Agenda Item No. 9

WEST OXFORDSHIRE DISTRICT COUNCIL

FINANCE AND MANANGEMENT OVERVIEW AND SCRUTINY COMMITTEE

WEDNESDAY 7 FEBRUARY 2018

CABINET - WEDNESDAY, 14 FEBRUARY 2018

TREASURY MANAGEMENT STRATEGY STATEMENT AND CAPITAL STRATEGY 2018/2019 – 2020/2021

REPORT OF THE GROUP MANAGER GO SHARED SERVICES

(Contact: Jenny Poole, Tel: (01285) 623313)

(The Treasury Management Strategy Statement, Capital Strategy and the Prudential Indicators and Limits will also be approved by Council as part of the formal budget and tax setting process).

1. PURPOSE

To consider the Council's Treasury Management Strategy for 2018/19 and the Capital Strategy 2018/19 together with the Prudential Indicators, MRP Statement and the Use of Specified and Non Specified Investments.

2. RECOMMENDATIONS

(a) That the Committee considers the draft Treasury Management Strategy and Capital Strategy, including the adoption of the MRP statement and application of "Option 3: the Asset Life Method" for charging MRP in 2018/19, and make appropriate recommendations to Cabinet.

(b) That the Committee considers the Prudential Indicators and Limits for 2018/2019 to 2020/2021 (as outlined in the Treasury Management Strategy and Capital Strategy and summarised in Appendix C) and make appropriate recommendations to Cabinet.

3. BACKGROUND

4. Local authorities in England are legally obliged to "have regard" to the CIPFA Treasury Management Code and the Prudential Code by relevant Capital Finance Regulations.

5. Local authority investment decisions have been making headlines in recent months, with some elements of the national press calling into question the role of local authorities investing in property and assets as a means to generate income. However as funding has decreased councils have increasingly relied upon new sources of income to plug the funding gaps. Councils investing in property, and other assets, is nothing new; many local authorities have historical held major assets including retail sites, farms and residential property. In recent years however the emphasis on using these assets to generate a commercial yield has become much greater and this has involved out of area investment. The scaling up of investments by local councils has peaked the interests of the Department for Communities and Local Government, (DCLG), and the Chartered Institute of Public Finance and Accountancy (CIPFA) resulting in recently published changes to the Treasury Management Code and the Prudential Code.

6. Following consultations in February and August 2017, CIPFA published its new 2017 editions of ***Treasury Management in the Public Services: Code of Practice and Cross-sectoral Guidance Notes and the Prudential Code for Capital Finance in Local Authorities*** just before Christmas 2017. At the time of drafting this report updated sector specific guidance notes have not been published, which include the updated treasury management indicators for local authorities.

7. In response to these changes, Council will consider the Treasury Management Strategy for 2018/19 based upon the requirements of the 2011 Code and in line with current governance practices. The changes to the Prudential Code have introduced a requirement for the Council to approve a Capital Strategy with effect from 2018/19. A working draft of the Council's Capital Strategy is attached at Appendix 'B'. The Capital Strategy will be considered by Council, however, both Strategies may require further amendments once the Treasury Management Guidance Notes, which include the Treasury Management Indicators, and the new DCLG Investment Guidance is available.

8. The proposed Treasury Management Strategy Statement for 2018/19, with supporting information, is attached at Appendix 'A'.

9. The draft strategy has been based on a template provided by the Council's treasury advisors, Arlingclose, which has been modified to this Council's circumstances.

10. The Annual Investment Strategy investment options have been selected to minimise the risk to the Council's investments whilst providing the scope and flexibility of investment options to enable the Council to maximise its investment returns.

11. The purpose of this Treasury Management Strategy Statement is to approve:

    - Treasury Management Strategy 2018/19
    - Annual Investment Strategy for 2018/19
    - Prudential Indicators for 2018/19, 2019/20 and 2020/21
    - MRP Statement

12. The authority has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

13. A summary of the Prudential Indicators from 2018/19 to 2020/21 is included at Appendix C.

14. ALTERNATIVES/OPTIONS

The Committee may suggest amendments to the proposed Treasury Management Strategy for 2018/2019 to 2020/2021 and Capital Strategy 2018/19.

15. FINANCIAL IMPLICATIONS

There are no direct financial implications

16. REASONS

To incorporate the requirements of the Local Government Act 2003 and the guidance on Local Government Investments whilst complying with the principles of the CIPFA Code of Practice for Treasury Management and the Prudential Code for Capital Finance in Local Authorities.

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Date: 25th January 2018

Background Papers:

ODPM Guidance under Section 15(1) (a) Local Government Act 2003.
CIPFA Treasury Management in the Public Service Code of Practice and Cross-Sectoral Guidance Notes.
CIPFA Prudential Code for Capital Finance in Local Authorities
Arlingclose Treasury Management Strategy Report.

Treasury Management Strategy Statement And Investment Strategy 2017/18 to 2019/20

Introduction

In February 2011 the Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year.

In addition, the Department for Communities and Local Government (CLG) issued revised *Guidance on Local Authority Investments* in March 2010 that requires the Authority to approve an investment strategy before the start of each financial year.

This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the CLG Guidance.

The Authority has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

Revised strategy: In accordance with the CLG Guidance, the Authority will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, in the Authority's capital programme or in the level of its investment balance.

1. Economic background

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.

Consumer price inflation reached 3.1% in November 2017 as the post-referendum devaluation of sterling continued to feed through to imports. Unemployment continued to fall and the Bank of England's Monetary Policy Committee judged that the extent of spare capacity in the economy seemed limited and the pace at which the economy can grow without generating inflationary pressure had fallen over recent years. With its inflation-control mandate in mind, the Bank of England's Monetary Policy Committee raised official interest rates to 0.5% in November 2017.

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.

2. Credit outlook

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.

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.

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.

3. Interest rate forecast

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.

