Division(s): N/A

AUDIT & GOVERNANCE COMMITTEE – 10 JANUARY 2018

TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY FOR 2018/19

Report by the Director of Finance

Executive Summary

1. The Treasury Management Strategy Statement, which incorporates the Annual Investment Strategy for 2018/19, complies with the requirements of relevant legislation, codes of practice and guidance. CIPFA consulted on changes to the Code of Practice in 2017, but has yet to publish a revised Code.

2. The Council is required to approve Prudential Indicators for 2018/19, 2019/20 and 2020/21. DRAFT Prudential Indicators are set out at Appendix A. These are currently in draft form as they are dependent upon updates to the Capital Programme but will be included in the Treasury Management Strategy Statement as an annex to the Service and Resource Planning Report to be approved by Council on 13 February 2018.

3. The strategy for financing prudential borrowing during 2018/19 maintains the option to use temporary internal balances.

4. The Annual Investment Strategy for 2018/19 is based on an average base rate of 0.63% and assumes an average in-house return of 0.70%. The average cash balance for 2018/19 is forecast to be £333.0m, including externally managed funds. Due to the early timing of the report, forecast cash balances and the average in house rate of return represent an initial position based on information available to date. Work to further improve the accuracy of these forecasts is continuing alongside the preparation of the 2018/19 budget and should this create a materially different position then updated figures will be reported to Cabinet on 23 January.

5. The lists of proposed specified and non-specified investment instruments are set out in full in Appendices B and C respectively. The maximum maturity and duration limits for counterparties are currently determined by matrices based on Fitch credit ratings. The matrices proposed for 2018/19 and the full rationale for determining the credit worthiness of existing and potential counterparties is set out in paragraphs 65 to 80.

6. The Council intends to continue to place funds in pooled funds with the external fund managers. Further details are given in the section on External Funds.

7. The Council will continue to prioritise the security and liquidity of capital. The Council will aim to achieve investment returns that are commensurate with these

priorities. To achieve this, the Treasury Management Strategy Team (TMST) will aim to maintain a balanced portfolio between longer term deposits with high credit quality counterparties and investments in liquid instruments and shorter term deposits with Money Market Funds (MMFs), local authorities and high credit quality financial institutions.

8. Revisions to the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice in 2011 following the granting of the general power of competence to local authorities in the Localism Act 2011 require the Council to state its policy on the use derivatives. This is set out in Policy on Use of Financial Derivatives.

9. The Council will continue to benchmark the performance of the Treasury Management function through membership of the CIPFA benchmarking club and the benchmarking undertaken by the Council's Treasury advisor Arlingclose. In-house performance will also continue to be benchmarked against 3-month London Interbank Bid Rate (LIBID).

Treasury Management Strategy Statement & Annual Investment Strategy for 2018/19

Background

10. The Local Government Act 2003 and supporting regulations require the Council to 'have regard to' the 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.

11. 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). The Annual Investment Strategy sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

12. Treasury management is defined as: "The management of the local authority's 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."

13. The proposed strategy for 2018/19 in respect of the following aspects of the treasury management function is based upon the views of the Council's Treasury Management Strategy Team (TMST)1, informed by market forecasts provided by the Council's treasury advisor, Arlingclose Limited. The strategy covers:

- Treasury limits in force which limit the treasury risk and activities of the Council;

[1] Comprising the Director of Finance, Service Manager (Pensions), Strategic Finance Manager (Treasury & Banking) and Financial Manager (Treasury Management).

- Treasury Management Prudential Indicators for 2018/19, 2019/20 and 2020/21;
- the current treasury position;
- prospects for interest rates;
- the borrowing strategy;
- the borrowing requirement and
- the Annual Investment Strategy.

14. It is a statutory requirement for the Council to produce a balanced budget and to calculate its council tax requirement for each financial 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 whereby increases in charges to revenue caused by increased borrowing to finance additional capital expenditure (and any increases in running costs from new capital projects) are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

Treasury Limits for 2018/19 to 2020/21

15. It is a statutory duty, under section 3 (1) of the Local Government Act 2003, for the Council to determine and keep under review the amount it can afford to borrow. This amount is termed the 'Affordable Borrowing Limit' and is equivalent to the 'Authorised Borrowing Limit' as specified in the Prudential Code.

16. The Authorised Borrowing Limit requires the Council to ensure that total capital investment remains within sustainable limits and that the impact upon future council tax levels is 'acceptable'.

