Capital & Investment Strategy - 2019/20 to 2028/29 (incorporating the Treasury Management Strategy Statement 2019/20)

Purpose and Objectives

1. The Prudential Code for Capital Finance in Local Authorities was updated by the Chartered Institute of Public Finance and Accountancy in December 2017. The code requires that for each financial year, a local authority should prepare at least one Investment Strategy which should contain the disclosures and reporting requirements specified in the guidance. The Strategy must be approved by full Council.

2. The definition of an investment covers all the financial assets of a local authority as well as other non-financial assets that the organisation holds primarily or partially to generate a profit; for example, investment property portfolios. This may therefore include investments that are not managed as part of normal treasury management processes or under treasury management delegations.

3. The objectives of the Prudential Code are to ensure that the capital expenditure plans of local authorities are affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good professional practice and in full understanding of the risks involved.

4. The Prudential Code requires authorities to look at capital expenditure and investment plans in the light of overall organisational strategy and resources and ensure that decisions are made with sufficient regard to the long-term financing implications and potential risks to the authority.

5. The Prudential Code sets out that in order to demonstrate that the authority takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability, authorities should have in place a capital strategy. The capital strategy should set out the long-term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.

6. This Capital & Investment strategy sets out the requirements of the Prudential Code covering all the investments of the authority and covers the following areas:

- The Council's Corporate Plan priorities and the local context
- Financial context and funding streams
- Approach to capital investment
- Capital Programme financing principles
- Capital programme approach and overview of existing Capital Programme
- Capital investment proposals for 2019/20 – 2028/29
- Capital governance and decision-making
- Prudential Indicators for capital finance
- Treasury Management Strategy Statement (including external debt)

Introduction

7. The Capital & Investment Strategy is a policy document that outlines Oxfordshire County Council's approach to investments over the next ten years. It is closely linked to other key strategic and policy documents, such as:
    - The Corporate Plan
    - The Oxfordshire Infrastructure Strategy (OxIS)
    - The SEND Sufficiency Strategy
    - School Organisation Plan
    - Oxfordshire Local Industrial Strategy
    - Oxfordshire Joint Statutory Spatial Plan
    - The Highways Asset Management Plan
    - The Financial Strategy including the Medium Term Financial Plan

8. The Capital & Investment Strategy complements the key documents above by defining the approach, structure and governance for the effective financing and management of the Council's capital investment needs and ambitions. It outlines how capital investment contributes to the Council's priorities and how the Council's existing and proposed capital resources will be effectively managed to meet the planned needs plus opportunities for meeting the ambitions for longer term capital investments.

9. It is inevitable that the level of capital resources required to meet capital investment needs and aspirations will exceed the actual resources available. Therefore, one of the key purposes of the Capital & Investment Strategy is to ensure that capital projects or programmes are only approved where they accord with the capital investment principles.

10. The Council seeks to employ a variety of different resources to close the funding gap. In this context, the second key purpose of the Capital & Investment is to ensure that capital investment plans are affordable, prudent, sustainable and demonstrate value for money. It provides the framework for

determining capital spending plans and the effective use of the Council's capital resources.

The Council's Corporate Plan Priorities

11. The Capital & Investment Strategy emphasises the significant contribution that the capital programme can make in delivering the corporate priorities of thriving communities, thriving people and thriving economy and in bringing benefits for wider communities. It also seeks to ensure that resources are used in the most efficient way and support the Council's objectives most effectively.

Local Context

12. Oxfordshire's population is around 682,400[1] and the county's area is 260,500 hectares. It is the most rural county in the South-East region; over 40%[2] of Oxfordshire's population live in settlements of fewer than 10,000 people. Almost a quarter of Oxfordshire's population live in the city of Oxford with a similar proportion in its largest market towns and the remainder living in more rural areas. The population is ageing with substantial recent growth in the number of people aged 85 and over.

13. The County is facing significant demographic pressures. Economic prosperity and the quality of the environment make Oxfordshire an attractive place in which to live and work. Between 2016 and 2031, the council's population forecasts predict the county's population will grow by over 27%[3], whilst over the same period, the number of people aged 85 and over is forecast to grow by 55%. This will increase the number of people requiring intensive support from the social and health care system. In addition, the growth in new housing across the county and an increase in fertility rates will lead to an increase in the number of children requiring school places. There has also been a significant increase in the number of children requiring an Education, Health and Care Plan leading to a pressure on special school and resource base provision.

14. Oxfordshire plays a critical and growing role in the UK economy, being one of three net contributors to the national exchequer and generating an estimated £22 billion GVA. Oxfordshire's relationship to neighbouring authorities through the Oxford Cambridge Arc is becoming increasingly important as a regional entity; with an emerging ambition to double our GVA by 2040, this region is nationally and internationally significant. This added growth will be achieved by unlocking opportunities through the emerging Arc local industrial

---

[1] ONS 2017 population estimate
[2] ONS Census 2011, as a proportion of Oxfordshire's total population
[3] Oxfordshire County Council's population forecasts released April 2018

strategies and by delivering a substantial uplift of new homes and through major investment in road and rail infrastructure.

15. The emerging Local Industrial Strategy (OxLIS) will see an unprecedented focus on the strategic promotion of growth in Oxfordshire especially in Artificial Intelligence and disruptive technology sectors where rapid growth is predicted.

16. Oxfordshire's local authorities worked collectively through the Growth Board on an Oxfordshire Infrastructure Strategy (OxIS) designed to identify, map and prioritise Oxfordshire's infrastructure requirements to 2040 and beyond. Significant elements of this were completed and published in the course of 2017.