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.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix A1.

4. Balances

On 31st December 2017, the Authority held £38.5m of investments. This is set out in further detail at Appendix A2. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

	31.3.17 Actual £m	31.3.18 Estimate £m	31.3.19 Forecast £m	31.3.20 Forecast £m	31.3.21 Forecast £m
General Fund CFR	4.9	9.4	10.4	15.4	16.4
Internal borrowing	**4.9**	**9.4**	**10.4**	**15.4**	**16.4**
Less: Usable reserves	27.9	25.5	25.3	25.4	24.9
Less: Working capital	10.1	10.1	10.1	10.1	10.1
Investments	**33.2**	**26.4**	**25.2**	**20.3**	**19.0**

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The Authority is currently debt free however its capital expenditure plans do currently imply the need to borrow over the forecast period to increase the Council's property portfolio. Investments are forecast to fall to £19m as capital receipts are used to finance capital expenditure and reserves are used to finance the revenue budget.

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2018/19.

5. Borrowing Strategy

The Authority currently does not hold any loans.

The capital expenditure plans set out in the Capital Strategy provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The balance sheet forecast in table 1 shows that the Authority does not expect to need to borrow in 2018/19. The Authority may however borrow externally if internal borrowing is not sufficient to fund the capital programme, providing this does not exceed the authorised limit for borrowing of £25 million.

The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs 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.

Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

Sources of borrowing:

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

- Public Works Loan Board (PWLB) and any successor body;
- any institution approved for investments (see below);
- any other bank or building society authorised to operate in the UK;
- UK public and private sector pension funds (except Oxfordshire County Council Pension Fund);
- capital market bond investors;
- Other sources of debt finance: In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:
- operating and finance leases;
- hire purchase;
- Private Finance Initiative;
- sale and leaseback.

Short-term and variable rate loans: These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

6. Investment Strategy

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £30m and £47m, levels may be slightly lower in the coming year as a result of internal borrowing.

Objectives

Both the CIPFA Code and the CLG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

Negative interest rates

If the UK enters into a recession in 2018/19, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Approved counterparties: The Authority may invest its surplus funds with any of the counterparty types in table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 2: Approved investment counterparties and limits

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£7m 5 years	£7m 20 years	£7m 50 years	£5m 20 years	£5m 20 years
AA+	£7m 5 years	£7m 10 years	£7m 25 years	£4m 10 years	£5m 10 years
AA	£7m 4 years	£7m 5 years	£5m 15 years	£4m 5 years	£5m 10 years
AA-	£7m 3 years	£7m 4 years	£5m 10 years	£3m 4 years	£5m 10 years
A+	£7m 2 years	£7m 3 years	£5m 5 years	£3m 3 years	£5m 5 years
A	£7m 13 months	£7m 2 years	£5m 5 years	£3m 2 years	£3m 5 years
A-	£7m 6 months	£7m 13 months	£5m 5 years	£2m 13 months	£3m 5 years
None	£2m 6 months	£2m 6 months	n/a	n/a	n/a
Pooled funds	£5m per fund				

This table must be read in conjunction with the notes below

Credit rating

Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

Banks unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

Banks secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment as part of a diversified pool in order to spread the risk widely.

Registered providers: Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing, formerly known as housing associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain the likelihood of receiving government support if needed.

Pooled funds: Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

Operational bank accounts: The Council banks with Lloyds (Lloyds Banking Group). On adoption of this Strategy, it will meet the minimum credit criteria of A- (or equivalent) long term. It is the Councils intention that even is the credit rating of Lloyds Bank falls below the minimum criteria A- the bank will continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements.

Policy Investments: The Authority will provide cash-flow cover for a third-party organisations linked to the Authority. The following limit is set for 2018/19:

- Publica Group - £500k up to one year duration
- UBICO £500k up to one year duration

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and

- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other information on the security of investments: The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Specified investments: The CLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council, or
  - a body or investment scheme of "high credit quality".

The Authority defines "high credit quality" organisations and securities 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. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

Non-specified investments: Any investment not meeting the definition of a specified investment is classed as non-specified. The Authority does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in table 3 below.

Table 3: Non-specified investment limits

	Cash limit
Total long-term investments	£20m
Total investments without credit ratings or rated below A-(except UK Government and local authorities)	£10m
Total investments (except pooled funds) with institutions domiciled in foreign countries rated below AA+	£10m

Investment limits: A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£7m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£7m per group
Any group of pooled funds under the same management	£5m per manager
Foreign countries	£4m per country
Registered providers	£5m in total
Unsecured investments with building societies	£5m in total
Money Market Funds	£15m in total

Liquidity management: The Authority uses purpose-built cash flow forecasting software, Logotech, to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium term financial plan and cash flow forecast.

Non-Treasury Investments

Although not classed as treasury management activities and therefore not covered by the CIPFA Code or the CLG Guidance, the Authority may also purchase property for investment purposes and may also make loans and investments for service purposes, for example in shared ownership housing, as loans to local businesses and landlords, or as equity investments and loans to the Authority's subsidiaries.

Such loans and investments will be subject to the Authority's normal approval processes for revenue and capital expenditure and need not comply with this treasury management strategy.

Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	Target
Portfolio average credit rating	A+

Interest rate exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

	2018/19	**2019/20**	**2020/21**
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	50%	50%	50%

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.

Principal sums invested for periods longer than 364 days: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

	2018/19	**2019/20**	**2020/21**
Limit on principal invested beyond year end	£20m	£20m	£20m

Other Items

There are a number of additional items that the Authority is obliged by CIPFA or CLG to include in its Treasury Management Strategy.

Policy on the use of financial derivatives: 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 Authority 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 Authority 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, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

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.

Investment training: The needs of the Authority's treasury management staff for training in investment management are assessed annually as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA.