17. Whilst termed an "Affordable Borrowing Limit" within the Act, the capital plans to be considered for inclusion incorporates financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

Prudential Indicators for 2018/19 to 2020/21

18. The Prudential Code for Capital Finance in Local Authorities (2011) requires the Council to set and monitor against Prudential Indicators in the following categories:

    - Affordability
    - Prudence
    - Capital Expenditure
    - External Debt
    - Treasury Management

    Further Treasury Management indicators are specified in the Code of Practice on Treasury Management (2011).

19. Prudential Indicators are set out in full at Appendix A to this strategy:

i. Gross debt and the Capital Financing Requirement
ii. Estimates of Capital Expenditure
iii. Ratio of Financing Costs to Net Revenue Stream
iv. Capital Financing Requirement
v. Incremental Impact of Capital Investment decisions
vi. Authorised Limit and Operational Boundary for External Debt
vii. Actual External Debt
viii. Adoption of the CIPFA Treasury Management in the Public Services Code of Practice
ix. Gross and net debt
x. Upper and lower limits to maturity structure of fixed rate borrowing
xi. Upper limits on fixed and variable rate interest exposures
xii. Upper limit to total of principal sums invested longer than 364 days

20. Prudential Indicators are reported to and monitored by the TMST on a regular basis and will be reported to the Audit & Governance Committee and Cabinet in the Treasury Management Outturn Report 2017/18 and the Treasury Management Mid-Term Review 2018/19, which will be considered in July and November 2018 respectively.

Forecast Treasury Portfolio Position

21. The Council's treasury forecast portfolio position for the 2018/19 financial year comprises:

	Principal £m	**Average Rate %**
Opening External Debt Balance		
PWLB	317.383	4.358
LOBO	45	3.943
Money Market Loans	5	3.950
TOTAL EXTERNAL DEBT		
2018/19 Average Cash Balance		
Average In-House Cash	264.349	
Average Externally Managed	68.651	
TOTAL INVESTMENTS	333.000	

22. The average forecast cash balance for 2018/19 is comprised of the following:

	Average Balance £m
Earmarked Reserves	62.000
Capital and Developer Contributions	189.397
General Balances	17.600
Cashflow and Working Capital Adjustments	47.353

Provisions and Deferred Income	13.650
TOTAL	333.000

Prospects for Interest Rates

Economic Background – Provided by Arlingclose

23. The major external influence on the Authority's treasury management strategy for 2018/19 will be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements. The domestic economy has remained relatively robust since the surprise outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.

24. In contrast, the US economy is performing well and the Federal Reserve is raising interest rates in regular steps to remove some of the emergency monetary stimulus it has provided for the past decade. The European Central Bank is yet to raise rates, but has started to taper its quantitative easing programme, signalling some confidence in the Eurozone economy.

Credit outlook – Provided by Arlingclose:

25. High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic slowdown will exacerbate concerns in this regard.

26. Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. In addition, the largest UK banks will ringfence their retail banking functions into separate legal entities during 2018. There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities.

27. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however remain very low.

Interest rate forecast – Provided by Arlingclose:

28. The Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.50% during 2018/19, following the rise from the historic low of 0.25%. The Monetary Policy Committee re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

29. Future expectations for higher short term interest rates are subdued and on-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions. The risks to Arlingclose's forecast are broadly balanced on both sides. The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

Treasury Management Strategy Team's View

30. The Council's TMST, taking into account the advice from Arlingclose, market implications and the current economic outlook, have determined the rates to be included in the Strategic Measures budget for 2018/19 and over the medium term. TMST forecast a 25 bps rise in the UK Bank Rate during 2018/19 on the basis that UK inflation will continue to overshoot the Bank of England's target, a position supported by the Bank of England's November 2017 Inflation Report. The Bank Rate forecasts set out below represent the average rate for the financial year:

- 2018/19 0.63% (increase from 0.50% to 0.75% in October 2018)
- 2019/20 0.88% (increase from 0.75% to 1.00% in October 2019)
- 2020/21 1.00%
- 2021/22 1.00%

31. The TMST team has agreed that based on the current portfolio of deposits and market rates, the target in-house rate of return should be 0.75% in 2018/19, reducing to 2.5 basis points above the forecast average base rate for 2019/20 and 5 basis points below the forecast average base rate for 2020/21 and 2021/22. These rates have been incorporated into the strategic measures budget estimates:

- 2018/19 0.70%
- 2019/20 0.88%
- 2020/21 1.00%
- 2021/22 1.00%

Borrowing Strategy

Arlingclose's View

32. The Public Works Loan Board (PWLB) sets new borrowing rates at the gilt yield plus 1.00%. Arlingclose have forecast gilt yields as follows:

- The 50 year gilt yield is expected to start the financial year at 1.70%, increasing gradually to 1.950% by December 2020.
- The 20 year gilt yield is expected to start the financial year at 1.85%, rising to 1.93% by the end of the forecast in December 2020.