17. Negotiations with national government partners led to Oxfordshire securing a Housing & Growth Deal in February 2018, providing £215m of government investment to support Oxfordshire's ambition to plan for and support the delivery of 100,000 homes by 2031. £150m of this funding is to fund transport and supporting infrastructure schemes to secure the delivery of priority housing and employment sites. £60m is to support a bespoke Oxfordshire wide affordable housing delivery programme that will support delivery of at least 1320 affordable homes across a range of tenures to start on site by 2021. A further £5m has been provided as capacity funding for costs of delivering the deal.

18. Oxfordshire partners and Government view the Housing & Growth Deal as a positive first stage in an on-going partnership to pursue a comprehensive approach to deliver housing and economic growth and will work together to explore opportunities arising from investment in the Cambridge-Milton Keynes-Oxford corridor and other funding streams.

19. Forward funding through the Growth Deal also helps unlock further funds that are paid by developers as new homes are built, to support the completion of the various infrastructure projects. This funding is typically made in the form of Community Infrastructure Levy or Section 106 payments. Therefore, the total value of the schemes to be unlocked by the five-year infrastructure programme is significantly higher than the initial £150m Growth Deal contribution - at over £480m, excluding the costs of the major rail projects which are still to be confirmed.

20. A further £300m of investment from the Government's Housing and Infrastructure Fund (HIF) is awaiting final approval. This will fund transport infrastructure needed to help bring forward the Didcot Garden Town and West Oxfordshire Garden Village, near Eynsham.

21. In this context, Oxfordshire County Council will need to play a significant role in delivering major infrastructure investment.

Partnership Working

22. The Council has a strong vision to create sustainable places by working closely with its partners. It recognises that it can only achieve its objectives through partnership working and is therefore committed to working with public, private, voluntary and community organisations.

23. The Council already has a history of pursuing joint-working and joint-service delivery initiatives for better outcomes for communities and residents of the County. It will continue to actively seek opportunities to work in partnership to provide capital investment in Oxfordshire.

24. The Council is currently working with:
    - All Oxfordshire District Councils, the City Council and OxLEP to deliver the Housing & Growth Deal;
    - OxLEP to deliver Local Growth Fund projects;
    - Cherwell District Council through our joint partnership arrangements; and
    - Oxfordshire District Councils and the City Council to deliver One Public Estate Projects.

Financial Context and Funding Streams

25. Since 2010, local government has seen significant reductions in the revenue funding received from government to address the national deficit; however, national capital funding allocations, despite large initial reductions, have returned to or increased from the pre-2010 levels. The establishment of Local Enterprise Partnerships (LEPs) in 2011 has resulted in significant funding for large infrastructure schemes through the Local Growth Fund. The government have committed to borrow for investment in infrastructure and innovation which will boost productivity through the National Productivity Investment Fund established in 2016, gives additional funding for housing, infrastructure and research & development.

26. For the Council, government capital grants have continued for basic need, school's structural maintenance and highways maintenance plus ad hoc specific grants such as that to address potholes. These grants are however not enough to meet local investment demand.

27. A key source of capital funding for the council is developer contributions. There have been significant contributions to the schools and transport programmes in recent years provided through development permissions. It is expected that developer contributions will continue to be an important

funding source for the council to deliver the infrastructure needed in these growth areas.

28. The Council changed its policy on disposal of surplus land and property in 2016; rather than automatically dispose of surplus assets, these are now considered on a case by case basis to maximise the value the Council achieves from them. Retention could be on the basis of potential development opportunities, enhancing value of the asset through planning permission processes, due to future expected valuation increases or other similar reasons.

29. The Council made a decision to release its small-holdings' estates in the 1990s; however, sites that were recognised to hold long term potential for residential development were purposely held. There is only c132 hectares remaining of land holdings, of which c86 hectares relate to land development deals that are in progress and c£40m of expected receipts from this, which will be realised from 2024 onwards. These have already been included as funding in the existing 10-year Capital Programme (2018-2028).

30. Another source of capital funding is prudential borrowing. The Council must ensure that borrowing is affordable, prudent and cost effective. This has provided the Council with the flexibility to raise capital funding as demand and business opportunities arise, particularly where there is a case of invest to save. However, prudential borrowing has revenue implications for the Council in the form of financing costs. The recently agreed Street Lighting LED replacement programme of £41m replacing traditional lanterns with LED is an example of a programme funded by prudential borrowing. And as an invest to save scheme, the costs will be repaid from the savings in the energy costs that will be generated from the programme.

Approach to Capital Investment

31. The Council's approach to capital investment is integral to the Council's financial planning processes. The approach aims to ensure that:
    a. Capital expenditure contributes to the achievement of the priorities set out in the Corporate Plan;
    b. An affordable and sustainable capital programme is agreed;
    c. Use of resources and value for money is maximised;
    d. A clear framework for making capital investment decisions is provided;
    e. A corporate approach to the use of capital resources is maintained;
    f. Sufficient assets to provide services are acquired, or built, and maintained;
    g. Invest to save initiatives to make efficiencies within the Council's revenue budget are encouraged;

h. Investment in existing assets to enhance their value, including acquisition of land, is supported;
i. An appraisal and prioritisation process for new schemes is robust