The increased Member consideration of treasury management matters requires a suitable training process for Members and officers. This Council has addressed this important issue by providing some training sessions for the FMOS on the subject of Treasury Management.

Investment advisers: The Authority recently re-appointed Arlingclose Limited as treasury management advisers for three years plus the option for a further two years after a joint tender with Cotswold District Council. The Authority receives specific advice on investment, debt and capital finance issues.

Financial Implications

The budget for investment income in 2018/19 remains unchanged at £607k, based on an average investment portfolio of £39.5 million at an interest rate of 1.55%. If actual levels of investments and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

Arlingclose Economic & Interest Rate Forecast November 2017

Underlying assumptions:

- In a 7-2 vote, the MPC increased Bank Rate in line with market expectations to 0.5%. Dovish accompanying rhetoric prompted investors to lower the expected future path for interest rates. The minutes re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

- Further potential movement in Bank Rate is reliant on economic data and the likely outcome of the EU negotiations. Policymakers have downwardly assessed the supply capacity of the UK economy, suggesting inflationary growth is more likely. However, the MPC will be wary of raising rates much further amid low business and household confidence.

- The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. While recent economic data has improved, it has done so from a low base: UK Q3 2017 GDP growth was 0.4%, after a 0.3% expansion in Q2.

- Household consumption growth, the driver of recent UK GDP growth, has softened following a contraction in real wages, despite both saving rates and consumer credit volumes indicating that some households continue to spend in the absence of wage growth. Policymakers have expressed concern about the continued expansion of consumer credit; any action taken will further dampen household spending.

- Some data has held up better than expected, with unemployment continuing to decline and house prices remaining relatively resilient. However, both of these factors can also be seen in a negative light, displaying the structural lack of investment in the UK economy post financial crisis. Weaker long term growth may prompt deterioration in the UK's fiscal position.

- The depreciation in sterling may assist the economy to rebalance away from spending. Export volumes will increase, helped by a stronger Eurozone economic expansion.

- Near-term global growth prospects have continued to improve and broaden, and expectations of inflation are subdued. Central banks are moving to reduce the level of monetary stimulus.

- Geo-political risks remains elevated and helps to anchor safe-haven flows into the UK government bond (gilt) market.

Forecast:

- The MPC has increased Bank Rate, largely to meet expectations they themselves created. Future expectations for higher short term interest rates are subdued. On-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions.

- Our central case for Bank Rate is 0.5% over the medium term. The risks to the 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.

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.19**
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**
Downside risk	0.00	0.00	0.00	0.00	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	**-0.15**
3-month LIBID rate														
Upside risk	0.10	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.22**
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**
Downside risk	-0.10	-0.10	-0.15	-0.15	-0.15	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	**-0.20**
1-yr LIBID rate														
Upside risk	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	**0.27**
Arlingclose Central Case	**0.70**	**0.70**	**0.70**	**0.70**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.77**
Downside risk	-0.15	-0.20	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.15	-0.15	**-0.26**
5-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**0.75**	**0.75**	**0.80**	**0.80**	**0.80**	**0.85**	**0.90**	**0.90**	**0.95**	**0.95**	**1.00**	**1.05**	**1.10**	**0.89**
Downside risk	-0.20	-0.20	-0.25	-0.25	-0.25	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	**-0.33**
10-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.30**	**1.30**	**1.35**	**1.40**	**1.45**	**1.50**	**1.55**	**1.55**	**1.36**
Downside risk	-0.20	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	**-0.33**
20-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**1.85**	**1.85**	**1.85**	**1.85**	**1.85**	**1.90**	**1.90**	**1.95**	**1.95**	**2.00**	**2.05**	**2.05**	**2.05**	**1.93**
Downside risk	-0.20	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.38**
50-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.75**	**1.80**	**1.85**	**1.90**	**1.95**	**1.95**	**1.95**	**1.95**	**1.82**
Downside risk	-0.30	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.39**

Existing Investment Position (31 Dec 2017)

	31st December 2017 **Actual Portfolio** **£m**	31st December 2017 **Average Rate** **%**
Other long-term liabilities:		
Private Finance Initiative	0	
Finance Leases	0	
Transferred Debt	0	
Total other long-term liabilities	**0**	
Total gross external debt	**0**	
Treasury investments:		
Banks & building societies (unsecured)	11.7	0.60
Housing Association Loans	5	3.35
Government (incl. local authorities)	2	0.65
Corporate bonds and loans	2.5	4.75
Money Market Funds	4.31	0.29
Other pooled funds	12.99	2.58
Total treasury investments	**38.5**	**1.86**
Net investments	**38.5**	**1.86**

Capital Strategy – Working Document

Background

Local authority investment decisions have been making headlines during 2017, with some elements of the national press calling into question the role of local authorities investing in property and assets as a means to generate income. However as funding has decreased councils have increasingly relied upon new sources of income to plug the funding gaps. Councils investing in property, and other assets, is nothing new; many local authorities have historically held major assets including retail sites, farms and residential property. In recent years however the emphasis on using these assets to generate a commercial yield has become much greater and this has involved out of area investment. The scaling up of investments by local councils has led to increased public awareness and as a consequence increased the interest of the Department for Communities and Local Government, (DCLG), and the Chartered Institute of Public Finance and Accountancy (CIPFA) resulting in recently published changes to the Treasury Management Code and the Prudential Code.

The Capital Strategy is intended to give a high level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability. The strategy aims to include sufficient detail to allow all Members to see how stewardship, value for money, prudence, sustainability and affordability will be secured and to meet legislative requirements on reporting.

Long-term context in which capital expenditure and investment decisions are made

The Council's Medium Term Financial Strategy (MTFS) sets the context for the Council's finances over the medium term. The MTFS identifies risks to the sustainability of the Council's finances (revenue and capital) and the level of savings/new or increased income streams to be found to enable the Council to set a balanced budget. The MTFS is the financial link to the Council's aim and priorities as set out in its Corporate Plan.