- The 10 year gilt yield is expected to start the financial year at 1.25%, rising to 1.36% by December 2020.
- The 5 year gilt yield is expected to start the financial year at 0.75% and to reach 0.89% by December 2020.

33. Arlingclose's forecasts have an upside variation range of between 25 and 40 basis points, and a downside variation range of between 25 and 50 basis points depending on the economic and political climate.

Treasury Management Strategy Team's View

34. It is expected that the Bank Rate will increase by 25 basis points to 0.75% during 2018/19 and that there will continue to be a high "cost of carry2" associated with the long-term borrowing compared to temporary investment returns. The TMST will continue to monitor the Council's debt portfolio and will consider debt repayment if it is in the Council's interest.

35. In April 2011, the Government replaced the 'credit approval' system for capital financing with direct provision of capital resources in the form of capital grant. This means that the Council only needs to borrow to finance prudential borrowing schemes. The Council's Capital Financing Strategy applies capital grants, developer contributions, capital receipts and revenue contributions to fund capital expenditure before using prudential borrowing. This means that the majority of the current capital programme is fully funded without the need to take up any new borrowing.

36. Financing the Council's borrowing requirement internally would reduce the cost of carry in the short term but there is a risk that the internal borrowing would need to be refinanced with external borrowing at a time when PWLB (or its successor) and market rates exceed those currently available. This could result in higher financing costs over the long term.

37. Internal borrowing is a short-term financing solution as cash surpluses are temporary balances made up of creditors over debtors, earmarked reserves and capital reserves. As reserves are drawn down for their earmarked purpose internal borrowing will need to be replaced with external borrowing.

38. The Council's TMST have agreed that they should continue to have the option to fund new or replacement borrowing up to the value of £50m of the portfolio through internal borrowing. Internal borrowing will have the effect of reducing some of the "cost of carry" of funding. Internal borrowing will also be used to finance prudential schemes.

39. If market conditions change during the 2018/19 financial year such that the policy to borrow internally is no longer in the short term or long term interests of the Council, the TMST will review the borrowing strategy and report any changes to Cabinet.

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[2] The difference between the interest payable on borrowing on debt and the interest receivable from investing surplus cash.

40. As the Accountable Body for OxLEP ltd, the Oxfordshire Local Enterprise Partnership, the Council will be required to prudentially borrow £42m on behalf of OxLEP for project funding from 2018/19 onwards. The loans will be repaid through the retained business rates of OxLEP. This represents projects to be delivered by the Council. The TMST monitor interest rates and will consider forward borrowing on behalf of OxLEP at the end of 2017/18 if it is determined to be cost-effective. This is consistent with the expectation that interest rates and Gilt yields will continue to rise over the period.

41. The Council will be able to apply for the new Local Infrastructure Rate, at a discounted interest rate of gilts + 60 basis points. The borrowing on behalf of OxLEP may be eligible as the schemes are all major infrastructure schemes. In 2017/18, OxLEP were able to borrow through the Public Work Loan Board (PWLB) project rate at a discounted rate 40 basis point below the standard rate across all loan types and maturities. As at 30 November 2017 this had not been required.

42. The Council's chief objective when borrowing money is to strike an appropriate balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.

43. The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board and any successor body
- UK local authorities
- any institution approved for investments (see below)
- any other bank or building society authorised by the Prudential Regulation Authority to operate in the UK
- UK public and private sector pension funds
- capital market bond investors
- special purpose companies created to enable joint local authority bond issues.

Borrowing for the Capital Financing Requirement

44. The Council's Capital Financing Requirement (CFR) represents the Council's underlying need to finance capital expenditure by borrowing. The CFR is the value of the Council's assets that have not been permanently financed, in other words, borrowing has been used to finance spending. When capital expenditure is financed by grants, capital receipts or direct contributions from revenue this is not included the CFR.

45. The Council is required to make an annual contribution from revenue towards the repayment of debt termed the Minimum Revenue Provision (MRP). This contribution reduces the CFR and effectively provides the resource to permanently finance the capital expenditure and reduce the Council's borrowing

requirement by that amount. The Council's MRP Policy Statement sets out the methodology that the Council applies in its MRP calculation.