Capital Programme Financing Principles

32. The Council's capital programme financing principles are:
    a. The government grants received for basic need, school maintenance and highways maintenance are treated as a single flexible pot that fund the statutory requirements of the provision of school places and school and highways maintenance as the first priority.
    b. Capital receipts are also treated as a corporate resource and used across the capital programme flexibly.
    c. The Council will continue to be proactive in ensuring, as far as possible, that all additional capital investment needs arising from new developments are funded from developer contributions.
    d. Ringfenced resources are used for the purposes for which they are issued.
    e. Prudential borrowing will be considered where:
        i. capital investment will result in future revenue savings and the cost of borrowing can be met from the savings; or
        ii. the council has a significant unmet capital need. The borrowing is repaid from revenue over the life of the asset and this implication is taken into account when assessing the affordability of the proposal.
        iii. It contributes towards the overall investment approach, subject to clear and demonstrable business case;
    f. The Council will try wherever possible to influence investment through the targeted use of its limited capital resources to lever in other investment to meet its objectives. However, the Council is clear that projects that may bring in further investment will only be supported if they meet the Council's priorities and objectives. The Council also evaluates long-term implications of accepting any external funding provision, in particular on its revenue budget.
    g. The Capital Programme will maintain a 3% contingency level.
    h. The Council will continue to employ an effective year-end financing strategy that is aimed at minimising the liability on the revenue budget. The first calls on capital resources are therefore external funding (including S106), grants, capital receipts and reserves. The final calls, where necessary, are on prudential borrowing.

Commercial Activity

33. The Prudential Code requires that where authorities have commercial investments, that local authorities should disclose the contribution they make towards the service delivery objectives and/or place making role of the

authority. In addition, the types of investment, due diligence processes, the proportionality of those investments and the local authority's risk appetite are also required to be set out.

Capital Programme Approach

34. Last year, in-line with the ambition to focus on a longer-term approach to financial planning, the Council moved from a four year to a ten-year capital programme. The extended programme enables strategic choice and options around developing our community assets, responding to issues such as rising demand in adults and children's services and allows for a planned approach to the replacement of assets.

35. With this in mind, the overall vision for the capital programme is to have a diverse portfolio of activity, ensuring the continued creation of new infrastructure; maintenance of existing infrastructure; plus, replacement of old infrastructure, for the benefit of Oxfordshire residents and businesses. This will deliver value for money within an affordable financial envelope by generating income and growth, enabling the delivery of savings and focussing on creating better places to live and work. This is all underpinned by the needs of the people and businesses of Oxfordshire to meet the Council's overall vision.

36. In alignment with the vision for the capital programme, there is a new focus on:
    - Developing the Council's assets and responding to rising demand (social care and highway condition)
    - Improving and retaining our assets to generate positive return
    - New approach to borrowing to take a longer term and more responsible approach to asset management (including statutory compliance)
    - New approach to investment in further assets where this meets our corporate objectives
    - Strategies underpinning investment decisions

37. To support this vision a portfolio area approach has been adopted for the capital programme. This allows for a policy led methodology or the ambition to achieve a desired outcome. The portfolio areas are:

    - **Schools Estate:** including basic need (new schools and expansion), maintenance, health and safety and improvements
    - **Non-Schools Estate:** including health & safety, maintenance, improvements
    - **Operational Assets:** including vehicles, ICT systems and equipment and vehicles
    - **Highways and associated infrastructure:** including street lighting, and bridges

- **Organisational redesign:** including schemes to address demand management and digitalisation

38. Allocations for the portfolio areas have been based on a combination of identified schemes with known budget requirements, identified schemes with estimated budget requirements and general allocations where services can bring forward business cases to bid for the funding. For the portfolio areas, detailed business cases will be brought forward to the Capital Investment Programme Board who will approve them or make recommendations to Cabinet for inclusion in the capital programme, depending on the approval thresholds in the Financial Procedure Rules (FPRs).

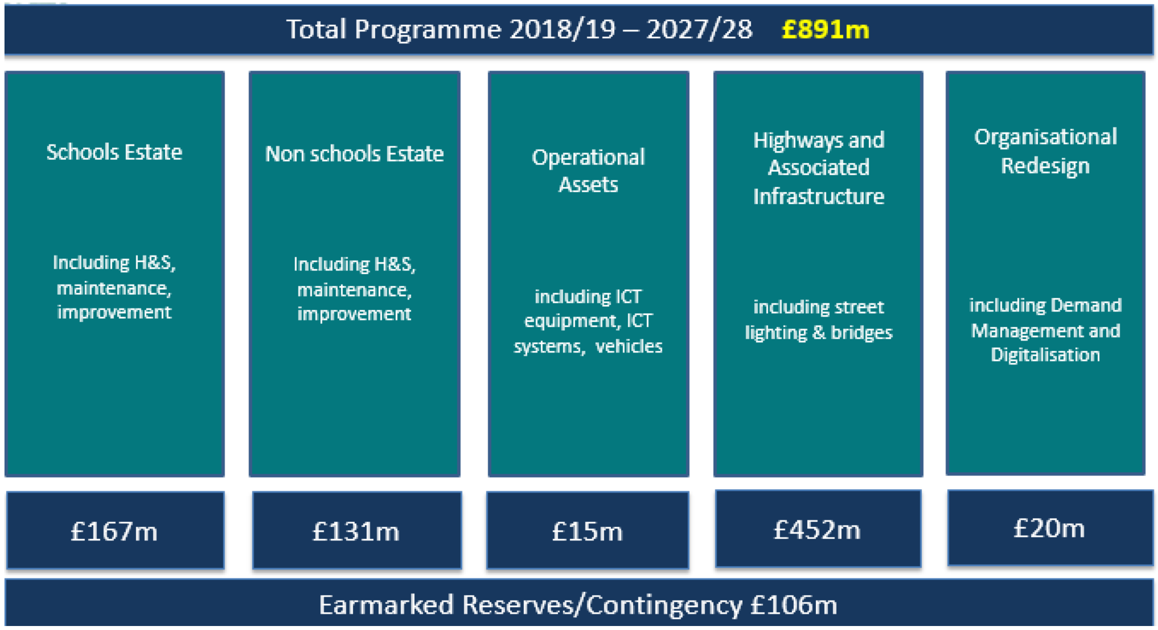
Investing in Oxfordshire Strategy

39. Linked to the new approach to capital programme planning, the Council will be developing a strategy about Investing in Oxfordshire. The primary objective of this strategy will be to achieve policy benefits or service outcomes, whether this is supporting economic growth, delivery of services, creating affordable housing etc. This will build on the existing approach of investing in existing assets to enhance their value, including acquisition of land. The strategy will be brought forward for approval in the new financial year.