Some capital expenditure is annual (e.g. demand led requests for Disabled Facilities Grants, or rolling replacement of computer equipment), some is cyclical (e.g. replacement of gymnasium equipment, operational vehicles) other investment fits in with the Council's objectives and Priorities (e.g. provision of car parking facilities, investment in leisure centres).

The Capital Programme will contain a mix of annual, cyclical and Council priority investment.

The MTFS includes the impact of economic factors such as inflation and interest rates (borrowing costs and investment income) on the Council's revenue budgets. The Council uses specialist advisors to provide intelligence on likely changes to economic factors.

One of the most significant factors to the MTFS is the forecast of changes to the central government methodology on funding local government or changes to the role and responsibilities of various tiers of local government. This is often one of the most challenging aspects to producing a robust MTFS due to the link to the parliamentary cycle and national pressures which means that forecasting out over the long term with any degree of reliability is almost impossible.

Capital expenditure

The approval process

The Council maintains a Capital Programme, which includes non-treasury management investment, and covers the current financial year and a forecast for the subsequent five financial years. The Capital Programme is approved by Council, following a Scrutiny process and recommendation by the Cabinet. The impact of the capital programme on the Council's revenue budgets is included with the Council's Medium Term Financial Strategy and the detailed revenue budget for the financial year.

Officers in the Council's finance team will support the option appraisal process to ensure that each request for capital expenditure properly takes into account the revenue implications of the capital expenditure, including financing costs. The finance team will report to Cabinet and Council on the impact upon the capital programme, Medium Term Financial Strategy and Prudential Indicators.

Where the capital investment was not planned as part of the annual Capital Strategy, Capital Programme, MTFS and Revenue Budget process, approval will be sought in line with the Council's Financial Rules or Scheme of Delegation.

In assessing affordability, the Council will consider the council tax implications of its capital programme, borrowing and investment decisions. The Council will set and monitor Prudential Indicators as key indicators of affordability.

Long-Term Financing Strategy

The Council has previously funded capital expenditure through the application of capital receipts, capital grants (including s.106 funds) earmarked revenue reserves or revenue contributions. As at 31st March 2017, the Council held no debt.

The Council's capital programme includes details of how the capital programme will be funded, including any increase in the borrowing requirement. For 2017/18, the Council has included a provision for borrowing up to £7 million to finance capital expenditure plans. However, due to in-year adjustments to the capital programme, the revised borrowing forecast is £4.6 million.

The Council's borrowing requirement is small compared to its average cash investments of £38.5 million (as at 31 December 2017). Table 1 sets out the Council's forecast borrowing requirement compared to forecast usable reserves, working capital and investments for the next three financial years.

Table 1: Balance sheet summary and forecast

	31.3.17 Actual £000	31.3.18 Estimate £000	31.3.19 Forecast £000	31.3.20 Forecast £000	31.3.21 Forecast £000
Total CFR	**4,864**	**9,460**	**10,420**	**15,420**	**16,420**
External borrowing	0	0	0	0	0
Internal borrowing	**4,864**	**9,460**	**10,420**	**15,420**	**16,420**
Usable reserves	27,900	25,500	25,300	25,400	24,900
Working capital	10,100	10,100	10,100	10,100	10,100
Investments	**33,200**	**26,400**	**25,200**	**20,300**	**19,000**

Initially, the Council will borrow against its internal cash balances, supplemented occasionally by short-term borrowing at the best rate available from the market which may include borrowing from other local authorities. The market interest rate charges are considerably more affordable than through Public Works Loan Board Borrowing, indicative PWLB borrowing rates are set out below.

PWLB borrowing rates

Notice Number	14
Change Date	10/01/2018

	PWLB Certainty Rate		
	PWLB EIP	PWLB Annuity	PWLB Maturity
3 years	1.32	1.32	1.43
5 years	1.41	1.41	1.64
7 years	1.50	1.51	1.85
10 years	1.66	1.67	2.14
15 years	1.93	1.95	2.48
20 years	2.16	2.20	2.65
25 years	2.35	2.40	2.69
30 years	2.49	2.55	2.65
40 years	2.65	2.68	2.47
50 years	2.69	2.66	2.39

These rates compare with short-term borrowing from other local authorities at rates which are typically less than 1% and often nearer to 0.6%.

Asset Management

The Council's land and property assets, including commercial property are managed by the Land, Legal and Property services team. Commercial Property is valued in accordance with international financial reporting standards and reported within the Council's financial statements.

Other assets (e.g. vehicles and equipment) are managed by the relevant operational service area.

The Council's Land, Legal and Property services team and operation service managers liaise with the Council's Insurance Officer to ensure that appropriate insurance is in place for all Council assets.

Maintenance Requirements

For operational and investment property assets, wholly used by the Council (or its contractors or commercial property tenants), maintenance requirements are managed by the Council's Property Services team.

For operational assets where a contractor has some repairing responsibilities, such as leisure centres, the Council's Property Services team and the contract monitoring officers ensure that the contractor fulfils their responsibilities (generally internal repairs and maintenance). The Council's Property Service team, working with the contract monitoring officers, ensure that the Council responsibilities for structural repairs and maintenance are fulfilled.

Planned Disposals

The Council is not planning any significant asset disposals. The Council's Financial Statements identify the value of surplus assets available for disposal.

The Council holds some land in the district which could be developed to provide economic benefit within the district. The Council will consider proposals from developers where the developer proposals align with the Council's priorities. Any decisions on development of this nature would be recommended to the full Council by the Cabinet on consideration of a full business case, including options appraisal and advice from relevant experts.

The Council is a member of the Oxfordshire One Estate Programme Board which aims to deliver the best value for money from the wider public estate across Oxfordshire. Any proposals from the Board would be recommended to the full Council by the Cabinet on consideration of a full business case, including options appraisal and advice from relevant experts.