46. Under the Prudential Code, the Council must ensure that gross external borrowing does not, except in the short term, exceed the sum of the CFR in the previous year plus estimates of any increases to the CFR for the current and next two financial years. Where the gross debt is greater than the CFR the reasons for this should be clearly stated in the annual treasury management strategy. The Council's current position is set out below.

47. The Council's CFR is currently forecast to increase over the medium term financial plan. This is a result of the requirement to borrow on behalf of the OxLEP discussed in paragraph 40.

48. The Council's external debt is also forecast to increase over the medium term financial plan as new external borrowing required for OxLEP projects is forecast to exceed the rate at which existing long term debt is repaid upon maturity.

49. The Council's external debt is forecast to exceed the CFR in 2017/18. In 2018/19, 2019/20 and 2020/21, external debt will fall below the expected CFR, resulting in an internal borrowing requirement.

Borrowing Instruments

50. The TMST's forecast for the period 2018/19 – 2021/22 for 20 and 50 year PWLB rates over the medium term are an average rate of 2.26% and 2.19% per year respectively.

51. In November 2012, the PWLB introduced the Certainty Rate which allows eligible Councils to borrow at a discounted rate of 0.20% below the advertised borrowing rate. Eligibility is established by the submission of an annual application form to the Department of Communities and Local Government. The Council has successfully applied and qualified for the rate for the period from 1 November 2017 to 31 October 2018.

52. An annual application will be made to renew eligibility for the Certainty Rate, in order to maintain the option should it be required.

53. The Council has historically set a maximum limit of 20% of the debt portfolio to be borrowed in the form of Lender's Option Borrower's Option (LOBOs). It is recommended that this remain as the limit for 2018/19. As at 30 November 2017, LOBOs represent 12.05% of the total external debt.
54. The Council has four £5m LOBO's with call options in 2018/19, three of which have two call options in year, whilst one has a single call option in year. At each call date, the lender may choose to exercise their option to change the interest rate payable on the loan. If the lender chooses to do so, the Council will evaluate alternative financing options before deciding whether or not to exercise the borrower's option to repay the loan or to accept the new rate offered. It is likely that if the rate is changed the debt will be repaid.

Annual Investment Strategy

55. The Council has regard to the Office of the Deputy Prime Minister's Guidance on Local Government Investments ("the Guidance") issued in March 2004 and CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). It also has regard to the subsequent Communities and Local Government update to the Investment Guidance, Capital Finance Regulations and Minimum Revenue Provision Guidance issued in April 2010. The Council's investment priorities are: -

- The security of capital and
- The liquidity of its investments

56. The Council also aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The borrowing of monies purely to invest or on-lend and make a return is unlawful and the Council will not engage in such activity.

57. The Treasury Management Code of Practice requires the Council to approve a Treasury Management Policy Statement. Good practice requires that this statement is regularly reviewed and revised as appropriate. The Treasury Management Policy Statement is included at Appendix D. Cabinet is recommended to recommend Council to approve the Treasury Management Policy Statement.

Investment Instruments

58. Investment instruments identified for use in the 2018/19 financial year are set out at Appendices B and C under the 'Specified' and 'Non-Specified' Investment categories.

59. Guidance states that specified investments are those requiring "minimal procedural formalities". The placing of cash on deposit with banks and building societies 'awarded high credit ratings by a credit rating agency', the use of AAA rated Money Market Funds (MMFs) and investments with the UK Government and local authorities qualify as falling under this phrase as they form a normal part of day to day treasury management.

60. Money market funds (MMFs) will be utilised, but good treasury management practice prevails and whilst MMFs provide good diversification the council will also seek to diversify any exposure by using more than one MMF where practical. It should be noted that while exposure will be limited, the use of MMFs does give the council exposure to institutions that may not be included on the approved lending list for direct deposits. This is deemed to be an acceptable risk due to the benefits of diversification. The Treasury team use an online portal to provide details of underlying holdings in MMFs. This enables more effective and regular monitoring of full counterparty risk.

61. All specified investments will be sterling denominated, with maturities up to a maximum of 1 year, meeting the 'high' credit rating criteria where applicable.

62. Non-specified investment products are those which take on greater risk. They are subject to greater scrutiny and should therefore be subject to more rigorous justification and agreement of their use in the Annual Investment Strategy; this applies regardless of whether they are under one year investments and have high credit ratings.

63. A maximum of 50% of the portfolio will be held in non-specified investments.

Changes to Instruments

64. There are no proposed changes to instruments for 2018/19

Credit Quality

65. The updated CIPFA Code of Practice on Treasury Management (2011) recommends that Councils have regard to the ratings issued by the three major credit rating agencies (Fitch, Moody's and Standard & Poor's) and to make decisions based on all ratings.