Capital Programme Overview

40. The current capital programme for 2018/19 to 2027/28 totals £891m[4].The existing programme predominately comprises School Basic Need projects, the annual highways maintenance programme and large transport schemes that have received specific government grant funding. These include City Deal, Local Growth Fund, the Housing and Growth Deal and additional highways pothole funding. The current programme also includes investment, funded by prudential borrowing, in the street lighting estate. The table below sets out the current programme summary.

[4] Based on the Capital Programme presented to Cabinet in December 2018



Capital investment proposals 2019/20 - 2028/29

41. The new Capital Programme proposed alongside this strategy, extends the programme period to 2028/29. Details of proposed new capital investments are set out in Annex 3.

42. In addition to extending the programme by a year, the portfolio allocations have been reviewed in light of emerging proposals, agreed programmes and revised funding levels.

43. The proposed programme includes investment of £120m in the Council's assets approved by Cabinet in September 2018. Reduced funding and deterioration in asset condition in highways and property has led to reassessment of the benefits of investment. Investment at this stage would allow repairs to many of the roads already in poor condition and reduce the number of potholes that arise and improve the longevity of future repairs in these areas, thus reducing the increasing pressure on revenue resources.

44. The Schools estate allocation reflects £19.5m investment linked to the SEND strategy, agreed by Cabinet in December 2018, to increase the provision of Special School places in the county. £10m of this relates to the rebuild of Northfield School with an expanded number of places. Further amounts are available for additional SEN bases at mainstream schools and the expansion of existing special schools. The school's estate allocation also includes provision to increase the number of early year's places across the county.

45. The Non-Schools Estate allocation includes estimated allocations to address several immediate and critical legacy issues arising from both the decline in

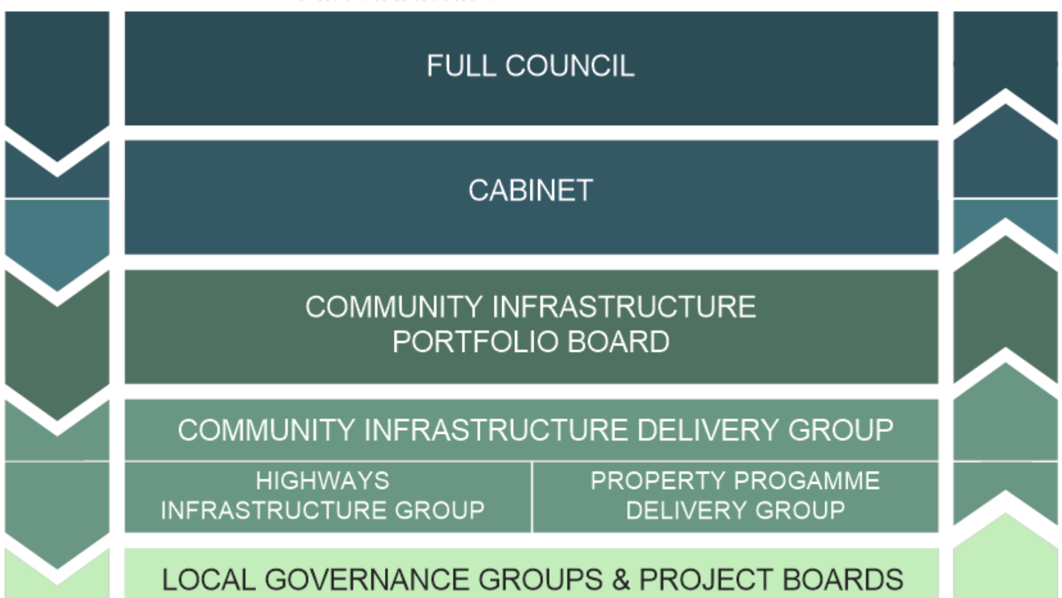
the spend on maintenance and Carillion's liquidation. This includes the rectification of known defects with completed projects; the treatment of latent defects (defects not known at this point that could emerge over time); the assessment of the estates compliance with statutory and health & safety requirements; and the condition of both the School's and Non-School's estate.

Governance Arrangements

46. The Prudential Code sets out that the responsibility for decision making and on-going monitoring in respect of capital expenditure, investment and borrowing, including prudential indicators, remains with full council. Although detailed implementation and monitoring may be delegated to a committee.

47. Capital governance arrangements were reviewed during 2017 and a new structure was put in place to establish a strong link between the mainstream capital programme and capital investment needs arising from the growth agenda and from organisational strategic issues such as rising demand in adults and children's services. The Council also recognises that a truly corporate approach to strategic capital investment, infrastructure and asset planning is essential.

48. The governance structure is set out below:



Council and Cabinet

49. Council and the Cabinet are the key democratic decision-making bodies as per the Council’s constitution. The Council approves the key policy documents and the capital programme as part of the Council’s Policy and Budgetary Framework. The Cabinet recommends priorities, policy direction and the capital programme to the Council for approval. The Cabinet also approves new inclusions to the capital programme in line with the scheme of delegation and the financial procedure rules.

The Community Infrastructure Portfolio Board (CIPB)

50. The Community Infrastructure Portfolio Board (CIPB) is a director-level working group to be the senior point of contact in the delivery of all capital infrastructure projects. It takes its decision-making power from the delegated authority of member officers as per Financial Procedure Rules and the council's Constitution. It makes decisions only where priorities are already agreed by the Cabinet as part of the Council’s budgetary framework. It also ensures that necessary consultation is carried out with the Informal Cabinet and relevant Directors as part of the decision-making process.