Funding Restrictions

The Council produces group accounts to reflect its ownership of Publica Group (Support) Ltd. Publica does not hold any land and property assets, the assets on the balance sheet include vehicles and operational machinery. Publica finances the replacement of assets through the overhead charges included in the revenue contract charges to its clients, including the Council. The Council does not provide capital financing to Publica other than through an element of the annual contract sum for service provision.

Debt Management

Borrowing Projections

The Council's borrowing projections are set out below:

	2018/19 £ million	2019/20 £ million	2020/21 £ million	2021/22 £ million	2022/23 £ million
Planned Capital Expenditure	3.807	7.847	2.325	1.247	3.597
Capital Expenditure Funded	2.847	2.847	1.325	1.247	1.247
In-year Borrowing Requirement	**0.960**	**5.000**	**1.000**	**0**	**2.350**
Cumulative Borrowing Requirement	**10.420**	**15.420**	**16.420**	**16.420**	**18.770**

Capital Financing Requirement and liability benchmark

As the Council is currently debt free, the Capital Financing Requirement is the same as the Borrowing Requirement shown in the table above.

NEED GUIDANCE (NOT YET PUBLISHED) ON THE LIABILITY BENCHMARK AND INCLUDE TEXT AS APPROPRIATE.

Provision for the repayment of debt

The Council will provide for the repayment of debt in accordance with its Minimum Revenue Provision as set out below

Minimum Revenue Provision Policy Statement 2018/19:

For many years local authorities were required by Statute and associated Statutory Instruments to charge to the Revenue Account an annual provision for the repayment of debt associated with expenditure incurred on capital assets. This charge to the Revenue Account was referred to as the Minimum Revenue Provision (MRP). In practice MRP represents the financing of capital expenditure from the Revenue Account that was initially funded by borrowing.

In February 2008 the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 [Statutory Instrument 2008/414] were approved by Parliament and became effective on 31st March 2008. These regulations replaced the formula based method for calculating MRP which existed under previous regulations under the Local Government Act 2003. The new regulations required a local authority to determine each financial year an amount of MRP which it considers to be prudent. Linked to this new regulation, the Department of Communities and Local Government

(CLG) produced Statutory Guidance which local authorities are required to follow, setting out what constitutes a prudent provision.

The CLG Guidance recommends that before the start of the financial year, a statement of MRP policy for the forthcoming financial year is approved by Full Council.

The broad aim of the Policy is to ensure that MRP is charged over a period that is reasonably commensurate with the period over which the capital expenditure which gave rise to the debt provides benefits. In the case of borrowing supported by Revenue Support Grant, the aim is that MRP is charged over a period reasonably commensurate with the period implicit in the determination of that grant. Where a local authority's overall CFR is £nil or a negative amount there is no requirement to charge MRP.

The move to International Financial Reporting Standards (IFRS) means that Private Finance Initiative (PFI) schemes and Operating Leases can be brought onto the Balance Sheet. Where this is the case, such items are classed in accounting terms as a form of borrowing. CLG has therefore amended the Capital Finance Regulations to ensure that the impact on the Revenue account is neutral, with MRP for these items matching the principal repayment embedded within the PFI or lease agreement.

MRP Options:

Four options for prudent MRP provision are set out in the CLG Guidance. Details of each are set out below with a summary set out in Table 1:

Option 1 – Regulatory Method:

This method replicates the position that would have existed under the previous regulatory environment. MRP is charged at 4% of the Authority's underlying need to borrow for capital purposes; the Capital Financing Requirement (CFR). The formula includes an item known as "Adjustment A" which was intended to achieve neutrality between the CFR and the former Credit Ceiling which was used to calculate MRP prior to the introduction of the Prudential System on 1st April 2004. The formula also took into account any reductions possible related to commutation of capital related debt undertaken by central government.

As the Council is debt-free, this option does not apply to the Council.

Option 2 – CFR Method:

This method simplifies the calculation of MRP by basing the charge solely on the authority's CFR but excludes the technical adjustments included in Option 1. The annual MRP charge is set at 4% of the non-housing CFR at the end of the preceding financial year.

As the Council is debt-free, this option does not apply to the Council.

Option 3 – Asset Life Method:

Under this method MRP is determined by the life of the asset for which the borrowing is undertaken. This can be calculated by either of the following methods:

(a) Equal Instalments: where the principal repayment made is the same in each year, or

(b) Annuity: where the principal repayments increase over the life of the asset.

The annuity method has the advantage of linking MRP to the benefits arising from capital expenditure, where these benefits are expected to increase over the life of the asset.

MRP commences in the financial year following that in which the expenditure is incurred or, in the year following that in which the relevant asset becomes operational.

The estimated life of the asset will be determined in the year that MRP commences and will not be subsequently revised. However, additional repayments can be made in any year which will reduce the level of payments in subsequent years.

If no life can be reasonably attributed to an asset, such as freehold land, the life is taken to be a maximum of 50 years. In the case of freehold land on which a building or other structure is constructed, the life of the land will be treated as equal to that of the structure.

In instances where central government permits revenue expenditure to be capitalised, the Statutory Guidance sets out the number of years over which the charge to revenue must be made. The maximum useful life for expenditure capitalised by virtue of a direction under s16(2)(b) is 20 years

MRP in respect of PFI and Operating Leases brought onto the Balance Sheet under IFRS falls under Option 3.

The General Fund MRP charge using this method is estimated at £319,000 for 2018/19.

Option 4 - Depreciation Method:

The depreciation method is similar to that under Option 3 but MRP is equal to the depreciation provision required in accordance with proper accounting practices to be charged to the Income and Expenditure account.

The General Fund MRP charge for this method is £319,000 for 2018/19.

Conditions of Use:

The CLG Guidance puts the following conditions on the use of the four options:

- Options 1 and 2 can be used on all capital expenditure incurred before 1st April 2008 and on Supported Capital Expenditure on or after that date.