66. Whilst the Council will have regard to the ratings provided by all three ratings agencies, the Council uses Fitch ratings as the basis by which to set its minimum credit criteria for deposits and to derive its maximum counterparty limits. Counterparty limits and maturity limits are derived from the credit rating matrix as set out in the tables at paragraphs 77 and 78 respectively.

67. The TMST may further reduce the derived limits due to the ratings provided by Moody's and Standard & Poor's or as a result of monitoring additional indicators such as Credit Default Swap rates, share prices, Ratings Watch & Outlook notices from credit rating agencies and quality Financial Media sources.

68. Notification of any rating changes (or ratings watch and outlook notifications) by all three ratings agencies are monitored daily by a member of the Treasury Management Team. Updates are also provided by the Council's Treasury Management advisors Arlingclose and reported to TMST.

69. Where a change in the Fitch credit rating places a counterparty on the approved lending list outside the credit matrix (as set out in tables at paragraphs 77 and 78), that counterparty will be immediately removed from the lending list.

70. Where a counterparty has been placed on Negative Watch or Outlook by any of three major credit rating agencies the counterparty's status on the approved lending list will be reviewed by the TMST and appropriate action taken.

71. The Authority defines "high credit quality" organisations as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher with the Fitch ratings agency.

Liquidity Management

72. The Council has developed a cash flow forecast which is used to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast. The Council uses instant access bank deposit accounts and money market funds for balances forecast to be required at short notice to meet commitments due. The TMST will continue to monitor options available to maintain the required liquidity, and will open new accounts with approved counterparties as appropriate.

Lending Limits

73. In addition to the limits determined by the credit quality of institutions, the TMST apply further limits to mitigate risk by diversification. These include:

- Limiting the amount lent to banks in any one country (excluding the UK) to a maximum of 20% of the investment portfolio.

- Limiting the amount lent to any bank, or banks within the same group structure to 10% of the investment portfolio.

74. Where the Council has deposits on instant access, this balance may temporarily exceed the 10% bank or group limit. However, the limits as set out in paragraphs 77 and 78 will still apply.

75. Counterparty limits as set out in paragraphs 77 and 78, may be temporarily exceeded by the accrual and application of interest amounts onto accounts such as call accounts, money market funds or notice accounts. Where the application of interest causes the balance with a counterparty to exceed the agreed limits, the balance will be reduced when appropriate, dependent upon the terms and conditions of the account and cashflow forecast.

76. Any changes to the approved lending list will be reported to Cabinet as part of the Financial Monitoring and Business Strategy Delivery Report.

77. The Council also manages its credit risk by setting counterparty limits. The matrix below sets out the maximum proposed limits for 2018/19. The TMST may further restrict lending limits dependent upon prevailing market conditions. BBB+ to BBB- ratings is included for overnight balances with the Council's bank, currently Lloyds Bank Plc. This is for practical purposes should the bank be downgraded.

LENDING LIMITS - Fitch Rating	Short Term Rating	
Long Term Rating	F1+	F1
AAA	£30m	£20m
AA+	£30m	£20m

AA	£25m	£15m
AA-	£25m	£15m
A+	£20m	£15m
A	£20m	£15m
A-	£15m	£10m
BBB+, BBB, BBB- (bank with which the Council has its bank account)	£20m	£20m

78. The Council also manages its counterparty risk by setting maturity limits on deposits, restricting longer term lending to the very highest rated counterparties. The table below sets out the maximum approved limits. The TMST may further restrict lending criteria in response to changing market conditions.

MATURITY LIMITS – Fitch Rating	Short Term Rating	
Long Term Rating	F1+	F1
AAA	3 years	364 days
AA+	2 years	364 days
AA	2 years	9 months
AA-	2 years	9 months
A+	364 days	9 months
A	9 months	6 months
A-	6 months	3 months
BBB+, BBB, BBB- (bank with which the Council has its bank account)	Overnight	Overnight

Other institutions included on the councils lending list

79. In addition to highly credit rated banks and building societies the authority may also place deposits with: -

- AAA rated Money Market funds,
- Collective Investment Schemes
- Local authorities.

Structured Products

80. As at 30 November 2017, the Council had no structured products within its investment portfolio. Structured products involve varying degrees of additional risk over fixed rate deposits, with the potential for higher returns. It is recommended that the authority maintain the option to use structured products up to a maximum of 10% of the investment portfolio. The Council will continue to monitor structured products and consider restructuring opportunities as appropriate.