51. The board controls the implementation programme of strategic capital investment for Oxfordshire and ensures that the investment is planned and delivered effectively. It facilitates effective decision-making and provides officer leadership, governance and challenge in the capital and asset portfolios.

The Community Infrastructure Delivery Group

52. The Community Infrastructure Delivery Group (CIDG) is a working group with a remit and function to be the first point of contact in the delivery of all capital infrastructure matters. It takes decision-making power from the delegated authority of member officers as per the Financial Procedure Rules. It makes decisions only where priorities are already agreed by Council as part of the Council’s budgetary framework.

53. The group will provide oversight on cost control / timescales / quality of individual major capital projects. The group enables the development of a programme of strategic capital investment for Oxfordshire and ensures that strategic capital investment is planned and delivered in the most effective way possible. It aims to facilitate effective decision-making and provides officer leadership, governance and challenge in the capital and asset arena.

Programme/Project Delivery Boards

54. The Over-arching Programme Delivery Boards deal with capital and asset management issues across portfolio areas and report progress to CIDG. Sub-programme and project delivery boards are responsible for effective programming of commissioned programmes/projects within the given scope and budget.

Capital Programme Implementation

55. The Council operates a two-stage approval process for capital resource allocation. If a project is approved at stage 1, it is accepted in principle to the capital programme and is allocated a project development budget. This stage is also called "commit to investigate". At stage 2, the project receives full approval for work to commence and expenditure to be incurred, subject to the budget constraints of the project delivery budget allocation.

56. A business case supports each approval stage that has:

   - Analysed a range of possible solutions at the feasibility phase of each major capital investment;
   - Based the options appraisal on the life cycle costs of possible solutions, including the discounted cost of future expenditures to determine their affordability;
   - Explored different project delivery models that, where possible, include partnerships, sharing costs with other organisations, obtaining grant contributions or generates revenue income;
   - Recommended the option that ensures the capital investment secures the maximum benefit.

Capital Expenditure Definitions

57. Expenditure which qualifies as capital under this strategy is set out on the Council's intranet using the link below. It also sets out information on de minimus values, abortive costs, abnormal costs and leases.

   https://intranet.oxfordshire.gov.uk/cms/content/what-capital-expenditure

Prudential Indicators for Capital Finance

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

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

59. The indicators have been based on the February 2019 capital programme which will be approved by Council on 12 February 2019 with the Service & Resource Planning Report.

60. The capital expenditure figures for beyond 2019/20 will be able to be revised in twelve months' time.

Prudence

Estimates of Capital Expenditure

61. The Council is required to make reasonable estimates of the total of capital expenditure that it plans to incur during 2019/20 and the following two financial years. The Council must also approve the actual expenditure for 2017/18 and revised expenditure for 2018/19.

	Actual	**Estimates**			
	2017/18 £m	**2018/19 £m**	**2019/20 £m**	**2020/21 £m**	**2021/22 £m**
Capital Expenditure	94.718	114.264	120.051	179.474	162.307

	Actual	**Estimates**			
	2017/18 £m	**2018/19 £m**	**2019/20 £m**	**2020/21 £m**	**2021/22 £m**
Prudential Borrowing	3.141	24.679	15.688	21.838	23.160
Grants and Contributions	88.675	89.235	104.213	157.571	136.858
Capital Receipts	0.514	0.000	0.000	0.000	2.187
Revenue	2.388	0.350	0.150	0.065	0.102
Reserves	0.000	0.000	0.000	0.000	0.000
TOTAL	**94.718**	**114.264**	**120.051**	**179.474**	**162.307**

The Capital Financing Requirement

62. Estimates of the end of year Capital Financing Requirement (CFR) for the Authority for the current and future years and the actual Capital Financing Requirement at 31 March 2018 that are recommended for approval are:

Year	Actual/Estimate	£m
2017/18	Actual	376.731
2018/19	Estimate	397.518
2019/20	Estimate	402.921
2020/21	Estimate	413.264
2021/22	Estimate	423.794

63. The Capital Financing Requirement measures the authority's underlying need to borrow for a capital purpose. In accordance with best professional practice the County Council does not associate borrowing with particular items or types of expenditure. The authority has an integrated Treasury Management Strategy and has adopted the CIPFA Code of Practice for Treasury Management in the Public Services. The Council has, at any point in time, a number of cashflows both positive and negative, and manages its treasury position in terms of its borrowings and investments in accordance with its approved treasury management strategy and practices. In day-to-day cash management, no distinction can be made between revenue cash and capital cash. External borrowing arises as a consequence of all the financial transactions of the authority and not simply those arising from capital spending. In contrast, the capital financing requirement reflects the authority's underlying need to borrow for a capital purpose.

Authorised Limit and Operational Boundary for External Debt

64. The Authority has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Authority and not just those arising from capital spending reflected in the CFR.

65. The Authorised Limit sets the maximum level of external debt on a gross basis (i.e. excluding investments) for the Authority. It is measured on a daily basis against all external debt items on the Balance Sheet (i.e. long and short-term borrowing, overdrawn bank balances and long-term liabilities). This Prudential Indicator separately identifies borrowing from other long-term liabilities such as finance leases. It is consistent with the Authority's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

66. The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

67. The Operational Boundary has been set on the estimate of the most likely, i.e. prudent but not worst-case scenario with sufficient headroom over and above this to allow for unusual cash movements. The Operational Boundary

links directly to the Authority's estimates of the CFR and estimates of other cashflow requirements.