- Options 3 and 4 are considered prudent options for Unsupported Capital Expenditure on or after 1st April 2008. These options can also be used for Supported Capital Expenditure whenever incurred.

MRP Policy for 2018/19:

It is proposed that for 2018/19 the Council adopts Option 3 for any unsupported borrowing (options 1 and 2 for supported capital expenditure not being relevant to this Council). For Option 3, the annuity method for calculating MRP will be used when applicable.

MRP under the CLG Guidance

MRP Options	1 Regulatory Method	2 CFR Method	3 Asset Life Method	4 Depreciation Method
Classifications of Capital Expenditure impacting on the CFR	Capital expenditure incurred before 1 April 2008			
	Supported Capital expenditure incurred after 1 April 2008		Unsupported Capital expenditure incurred after 1 April 2008	
			Expenditure capitalised by virtue of a Direction under s16(2)(b) of the Local Government Act 2003	
MRP Basis	Former regulations 28 and 29	4% of Non-Housing CFR	Equal Annual Instalments of Principal	Depreciation
Aspects of MRP charges	CFR excludes element attributable to Unsupported Capital Expenditure		EIP commences when asset operational	Depreciation MRP commences when asset operational
			Freehold land 50 years.	Depreciation MRP ceases when CFR component is £Nil
			Freehold land with structure >50 years	Depreciation MRP not adjusted for capital receipt
			Capitalisation periods	Depreciation MRP based on proportion of asset financed from "borrowing".
			PFI/Operating Leases brought on Balance Sheet under IFRS	

Risk and impact, or potential impact, on the overall financial sustainability

The Council's Medium Term Financial Strategy includes the revenue implications of the investment set out in this Strategy. The revenue impact of provision for repayment of debt, interest charges, maintenance charges and other associated revenue costs are all included within the revenue budget forecast. The overall impact upon General Fund Working Balance, capital resources and other revenue earmarked reserves is included in the Medium Term Financial Strategy.

The Chief Finance Officer provides an opinion report on the robustness of the level of reserves as a part of the budget setting report to Council in February each year. The budget report also sets out the significant risks to the Council's budget, the mitigating action and provides a financial assessment of the degree of risk carried by the Council and the adequacy of reserves to finance the risk.

The Authorised Limit for the coming year – minimum 3 year period

The Authorised Limit of borrowing during the next 3 years is set out below:

	2018/19 £ million	**2019/20 £ million**	**2020/21 £ million**
Authorised Limit	25	25	25

Operational Boundary for Borrowing

The Operational Boundary of borrowing during the next 3 years is set out below:

	2018/19 £ million	**2019/20 £ million**	**2020/21 £ million**
Operational Boundary	4.5	4.5	4.5

The Authority's approach to treasury management

Governance Process for Treasury Management

The 2017 changes to the Treasury Management Code and the Prudential Code provide the Council with the opportunity to revise its delegations from Council to Cabinet/Committees. However, overall responsibility for Treasury Management remains with Council.

Given that, at the time of preparing this strategy, detailed sectoral guidance on the 2017 changes to the Treasury Management Code and Prudential Code has not been published. In addition the Ministry of Housing, Communities and Local Government is still considering changes to its Investment Guidance. It is proposed that Council retains the responsibility for approving the Treasury Management Strategy and associated Treasury Management Practices.

The treasury management annual strategy, half-year performance report and annual report are currently considered by the Finance and Management Overview and Scrutiny Committee and Cabinet recommends approved by Council. No changes are proposed to these arrangements.

Projection of external debt and internal borrowing levels over the longer term

The Council's borrowing projection is set out under the Debt Management section of this document.

The proposed Treasury Management Strategy Statement 2018/19 permits the Council to allocate up to £20 million of its cash balances into longer term or less liquid investment products. To fund operational activity, the Strategy requires the Council to hold a minimum of £10 million in highly liquid investments products which can be used as internal borrowing to fund the Councils investment plans. As cash levels fluctuate during the year, this internal borrowing may be supplemented by short-term borrowing from third parties.

Short-term borrowing interest charges are forecast as follows for the next three years:

	2018/19 %	**2019/20 %**	**2020/21 %**
Base Rate + .8%	1.3	1.3	1.3

This compares to current Public Works Loan Board (PWLB) Certainty Rates as follows:

	2018/19 %
PWLB Rate 10 years	1.66
PWLB Rate 20 years	2.16
PWLB Rate 50 years	2.69

Given that the interest cost of short-term borrowing is forecast to be cheaper than PWLB borrowing over the medium term, it is more appropriate to use short-term lending rather than enter into loans with the PWLB.

The Council will seek the lowest interest rate available from lenders as set out in the Treasury Management Strategy. This includes institutions approved for investments, UK banks and building societies, UK public and private sector pension funds (except Oxfordshire Pension Fund), capital market bond investors, and local authorities.

The Council's liquidity forecast, assuming that long-term borrowing is deferred, is set out below:

	2018/19 £ million	**2019/20 £ million**	**2020/21 £ million**
Planned investment in less liquid investment products	15	10	9
Planned investment in highly liquid investment products (minimum)	10	10	10

Organisation's risk appetite in relation to Treasury Management

The Council's Treasury Management Strategy Statement sets out the Council's risk appetite in the Risk Assessment and Credit Ratings section of the Strategy.

Risks faced in terms of servicing current and future debt requirement

The Council is currently debt free and its current borrowing plans are limited. The Medium Term Financial Strategy includes the revenue implications of capital expenditure and investment. Therefore, the risk of servicing current and future debt requirements is minimal.

The most significant risks relate to cost overruns on investment projects increasing the Council's borrowing requirement or rapid increases in borrowing rates due to changing economic conditions.