External Funds

81. As at 30 November 2017, the Council had £57.3m invested in external funds (excluding MMFs), representing 14% of the Council's total investment portfolio. These funds have a variable net asset value which means that the value of the funds can decrease as well as increase depending on the performance of the instruments in the fund.

82. The Council uses external fund managers and pooled funds to diversify the investment portfolio through the use of different investment instruments, investment in different markets, and exposure to a range of counterparties. It is expected that these funds should outperform the Council's in-house investment performance over a rolling three-year period. The Council will have no more than 50% of the total portfolio invested with external fund managers and pooled funds (excluding MMFs). This allows the Council to achieve diversification while limiting the exposure to funds with a variable net asset value.

83. In order to ensure appropriate diversification within externally managed and pooled funds these should be diversified between a minimum of two asset classes.

84. The performance of the pooled funds is monitored by the TMST throughout the year against the funds' benchmarks and the in-house investment returns.

85. The TMST will keep the external fund investments under review and consider alternative instruments and fund structures, to manage overall portfolio risk. It is recommended that authority to withdraw, or advance additional funds to/from external fund managers, continue to be delegated to the TMST.

Investment Approach

86. Given the increased risk for short-term bank and building society deposits as a result of bail-in legislation, the Authority aims to diversify into more secure asset classes during 2018/19.

87. The weighted average maturity (WAM) of in-house deposits as at 30 November 2017 was 232 days. This was made up of £47.1m of instant access balances with a maturity of 1 day, and £339.8m of deposits with a WAM of 264 days.

88. The in-house WAM has increased from 210 days, reported on 30 November 2016. The small increase in WAM is mainly due to a higher investment balance on the 30 November 2017 than on the same day in 2016 meaning a larger proportion of the portfolio could be committed long term while still ensuring sufficient liquidity.

89. With continued uncertainty over the timing of further rises in the base rate, the TMST will aim to maintain the balance between longer-term deposits with local authorities and short-term secured and unsecured deposits with high credit quality financial institutions. Money Market Funds will continue to be utilised for instant access cash. This approach will maintain a degree of certainty about the investment returns for a proportion of the portfolio, while also enabling the

Treasury Management team to respond to any increases in interest rates in the short-term.

90. The Council maintain the option to invest directly in UK Government Gilts, T-bills, Certificates of Deposits and other Sovereign Bonds, use of such instruments remains dependent upon custody arrangements. If availability of acceptable credit worthy institutions is reduced, the Council may use the Debt Management Office Deposit Facility and will continue to prioritise security and liquidity of assets over investment returns.

91. It is proposed that any further changes required to the Annual Treasury Management Strategy & Annual Investment Strategy, continue to be delegated to the Chief Finance Officer in consultation with the Leader of the Council and Cabinet Member for Finance.

Policy on Use of Financial Derivatives

92. Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The CIPFA Code (2011) requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

93. The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

94. Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

95. It is the view of the TMST that the use of standalone financial derivatives will not be required for Treasury Management purposes during 2018/19. The Council will only use derivatives after seeking expertise, a legal opinion and ensuring officers have the appropriate training for their use.

Performance Monitoring

96. The Council will monitor its Treasury Management performance against other authorities through its membership of the CIPFA Treasury Management benchmarking club.

97. Arlingclose benchmark the performance of their clients against each other on a quarterly basis, looking at a variety of indicators including investment risk and returns.

98. The Council will benchmark its internal return against the 3 month London Interbank Bid Rate (LIBID) - the rate at which banks are willing to borrow from other banks.

99. Latest performance figures will be reported to the Audit & Governance Committee and Cabinet in the Treasury Management Outturn Report 2017/18, and the Treasury Management Mid-Term Review 2018/19, which will be considered in July and November 2018 respectively.

Investment Training

100. All members of the Treasury Management Strategy Team are members of CIPFA or other professional accounting body. In addition, key Treasury Management officers receive in-house and externally provided training as deemed appropriate and training needs are regularly reviewed, including as part of the staff appraisal process.

101. The Council has opted up to 'professional client' categorisation with under the second Markets in Financial Instruments Directive (MiFID II). In order to achieve this, evidence was required that the person(s) authorised to make investment decisions on behalf of the authority have at least one year's relevant professional experience and the expertise and knowledge to make investment decisions and understand the risks involved. Members of the TMST currently meet these criteria and training needs will be regularly monitored and reviewed to ensure continued compliance.