	2018/19 probable outturn	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£m	**£m**	**£m**	**£m**
Operational Boundary for External Debt				
Borrowing	400.000	410.000	425.000	440.000
Other long-term liabilities	25.000	25.000	25.000	25.000
TOTAL	**425.000**	**435.000**	**450.000**	**465.000**
Authorised Limit for External Debt				
Borrowing	410.000	420.000	435.000	450.000
Other long-term liabilities	35.000	35.000	35.000	35.000
TOTAL	**445.000**	**455.000**	**470.000**	**485.000**

Actual External Debt

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

Total External Debt as at 31.03.18	**£m**
External Borrowing	367.383
Other Long-term Liabilities	23.878
Total	**391.261**

Gross Debt and the Capital Financing Requirement

69. This is a key indicator of prudence. In order the ensure that the medium-term debt will only be for a capital purpose, the local authority should ensure that the gross debt does not, except in the short term, exceed the total of the capital financing requirement (CFR) in the preceding year plus the estimates of any additional increases to the capital financing requirement for the current and next two financial years.

70. The Director of Finance reports that the Council's level of gross debt exceeded the CFR in 2017/18. This is because the repayment of external debt has not been in-line with decrease in the CFR. From 2018/19 the CFR will be higher than gross debt, indicating a level of internal borrowing in line with this strategy. This view takes into account current commitments, existing plans and the proposals in the approved budget.

Debt	**31.03.18 Actual £m**	**31.03.19 Revised £m**	**31.03.20 Estimate £m**	**31.03.21 Estimate £m**	**31.03.22 Estimate £m**
External Borrowing	367.383	343.383	341.383	335.383	338.383
Long Term Liabilities	23.878	22.861	21.791	19.468	18.198
Total Debt	**391.261**	**366.244**	**363.174**	**354.851**	**356.581**

Affordability

The Ratio of Financing Costs to the Net Revenue Stream

71. This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs. The definition of financing costs is set out in the Prudential Code.

Year	**Actual/ Estimate**	**Financing Cost £m**	**Net Revenue Stream £m**	**Ratio %**
2017/18	Actual	30.591	440.170	6.95%
2018/19	Estimate	23.565	441.716	5.33%
2019/20	Estimate	22.817	446.778	5.11%
2020/21	Estimate	23.717	453.491	5.23%
2021/22	Estimate	22.510	464.599	4.84%

72. Financing costs include interest payable on borrowing, interest and investment income and the amount required for the minimum revenue provision (MRP). The ratio fell in 2017/18 due to the change in the MRP policy.

Minimum Revenue Provision Policy Statement for 2019/20

Introduction

1. The Council is required by statute to charge a Minimum Revenue Provision (MRP) to the General Fund Revenue account each year for the repayment of debt. The MRP charge is the means by which capital expenditure which has been funded by borrowing is paid for by council tax payers.

2. Until 2007/08, the basis of the calculation for the MRP was specified in legislation. Legislation (Statutory Instrument 2008 no. 414 s4) which came into force on 31 March 2008, gives local authorities more freedom to determine what a prudent level of MRP is.

3. The legislation requires local authorities to draw up a statement of their policy on the annual MRP, for full approval by Council before the start of the financial year to which the provision will relate.

4. The implementation of the International Financial Reporting Standards (IFRS) requirements brought some service concession arrangements on balance sheet and resulted in some leases being reclassified as finance leases instead of operating leases. Part of the service charge or rent payable is taken to reduce the balance sheet liability rather than being charged to revenue accounts. To ensure that this does not result in a one-off increase in the capital financing requirement and in revenue account balances, an amount equal to the amount that has been taken to the balance sheet is included in the annual MRP charge.

MRP Methodology Statement 2019/20

5. The Council is recommended therefore to approve the following statement:

6. For capital expenditure incurred before 1 April 2008, the MRP policy for 2017/18 onwards will be a straight-line charge of the outstanding pre-2008 expenditure as at 1 April 2017 calculated over a 50-year period.

7. For all unsupported (prudential) borrowing, the MRP policy will be based on the estimated life of the assets for which the borrowing is undertaken (Option 3 – Asset Life Method or Annuity Method).

8. In the case of finance leases and on-balance sheet Private Finance Initiative (PFI) type contracts, the MRP requirement will be regarded as being met by a charge equal to the element of the rent/charge that goes to write-down the balance sheet liability, including the retrospective element in the first year (Option 3 in modified form).

Treasury Management Strategy Statement & Annual Investment Strategy for 2019/20

Background

1. 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.

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). 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.

3. 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."

4. The proposed strategy for 2019/20 is based upon the views of the Council's Treasury Management Strategy Team (TMST)[5], informed by market forecasts provided by the Council's treasury advisor, Arlingclose Limited.

5. 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 2019/20 to 2021/22

6. 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.

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

7. 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’.

8. 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.

Forecast Treasury Portfolio Position

9. The Council’s treasury forecast portfolio position for the 2019/20 financial year comprises:

	Principal £m	**Average Rate %**
Opening External Debt Balance		
PWLB	293.383	4.510
LOBO	45.000	3.943
Money Market Loans	5.000	3.950
TOTAL EXTERNAL DEBT	343.383	
2019/20 Average Cash Balance		
Average In-House Cash	250.616	
Average Externally Managed	100.000	
TOTAL INVESTMENTS	350.616	

10. The average forecast cash balance for 2019/20 is comprised of the following:

	Average Balance £m
Earmarked Reserves	51.250
Capital and Developer Contributions	202.286
General Balances	22.500
Cashflow and Working Capital Adjustments	61.231
Provisions and Deferred Income	13.350
TOTAL	**350.616**

Prospects for Interest Rates

Economic Background – Provided by Arlingclose

11. The UK’s progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority’s treasury management strategy for 2019/20.

12. UK Consumer Price Inflation (CPI) for October was up 2.4% year/year, slightly below the consensus forecast and broadly in line with the Bank of England's November Inflation Report. The most recent labour market data for October 2018 showed the unemployment rate edged up slightly to 4.1% while the employment rate of 75.7% was the joint highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.3% as wages continue to rise steadily and provide some pull on general inflation. Adjusted for inflation, real wages grew by 1.0%, a level still likely to have little effect on consumer spending.