How risks are to be managed

The Council operates robust project management and governance processes for capital investment projects (such as investment in land and buildings). Potential cost overruns will therefore be identified as early as possible. The Council will then be able to decide on an appropriate response; for example, other capital investment can be postponed or delayed, the project facing the cost overrun may be re-scoped.

The risk of borrowing rates increasing will be managed by access to regular advice upon economic trends from experienced treasury advisors. Where the cost of short-term borrowing is likely to become on par with or exceed the cost of longer-term borrowing (e.g. from PWLB) the Council will manage a transition from short-term borrowing to long-term borrowing. The Council will ensure it is in a position to be able to access any discount rates available from the PWLB.

Commentary on sensitivity projections

Should interest rates increase by 0.5% above the forecasts in this strategy, the Council would incur an additional £58,000 of interest on borrowing per annum by the end of 2020/21. This would be more than offset by the additional interest received on highly liquid investments.

If there was a particularly large capital scheme e.g. decked car park (estimated cost £15 million) with a 10% cost overrun in the additional cost of Minimum Revenue Provision and interest on borrowing would be £45,000.

Summary of Knowledge and skills available to the organisation

The Council's treasury management function is provided through its strategic service provider Publica Group (Support) Ltd. The team of treasury officers have the following qualifications:

- Members of the Association of Accounting Technicians

In addition, the Team Leader has many years of experience of local authority treasury management working across 4 local authorities which utilise a mix of investment and borrowing products.

The treasury officers are supported by expert advice from the Council's treasury advisor Arlingclose Ltd. Arlingclose provide regular information and advice upon counter party risk and investment products which are in line with the risk appetite as set out within the Council's Treasury Management Strategy.

The treasury management knowledge and skills available to support the Council are therefore commensurate with the Council's risk appetite.

The Council's approach to Commercial Activity

Investments that are not part of Treasury Management Activity

In contrast to Treasury Management investments, where investments prioritise security and liquidity over yield, non-treasury investments may not prioritise security and liquidity over yield. Such decisions will be explicit, the additional risks will be set out clearly and will include the impact upon the Council's finances.

Sustainability identified and reported.

The full Council will consider recommendations from the Cabinet on investments which are not part of Treasury Management Activity for inclusion in the Council's Capital Programme. The Council decision will be based upon a report which sets of the full cost to the Council both in terms of capital investment and revenue implications. The revenue implications will include the cost of borrowing (interest and provision for debt repayment), forecast revenue, operational costs including repairs and maintenance costs, insurance and other asset management costs. The revenue implications will feed into the Council's Medium Term Financial Strategy.

The provision for debt repayment will be in line with the Council's Minimum Revenue Provision policy. The provision for debt repayment will reflect the planned asset life. The report will set out the risks associated with the investment and appropriate sensitivity analysis. For commercial property this will include the risk of void periods.

The report will include the link with this Capital Strategy and the impact upon Prudential Indicators.

The report will also identify the Council priorities which the investment is supporting.

<u>Due Diligence Processes and Procedures to reflect the additional risk</u>

Officers from Council's Finance and Legal teams will support the development of the investment proposal with support from external advisors as necessary. Officers, in consultation with the appropriate Member representatives, will identify appropriate due diligence checks to be carried out. As a minimum these will include:

- financial checks for suppliers, contractors or potential tenants;
- appropriate advice upon the local market and forecast market changes;
- for property acquisitions - independent valuation advice, property condition surveys and land registry checks;

The outcome of the due diligence checks will be reported to Members as part of the decision making report.

<u>Requirements for independent and expert advice</u>

Where necessary independent and expert advice will be sought to ensure due diligence is suitably robust.

<u>Authority Risk Appetite</u>

The Council accepts that investments that are not part of Treasury Management Activity carry a higher degree or risk, however, this needs to be reflected in the level of financial return or the relationship to delivery of the Council's approved priorities.

The due diligence processes will identify and quantify the degree of risk for Members to consider as part of the decision making process.

<u>Proportionality in relation to overall resources</u>

As at 31 March 2017, the Council's held:

- Investments in commercial property valued at £43.3 million;
- Investment in long term investments of £20.7 million;
- Investment in short term investments £4.5 million
- General Fund Working Balance of £11.8 million;
- Capital Reserves of £7.7 million; and
- £0 borrowing.

This compared to a net revenue budget of around £10 million.

The impact of the capital investment plans on the Council's Balance Sheet for the next four years are set out below:

	2018/19 £ million	2019/20 £ million	2020/21 £ million	2021/22 £ million
Commercial Property[1]	43	43	43	43
Long Term Investments[1]	15	10	10	10
Short Term Investments	10	10	10	10
GFWB	11.6	11.8	11.5	11.7
Capital Reserves	5.3	5.2	5.0	4.9
Borrowing	10.4	15.4	16.4	16.4

[1] ***Subject to annual valuations to feed into Statement of Accounts***

Scrutiny Arrangements

The Cabinet will make recommendations to full Council on new investments that are not part of Treasury Management Activity.

Financial Performance is reported quarterly to the Council's scrutiny committee(s) and to Cabinet. This will include the financial performance of investments which are not part of Treasury Management.

An annual report on Commercial Property will be presented to Finance Management Overview and Scrutiny Committee which will include yield; valuation and risk to future revenue.

Treasury Management performance is reported at half-year and year-end the Council's Finance Management Overview and Scrutiny Committee and to full Council.

The Council's internal audit provider (South West Audit Partnership Ltd) regularly audits the Council's treasury management activity and its processes and procedures for approving investment and performance management. SWAP report to the Council's Audit and General Purposes Committee.

Summary of knowledge and skills available to the authority.

The Council has experience of investing in commercial property in recent years. The Council's property service is provided through its strategic service provider Publica Group (Support) Ltd. The team of property officers have the following qualifications:

- Christine Cushway – BSc Hons Estates Management, ARICS
- Jasmine McWilliams – BSc Hons Estate Management, ARICS
- David Thurlow – BSc Hons Estate Management, MRICS, Registered Valuer

External consultants are also employed as necessary to provide advice on acquisition and management of investment properties.