Treasury Management Advisors

102. Arlingclose continue to provide the Council's Treasury Management Advisory Service, following the award of a three-year contract via a competitive procurement process in May 2017.

RECOMMENDATIONS as part of Cabinet Report

103. When the report is considered by Cabinet on 23 January it will be RECOMMENDED to RECOMMEND to Council to:

a) approve the Prudential Indicators for 2018/19, 2019/20 and 2020/21 as set out in Appendix A;

b) approve the Treasury Management Strategy Statement & Annual Investment Strategy 2018/19;

c) continue to delegate the authority to withdraw or advance additional funds to/from external fund managers to the TMST;

d) approve the continued delegation of changes required to the Annual Treasury Management Strategy Statement & Annual Investment Strategy to the Director of Finance in consultation with the Leader of the Council and Cabinet Member for Finance;

e) approve the Draft Treasury Management Policy Statement as set out at Appendix D.

RECOMMENDATIONS

104. The Committee is RECOMMENDED to:

a) endorse the Treasury Management Strategy for 2018/19 as outlined in the report;

b) note that due to the early timing of this report, Prudential Indicators i to vi have not been included in Appendix A as they are dependent on updates to the 2018 capital programme. Full indicators will be included when the report is considered by Council in February.

LORNA BAXTER
Director of Finance

Contact officer:
Donna Ross
Strategic Finance Manager - Treasury Management, Banking & Income
07747 020025

January 2018

Appendix A

Prudential Indicators 2018/19, 2019/20 and 2020/21

Indicators i to vi will only be available on finalisation of the 2019 capital programme.

vii. Actual External Debt

vii.i This indicator enables the comparison of Actual External Debt at year end to the Operational Boundary and Authorised Limit.

Total External Debt as at 31.03.17	**£m**
External Borrowing	385.383
Financing Liability	23.989
Total	**409.372**

viii. Adoption of the CIPFA Treasury Management in the Public Services Code of Practice

viii.i This indicator demonstrates that the Council has adopted the principles of best practice.

viii.ii The Council has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices.

Adoption of the CIPFA Code of Practice in Treasury Management
The Council approved the adoption of the CIPFA Treasury Management Code at its meeting of Full Council on 1 April 2003.

ix. Gross and net debt

ix.i This indicator is intended to identify where an authority may be borrowing in advance of need.

Upper Limit of net debt:

	2017/18	2018/19	2019/20	2020/21
Net Debt / Gross Debt	70%	70%	70%	70%

x. Upper and lower limits to maturity structure of fixed rate borrowing

x.i. This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

x.ii. It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

x.iii. LOBOs are classified as maturing on the next call date, this being the earliest date that the lender can require repayment.

Maturity structure of fixed rate borrowing during 2018/19	**Lower Limit %**	**Upper Limit %**
Under 12 months	0	20
12 months and within 24 months	0	25
24 months and within 5 years	0	35
5 years and within 10 years	5	40
10 years and above	50	95

xi. Upper limits on fixed and variable rate interest exposures

xi.i These indicators allow the Authority to manage the extent to which it is exposed to changes in interest rates.

Fixed interest rate exposure

xi.ii Limits in the table below have been set to reflect the current low interest rate environment. The limits set out offer the Council protection in an uncertain interest rate environment by allowing the majority of the debt portfolio to be held at fixed interest rates, thus not subjecting the Council to rising debt interest.

Upper limit for fixed interest rate exposure:

	2017/18	**2018/19**	**2019/20**	**2020/21**
Net principal re fixed rate borrowing / investments	£350m	£350m	£350m	£350m

xi.iii Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

Variable interest rate exposure

xi.iv The upper limit for variable rate exposure has been set to ensure that the Authority is not exposed to interest rate rises which could adversely impact on the revenue budget. As with the fixed rate exposure limits, the variable rate exposure limits set offer the council protection in an uncertain interest rate environment. This is achieved by ensuring variable rate debt is lower than variable rate investments, which would result in a net benefit if interest rates were to increase.

xi.v Interest rate exposure limits will be amended in future years to reflect any changes to the forecast trajectory of interest rates.

Upper limit for variable rate exposure:

	2017/18	2018/19	2019/20	2020/21
Net principal re variable rate borrowing / investments	£0	£0	£0	£0

xii. Upper limit to total of principal sums invested longer than 364 days

xii.i The purpose of this limit is to contain exposure to the risk of loss that may arise as a result of the Authority having to seek early repayment of the sums invested.

xii.ii It is proposed to maintain the upper limit at £85m in 2018/19 before reducing the limit to £65m in 2019/20 and 2020/21. This is to reflect the forecast reduction to in-house cash balances over the period.