13. The rise in quarterly GDP growth to 0.6% in Q3 from 0.4% in the previous quarter was due to weather-related factors boosting overall household consumption and construction activity over the summer following the weather-related weakness in Q1. At 1.5%, annual GDP growth continues to remain below trend. Looking ahead, the Bank of England, in its November Inflation Report, expects GDP growth to average around 1.75% over the forecast horizon, providing the UK's exit from the EU is relatively smooth.

14. Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy has been made since. However, the Bank expects that should the economy continue to evolve in line with its November forecast, further increases in Bank Rate will be required to return inflation to the 2% target. The Monetary Policy Committee continues to reiterate that any further increases will be at a gradual pace and limited in extent.

15. While US growth has slowed over 2018, the economy continues to perform robustly. The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the current 2%-2.25% in September. Markets continued to expect one more rate rise in December, but expectations are fading that the further hikes previously expected in 2019 will materialise as concerns over trade wars drag on economic activity.

Credit outlook – Provided by Arlingclose:

16. The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ringfencing legislation. Bank of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank are the ringfenced banks that now only conduct lower risk retail banking activities. Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and NatWest Markets are the investment banks. Credit rating agencies have adjusted the ratings of some of these banks with the ringfenced banks generally being better rated than their non-ringfenced counterparts.

17. The Bank of England released its latest report on bank stress testing, illustrating that all entities included in the analysis were deemed to have passed the test once the levels of capital and potential mitigating actions presumed to be taken by management were factored in. The Bank of England did not require any bank to raise additional capital.

18. European banks are considering their approach to Brexit, with some looking to create new UK subsidiaries to ensure they can continue trading here. The credit strength of these new banks remains unknown, although the chance of parental support is assumed to be very high if ever needed. The uncertainty caused by protracted negotiations between the UK and EU is weighing on the creditworthiness of both UK and European banks with substantial operations in both jurisdictions.

Interest rate forecast – Provided by Arlingclose:

19. Following the increase in Bank Rate to 0.75% in August 2018, the Authority's treasury management adviser Arlingclose is forecasting two more 0.25% hikes during 2019 to take official UK interest rates to 1.25%. The Bank of England's Monetary Policy Committee (MPC) has maintained expectations for slow and steady rate rises over the forecast horizon. The MPC continues to have a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose believes that MPC members consider both that ultra-low interest rates result in other economic problems, and that higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise when rate cuts will be required.

20. The UK economic environment remains relatively soft, despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the EU and Eurozone growth softens. While assumptions are that a Brexit deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" Brexit still hangs over economic activity (at the time of writing this commentary in late-December). As such, the risks to the interest rate forecast are considered firmly to the downside.

21. Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected based on Arlingclose's interest rate projections, due to the strength of the US economy and the European Central Bank's forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.7% and 2.2% respectively over the interest rate forecast horizon, however volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.

Treasury Management Strategy Team's View

22. 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 2019/20 and over the medium term. TMST forecast a 25 bps rise in the UK Bank Rate during 2019/20 on the basis that UK inflation will continue be slightly above the Bank of England's target, a position supported by the Bank of England's November 2018 Inflation Report. The Bank Rate forecasts set out below represent the average rate for the financial year:

    - 2019/20 0.88% (increase from 0.75% to 1.00% in October 2019)
    - 2020/21 1.00%
    - 2021/22 1.00%
    - 2022/23 1.25%

23. The TMST team has agreed that based on the current portfolio of deposits and market rates, the target in-house rate of return as set out below. These rates have been incorporated into the strategic measures budget estimates:

    - 2019/20 0.98%
    - 2020/21 1.00%
    - 2021/22 1.00%
    - 2022/23 1.25%

24. The Treasury Management Strategy Team continues to monitor the risks relating to Brexit.

Borrowing Strategy

Arlingclose's View

25. 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 - 1.95% at April 2019, rising to 2.00% by December 2021.
    - The 20-year gilt yield - 2.10% at April 2019, rising to 2.18% by December 2021.
    - The 10-year gilt yield - 1.65% at April 2019, rising to 1.70% by December 2021.
    - The 5-year gilt yield - 1.25% at April 2019, rising to 1.33% by December 2021.

26. Arlingclose's forecasts have an upside variation range of between 25 and 40 basis points, and a downside variation range of between 55 and 75 basis points depending on the economic and political climate.

Treasury Management Strategy Team's View

27. It is expected that the Bank Rate will increase by 25 basis points to 1.00% during 2019/20 and that there will continue to be a high "cost of carry6" 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.

28. 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 Programme Financing Principles 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.

29. 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.

30. Internal borrowing is a short-term financing solution which uses temporary cash surpluses to fund the Council's capital financing requirement. The temporary cash surpluses are 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.

31. The Council's TMST have agreed that they should increase the option to fund new or replacement borrowing up to the value of £100m 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.

32. If market conditions change during the 2019/20 financial year such that the policy to borrow internally is no longer in the short term or long-term interests

---

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

of the Council, the TMST will review the borrowing strategy and report any changes to Cabinet.

33. 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 2019/20 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 2018/19 if it is determined to be cost-effective.

34. 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.

35. 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.

36. 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

37. 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.

38. 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.

39. 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.

