falling sharply in the coming months.

Capita Asset Services forward view

7. Economic forecasting continues to be difficult given the number of external influences affecting the UK. Key areas of risk include:
   - Economic uncertainty caused by the ongoing unrest in Eastern Europe, the Middle East and Asia;
   - UK economic growth is weaker than we currently anticipate;
   - Weak economic growth or recession in the European Union, the UK’s main trading partner;
   - A resurgence of the Eurozone sovereign debt crisis;
   - Weak capitalisation of some European banks;
   - Monetary policy action failing to stimulate sustainable growth and combat the threat of deflation in western economies, especially the Eurozone and Japan.

8. The view of Capita Asset Services is that the overall balance of risks to economic recovery in the UK is currently evenly weighted. However, uncertainty remains over

how long the period of strong economic growth will last and the UK economy remains exposed to vulnerabilities in a number of key areas.

Prospects for interest rates

1. The bank base rate is forecast to remain unchanged at 0.25 per cent, rising in Q2 in 2019. Capita Asset Service’s central view for bank rate forecasts is shown below:

	Dec-16	Mar-17	Jun-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Bank of England base rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50
PWLB rates										
5 year borrowing	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.80	1.80	1.90
10 year borrowing	2.30	2.30	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50
25 year borrowing	3.00	2.90	2.90	2.90	3.00	3.00	3.00	3.10	3.10	3.20
50 year borrowing	2.70	2.70	2.70	2.70	2.80	2.80	2.90	2.80	2.90	3.00

2. Following the results of the EU referendum, we have been in a period of uncertainty. The MPC has made clear that interest rates will change in either direction in the coming months if the economic outlook changes considerably.

Benchmarking and Monitoring Security, Liquidity and Yield in the Investment Service.

1. These benchmarks are targets and so may be exceeded from time to time. Any variation will be reported, along with supporting reasons, in the Annual Treasury Report.

2. **Yield**. The local benchmark currently used to assess the performance of cash investments is the level of returns contrasted against the London Interbank Bid (LIBID) three month rate. This is the interest rate a bank would be willing to pay to borrow from another bank for three months.

   Property related investments are benchmarked against the IPD Balanced Property Unit Trust Index.

3. **Liquidity**. Liquidity is defined as the council "having adequate, though not excessive, cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives" (CIPFA Treasury Management Code of Practice).

4. In respect of this area, the council shall seek to:
   - maintain a minimal balance held in the council's main bank account at the close of each working day. Transfers to the councils call accounts, MMF and investments will be arranged in order to achieve this, while maintaining access to adequate working capital at short notice.
   - use the authorised bank overdraft facility or short term borrowing where there is clear business case for doing so, to cover working capital requirements at short notice

5. **Security of the investments**. In the context of benchmarking, assessing security is very much more a subjective area to assess. Security is currently evidenced by the application of minimum credit quality criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody's and Standard and Poor's). Whilst this approach embodies security considerations, benchmarking levels of risk is more problematic. One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy. The table beneath shows average defaults for differing periods of investment grade products for each Fitch long term rating category over the last 20-30 years.

Average defaults for differing periods of investment

Long term rating	1 year	2 years	3 years	4 years	5 years
AAA	0.00%	0.02%	0.06%	0.09%	0.13%
AA	0.02%	0.04%	0.14%	0.27%	0.38%
A	0.09%	0.24%	0.43%	0.61%	0.86%
BBB	0.20%	0.59%	1.02%	1.52%	2.00%

6. The council's minimum long term (i.e. plus 365 day duration) rating criteria is currently "A-". For comparison, the average expectation of default for a two year investment in a counterparty with an "A" long term rating would be 0.24 per cent of the total investment (e.g. for a £1m investment the average loss would be £2,400). **This is only an**

average - any specific counterparty loss is likely to be higher - but these figures do act as a proxy benchmark for risk across the portfolio.

Property Investment Policy

1. The case for property

1.1 The Council is restricted in the different investment vehicles it is legally allowed to invest in notwithstanding the over-riding need for prudence. Of the few avenues open, one is property and the returns from investing in property have generally been, and currently are, greater than the limited opportunities in the money markets.

1.2 In broad terms the returns are greater because the risks are greater. Factors to be taken into account when deciding the principle of investing in property include:

- investment will be for the long term since it may not be possible, or wise, to sell quickly,
- the costs of acquisition and disposal are higher,
- there are management costs, risk of rent default and failure to honour maintenance agreements,
- different types of property and different areas carry different risks,
- generally property tends to appreciate in value, although this will vary by type and area; however, in some cases the value may go down,
- property can become functionally obsolete necessitating major refurbishment,
- without regular repair and maintenance the condition will deteriorate and the responsibility for repairs/maintenance may not always rest with the tenant,
- certain types of property may become less desirable as time goes by; this can make re-letting difficult or attract a lower calibre of tenant.