	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m
Upper limit on principal sums invested longer than 364 days	85	85	65	65

Appendix B

Specified Investments

Investment Instrument	Minimum Credit Criteria	Use
Debt Management Agency Deposit Facility	N/A	In-house and Fund Managers
Term Deposits – UK Government	N/A	In-house
Term Deposits – other Local Authorities	N/A	In-house
Term Deposits – Banks and Building Societies	Short-term F1, Long-term BBB+, Minimum Sovereign Rating AA+	In-house and Fund Managers
Certificates of Deposit issued by Banks and Building Societies	A1 or P1	In-house on a buy and hold basis and Fund Managers
Money Market Funds	AAA	In-house and Fund Managers
Other Money Market Funds and Collective Investment Schemes[3]	Minimum equivalent credit rating of A+. These funds do not have short-term or support ratings.	In-house and Fund Managers
UK Government Gilts	N/A	In-house on a buy and hold basis and Fund Managers
Treasury Bills	N/A	In-house and Fund Managers
Reverse Repurchase Agreements - maturity under 1 year from arrangement and counterparty is of high credit quality (not collateral)	Long Term Counterparty Rating A-	In-house and Fund Managers
Covered Bonds – maturity under 1 year from arrangement	Minimum issue rating of A-	In-house and Fund Managers

[3] I.e., credit rated funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.

Appendix C

Non-Specified Investments

Investment Instrument	Minimum Credit Criteria	Use	Max % of total Investments	Max Maturity Period
Term Deposits – other Local Authorities (maturities in excess of 1 year)	N/A	In-house	50%	3 years
Term Deposits – Banks and Building Societies (maturities in excess of 1 year)	Short-term F1+, Long-term AA-	In-house and Fund Managers	50% in-house; 100% External Funds	3 years
Structured Products (e.g. Callable deposits, range accruals, snowballs, escalators etc.)	Short-term F1+, Long-term AA-	In-house and Fund Managers	50% in-house; 100% External Funds	3 years
UK Government Gilts with maturities in excess of 1 year	N/A	In-house and Fund Managers	50% in-house; 100% External Funds	5 years in-house, 10 years fund managers
Bonds issued by Multilateral Development Banks	AAA	In-house and Fund Managers	50% in-house; 100% External Fund	25 years

Investment Instrument	Minimum Credit Criteria	Use	Max % of total Investments	Max Maturity Period
Bonds issued by a financial institution which is guaranteed by the UK Government	AA	In-house and Fund Managers	50% in-house; 100% External Fund	5 years in-house
Collective Investment Schemes[4] but which are not credit rated	N/A	In-house and Fund Managers	50% In-house; 100% External Funds	Pooled Funds do not have a defined maturity date
Sovereign Bond Issues	AAA	In-house on a buy and hold basis. Fund Managers	50% in-house; 100% External Funds	5 year in-house, 30 years fund managers
Reverse Repurchase Agreements - maturity in excess of 1 year, or/and counterparty not of high credit quality.	Minimum long term rating of A-	In-house and Fund Managers	50% in-house; 100% External Funds	3 years
Covered Bonds	AAA	In-house and Fund Managers	50% in-house; 100% External Funds	20 years
Registered Providers	As agreed by TMST in consultation with the Leader and the Cabinet Member for Finance	In-house	50% In-house	5 years

The maximum limits for in-house investments apply at the time of arrangement.

[4] Pooled funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.

Appendix D

OXFORDSHIRE
COUNTY COUNCIL

TREASURY MANAGEMENT POLICY STATEMENT

1. Oxfordshire County Council defines its treasury management activities as:

   "The management of the organisation'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."

2. Oxfordshire County Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

3. Oxfordshire County Council acknowledges that effective treasury management will provide support towards achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management and to employing suitable performance measurement techniques, within the context of effective risk management.

4. The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.

5. The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Authority's investments followed by the yield earned on investments remain important but are secondary considerations.

6. The manner in which Oxfordshire County Council will seek to achieve these objectives and the arrangements for managing and controlling treasury management activities is prescribed in the treasury management practices which support this policy statement.

7. Responsibility for the implementation and monitoring of the Council's treasury management policies and practices are vested in the Council. The officer responsible for the execution and administration of treasury management decisions is the Director of Finance, who will act in accordance with this Policy Statement, Treasury Management Practices and CIPFA's Standard of Professional Practice on Treasury Management.

8. The Council nominates the Audit & Governance Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

9. Council will receive reports on treasury management policies, practices and activities including as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close.