40. 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 33 and increased investment in the Council's Capital Programme.

41. 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.

Borrowing Instruments

42. The TMST's forecast for the period 2019/20 – 2022/23 for 20 and 50-year PWLB rates over the medium term are an average rate of 2.80% and 2.60% per year respectively.

43. 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 2018 to 31 October 2019.

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

45. 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 2019/20. As at 30 November 2018, LOBOs represent 13.07% of the total external debt.

46. The Council has four £5m LOBO's with call options in 2019/20, 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. The TMST is also exploring early repayment of LOBO's where there is a financial benefit to do so.

Annual Investment Strategy

47. The Council complies with all relevant treasury management regulations, codes of practice and guidance. The Council's investment priorities are: -

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

48. 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.

49. 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. Council approved the statement in February 2018.The statement has been reviewed and there are no revisions proposed.

Investment Instruments

50. Investment instruments identified for use in the 2019/20 financial year are set out at Appendices A and B under the 'Specified' and 'Non-Specified' Investment categories.

51. 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 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.

52. 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.

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

54. 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.

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

Changes to Instruments

56. There are no proposed changes to instruments for 2019/20.

Credit Quality

57. The 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. 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 68 and 69 respectively.

58. 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.

59. 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.

60. 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 68 and 69), that counterparty will be immediately removed from the lending list.

61. 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.

62. 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

63. The Council forecasts its cash flow 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

64. 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.

65. 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 68 and 69 will still apply.

66. Counterparty limits as set out in paragraphs 68 and 69, 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.

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

68. The Council also manages its credit risk by setting counterparty limits. The matrix below sets out the maximum proposed limits for 2019/20. 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

69. 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

70. 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 and local authorities.

Structured Products

71. As at 30 November 2018, 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.

Revolving Credit Facility

72. The Council has a £10m revolving credit facility (RCF) investment with Network Homes, whereby Network Homes as the ability to draw down an amount, up to the value of £10m in any 6 month period from the RCF. The investment was arranged with the advice of Arlingclose in July 2017 and continues to be utilised in full. The investment returns 3 month LIBOR + 1.50% and has a final maturity in July 2020.

External Funds

73. 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. And, in order to ensure appropriate diversification within externally managed and pooled funds these should be diversified between a minimum of two asset classes.

74. As at 30 November 2018, the Council had £58m invested in external funds (excluding MMFs), representing 13% of the Council's total investment portfolio.

75. In December 2018 the TMST agreed to increase the exposure to external funds (excluding MMFs) to £100m from £58m, representing an increase of 10% to 23% of the Council's total investment portfolio. It was agreed to move away from lower yielding short dated funds and to invest in longer dated strategic funds with the aim of a more balanced portfolio with a higher return. There will be an equal allocation to 4 asset classes (Bond Funds, Equity, Property & Multi Asset) to limit overall portfolio volatility. All of the funds are income producing funds, as opposed to accumulating value funds. 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.

76. The external funds have a higher targeted income return than in house deposits of 3.75% which has been incorporated into the medium term financial plan.

77. The Council's holding in the Columbia Threadneedle Strategic Bond Fund was transferred from an accumulating fund to an income producing fund. The switch has realised a one-off gain of £2.9m which will be taken to the General Fund in 2018/19.

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

79. The weighted average maturity (WAM) of in-house deposits as at 30 November 2018 was 209 days. This was made up of £89.5m of instant access balances with a maturity of 1 day, and £295.5m of deposits with a WAM of 272 days.

80. With the increased investment in longer dated external funds, the TMST will aim to maintain the balance between medium-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.

81. 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.

82. 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.

Treasury Management Prudential Indicators

Gross and Net Debt

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

Upper Limit of net debt:	2018/19	2019/20	2020/21	2021/22
Net Debt / Gross Debt	70%	70%	70%	70%

Upper and lower limits to maturity structure of fixed rate borrowing

84. 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.

85. 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.

86. 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

Upper limits on fixed and variable rate interest exposures

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

<u>Fixed interest rate exposure</u>

88. 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	**2018/19**	**2019/20**	**2020/21**	**2021/22**
Net principal re fixed rate borrowing / investments	£350m	£350m	£350m	£350m

89. 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

90. 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.

91. 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	**2018/19**	**2019/20**	**2020/21**	**2021/22**
Net principal re variable rate borrowing / investments	£0	£0	£0	£0

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

92. 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.

93. It is proposed to maintain the upper limit of £150m in 2018/19. This limit had previously been set to reduce to £120m in 2020/21 however maintaining the £150m is to reflect higher forecast cash balance than previously forecast.

	2018/19 £m	**2019/20 £m**	**2020/21 £m**	**2021/22 £m**
Upper limit on principal sums invested longer than 364 days	150	150	150	150

94. 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 2018/19 and the Treasury Management Mid-Term Review 2019/20, which will be considered in July and November 2018 respectively.

Policy on Use of Financial Derivatives

95. 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.

96. 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.

97. 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.

98. It is the view of the TMST that the use of standalone financial derivatives will not be required for Treasury Management purposes during 2019/20. The Council will only use derivatives after seeking expertise, a legal opinion and ensuring officers have the appropriate training for their use.

Performance Monitoring

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

100. 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.

101. 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.

102. Latest performance figures will be reported to the Audit & Governance Committee and Cabinet in the Treasury Management Outturn Report 2018/19, and the Treasury Management Mid-Term Review 2019/20, which will be considered in July and November 2019 respectively.

Investment Training

103. 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.

104. 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

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

Appendix A

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[7]	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

[7] 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 B

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
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

Investment Instrument	Minimum Credit Criteria	Use	Max % of total Investments	Max Maturity Period
Collective Investment Schemes[8] 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 years 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.

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