2. How much to invest?

2.1 £8 million is invested in property and £49 million is invested in treasury investments. The investment in property currently represents 16 per cent of the total figure.

The maximum percentage of the investment portfolio in property should be no more than 80 per cent of the total, and the cash funds invested (i.e. not held for cash-flow purposes) should not fall below £10 million.

3. What type of property?

3.1 There are different types of property investment with assessment of prospects as follows:

i)	shops and offices	good - although may be subject to changing fashions and working practices
ii)	industrial	good but condition can be variable
iii)	leisure	good but may be best avoided since too close to our "core" business
iv)	agricultural	moderate but too risky now
v)	woodland	poor – some is owned for environmental/leisure purposes

3.2 **Average Yield Levels (%).** In general, property can be categorised as prime, secondary or tertiary in terms of its desirability. 'Rack-rented' means that the maximum market rental achievable is being received. Yield derives from both capital appreciation and rent. Lower yields can indicate that the investment attracts a lower degree of risk due to the ratio of rent to capital and other factors such as location, security and regularity of income.

In general, properties for investment will be from the categories: retail, offices, industrial land and buildings.

4. Where should it be located?

4.1 Direct property investments will be located in the UK and will be acquired subject to appropriate legal powers and business case.

5. What level of financial return?

5.1 As mentioned above, generally the greater the return, the greater the risk inherent in the investment. There are so many variables involving area, management, condition, leases, maintenance and the varying return on other investments that it is difficult to draw up hard and fast rules about them and their relationship with the rate of return.

With regard to the rate of return, each proposal will be considered on its merits.

6. Review

6.1 The Policy to be reviewed annually (along with the Treasury Management Strategy).

Explanation of Prudential Indicators

Central government control of borrowing was ended and replaced with Prudential borrowing by the Local Government Act 2003. Prudential borrowing permitted local government organisations to borrow to fund capital spending plans provided they could demonstrate their affordability. Prudential indicators are the means to demonstrate affordability.

Authorised limit for external debt – this is the maximum limit for external borrowing. This is the statutory limit determined under section 3(1) of the Local Government Act 2003. This limit is set to allow sufficient headroom for day to day operational management of cash flows.

Operational boundary for external debt – this is set as the more likely amount that may be required for day to day cash flow.

Upper limit for fixed and variable interest rate exposure – these limits allow the council flexibility in its investment and borrowing options.

Upper limit for total principal sums invested for over 364 days – the amount it is considered can be prudently invested for periods in excess of a year.

Treasury Management Practice (TMP) 1 – credit and counterparty risk management

The CLG issued Investment Guidance in 2010, and this forms the structure of the council's policy below.

The key aim of the guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. In accordance with the code, the head of finance has produced its treasury management practices (TMPs). This part, TMP1(1), covering investment counterparty policy requires approval each year.

The key requirements of both the Code and the guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of the following:

- the strategy guidelines for decision making on investments, particularly non-specified investments.
- the principles to be used to determine the maximum periods for which funds can be committed.
- specified investments the council will use. These are high security (ie have a high credit rating, although this is defined by the council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the council is:

Strategy guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified investments – These investments are sterling investments of not more than one year maturity, or those which could be for a longer period but where the council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments with:

- UK government Debt Management Agency Deposit Facility (DMADF)
- UK government – treasury stock (Gilts) with less than one year to maturity
- Supranational bonds of less than one year's duration
- Deposits with UK local authorities
- Pooled investment vehicles such as Money Market Funds (MMF) (AAA rated)
- Deposits with banks and building societies (minimum F1/A- rated)
- Certificates of deposits issued by banks and building societies (minimum rating as above)

Within these bodies, and in accordance with the Code, the council has set additional criteria to set the time and amount of monies which will be invested in these bodies. These criteria are as stated in Table 5 to this report.

Non-specified investments

These are any other type of investment (i.e. not defined or specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are as set out in Table 5.

GLOSSARY OF TERMS

Authorised Limit	The maximum amount of external debt at any one time in the financial year.
Basis Point (BP)	1/100th of 1%, i.e. 0.01%
Base Rate	Minimum lending rate of a bank or financial institution in the UK.
Benchmark	A measure against which the investment policy or performance of a fund manager can be compared.
Bill of Exchange	A financial instrument financing trade.
Callable Deposit	A deposit placed with a bank or building society at a set rate for a set amount of time. However, the borrower has the right to repay the funds on pre agreed dates, before maturity. This decision is based on how market rates have moved since the deal was agreed. If rates have fallen the likelihood of the deposit being repaid rises, as cheaper money can be found by the borrower.
Cash Fund Management	Fund management is the management of an investment portfolio of cash on behalf of a private client or an institution, the receipts and distribution of dividends and interest, and all other administrative work in connection with the portfolio.
Certificate of Deposit (CD)	Evidence of a deposit with a specified bank or building society repayable on a fixed date. They are negotiable instruments and have a secondary market; therefore the holder of a CD is able to sell it to a third party before the maturity of the CD.
Commercial Paper	Short-term obligations with maturities ranging from 2 to 270 days issued by banks, corporations and other borrowers. Such instruments are unsecured and usually discounted, although some may be interest bearing.
Corporate Bond	Strictly speaking, corporate bonds are those issued by companies. However, the term is used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.
Counterparty	Another (or the other) party to an agreement or other market contract (e.g. lender/borrower/writer of a swap/etc.)
CDS	Credit Default Swap – a swap designed to transfer the credit exposure of fixed income products between parties. The buyer of a credit swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the product. By doing this, the risk of default is transferred from the holder of the fixed income security to the seller of the swap.
CFR	Capital Financing Requirement.
CIPFA	Chartered Institute of Public Finance and Accountancy.
CLG	Department for Communities and Local Government.
Derivative	A contract whose value is based on the performance of an underlying financial asset, index or other investment, e.g. an option is a derivative because its value changes in relation to the performance of an underlying stock.
DMADF	Deposit Account offered by the Debt Management Office, guaranteed by the UK government.

ECB	European Central Bank – sets the central interest rates in the EMU area. The ECB determines the targets itself for its interest rate setting policy; this is the keep inflation within a band of 0 to 2 per cent. It does not accept that monetary policy is to be used to manage fluctuations in unemployment and growth caused by the business cycle.
Enhanced Cash Funds	A pooled investment fund. Longer dated investment than a MMF and, unlike a MMF, enhanced cash funds have variable asset value. Assets are marked to market on a daily basis and the unit prices vary accordingly. Investments can be withdrawn on a notice basis (the length of which depends on the fund) although such funds would typically be used for investments of 3 to 6 month duration.
Equity	A share in a company with limited liability. It generally enables the holder to share in the profitability of the company through dividend payments and capital gain.
Forward Deal	The act of agreeing today to deposit funds with an institution for an agreed time limit, on an agreed future date, at an agreed rate.
Forward Deposits	Same as forward dealing (above).
Fiscal Policy	The government policy on taxation and welfare payments.
GDP	Gross Domestic Product.
Gilt	Registered British government securities giving the investor an absolute commitment from the government to honour the debt that those securities represent.
Mark to Market Accounting	Accounting on the basis of the “fair value” of an asset or liability, based on the current market price. As a result, values will change with market conditions.
Minimum Revenue Provision	This is a prudent sum set aside each year to offset the principal repayment of any loan to smooth the impact on the local taxpayer.
Money Market Fund	A well rated, highly diversified pooled investment vehicle whose assets mainly comprise of short-term instruments. It is very similar to a unit trust, however a MMF relies on loans to companies rather than share holdings.
Monetary Policy Committee (MPC)	Government body that sets the bank rate (commonly referred to as being base rate). Their primary target is to keep inflation within plus or minus 1 per cent of a central target of 2.5 per cent in two years time from the date of the monthly meeting of the committee. Their secondary target is to support the government in maintaining high and stable levels of growth and employment.
Operational Boundary	The most likely, prudent but not worst case scenario of external debt at any one time.
Other Bond Funds	Pooled funds investing in a wide range of bonds.
PWLB	Public Works Loan Board.
QE	Quantitative Easing.
Retail Price Index	Measurement of the monthly change in the average level of prices at the retail level weighted by the average expenditure pattern of the average person.
Sovereign Issues (Ex UK Gilts)	Bonds issued or guaranteed by nation states, but excluding UK government bonds.

Supranational Bonds	Bonds issued by supranational bodies, e.g. European Investment Bank. The bonds – also known as Multilateral Development Bank bonds – are generally AAA rated and behave similarly to gilts, but pay a higher yield ("spread") given their relative illiquidity when compared with gilts.
Treasury Bill	Treasury bills are short-term debt instruments issued by the UK or other governments. They provide a return to the investor by virtue of being issued at a discount to their final redemption value.