The Council's legal team have experience of carrying out due diligence checks, particularly for commercial property acquisitions, and the legal officers have the following qualifications:

- Fflkljkdfsalkj
- Afjlljkd
- Ljfdfjldlj

The property and legal team work together with the Finance team to support the Council's Chief Finance Officer and the Publica Finance Director in developing investment proposals for the Council. External specialist advice is obtained when required to support these teams.

The Council, has previously invested in a range of commercial properties which are delivering a sustainable revenue stream to the Council. Any further investment in non-treasury management transactions will be set out in this, or future iterations of this strategy.

Other Long-Term Liabilities, such as Financial Guarantees

The most significant long-term liability relates to the Council's membership of the Oxfordshire Local Government Pension Scheme. Accounting disclosures can be found within the Council's financial statements. As at 31 March 2017, the long-term liability in relation to the pension scheme amounted to £37.4 million.

The Council has no other significant long-term liabilities or financial guarantees.

Knowledge and Skills

Chief Finance Officer Report on the affordability and risk associated with the Capital Strategy

WILL TAILOR REPORT IN BUDGET REPORT TO COVER THE AFFORDABILITY AND RISK ASSOCIATED WITH THE CAPITAL STRATEGY – COPY AND PASTE IN TO HERE

Setting the Prudential Indicators

Total Capital Expenditure

	2018/19 £ million	**2019/20 £ million**	**2020/21 £ million**	**2021/22 £ million**	**2022/23 £ million**
Planned Capital Expenditure	3.807	7.847	2.325	1.247	3.597
Capital Expenditure Funded	2.847	2.847	1.325	1.247	1.247

Operational Boundary

	2018/19 £ million	2019/20 £ million	2020/21 £ million
Operational Boundary	4.5	4.5	4.5

Authorised Limit

	2018/19 £ million	2019/20 £ million	2020/21 £ million
Authorised Limit	25	25	25

Proportion of financing costs to net revenue stream

	2018/19 £ million	2019/20 £ million	2020/21 £ million
Proportion of financing costs to net revenue stream	0.764:10.8	0.792:10.1	0.942:9.9

Borrowing Net of Treasury Management Investments

	2018/19 £ million	2019/20 £ million	2020/21 £ million
Borrowing Requirement (cumulative)	10.4	15.4	16.4
Treasury management investments	35.5	35.5	36.5
Borrowing	0	0	0
Net investments	25.1	20.1	20.1

Others (can be delegated to Committee) Local Indicators can be set to reflect local circumstances

No local indicators are recommended.

Schedule of Investment Management Practices for Non-Treasury Investment

THIS IS LIKELY TO BE DEVELOPED IN YEAR FOLLOWING PUBLICATION OF GUIDANCE AND DCLG INVESTMENT GUIDANCE

Register of Investments and Financial Guarantees
Treasury Investments

WEST OXFORDSHIRE						
Internal Investments as at:	31/12/2017					
Counterparty	Type of Investment		Principal	Start Date	Effective Maturity	Rate
HANOVER HOUSING ASSOCIATION	COMPANY LOAN	£	5,000,000	24/07/2013	24/07/2018	3.350%
A2DOMINION HOUSING GROUP LTD	CORPORATE BOND - FIXED	£	2,500,010	18/10/2013	18/10/2022	4.750%
COOPERATIEVE RABOBANK UA	DEPOSIT - FIXED	£	1,000,000	06/09/2017	05/09/2018	0.410%
COOPERATIEVE RABOBANK UA	DEPOSIT - FIXED	£	1,000,000	19/10/2017	18/10/2018	0.720%
DARLINGTON BUILDING SOCIETY	DEPOSIT - FIXED	£	1,000,000	22/11/2017	02/03/2018	0.580%
GOLDMAN SACHS INT'L BANK	DEPOSIT - FIXED	£	2,000,000	03/10/2017	03/01/2018	0.300%
LLOYDS BANK PLC	DEPOSIT - FIXED	£	1,700,000	13/04/2017	12/01/2018	0.650%
LLOYDS BANK PLC	DEPOSIT - FIXED	£	1,000,000	13/01/2017	15/01/2018	0.900%
LLOYDS BANK PLC	DEPOSIT - FIXED	£	2,000,000	31/03/2017	29/03/2018	0.800%
NATIONAL COUNTIES BUILDING SOCIETY	DEPOSIT - FIXED	£	1,000,000	15/11/2017	22/02/2018	0.570%
STANDARD CHARTERED BANK	DEPOSIT - FIXED	£	1,000,000	15/11/2017	15/02/2018	0.460%
BIRMINGHAM CITY COUNCIL	DEPOSIT - LA	£	2,000,000	28/04/2017	27/04/2018	0.650%
DB ADVISORS (DEUTSCHE)	MONEY MARKET FUND	£	1,070,000	31/12/2017	01/01/2018	0.294%
GOLDMAN SACHS ASSET MANAGEMENT	MONEY MARKET FUND	£	1,770,000	31/12/2017	01/01/2018	0.233%
INVESCO AIM	MONEY MARKET FUND	£	1,470,000	31/12/2017	01/01/2018	0.355%
Total - Internal Investments		**£**	**25,510,010**			**1.49%**

EXTERNAL FUND PORTFOLIO			WEST OXFORDSHIRE					From:	31/12/2016
FUND NAME	ASSET CLASS	No of Units Held in Period	Starting Value £	Current Value £	Capital Growth £	Dividends Earned £	Holding Period (yrs)	Capital Return	Income Return
INSIGHT - ILF LIQUIDITY PLUS FUND	CASH PLUS	2,051,800	2,018,827	2,019,956	1,128	6,209	1.0	0.06%	0.31%
PAYDEN & RYGEL STERLING RESERVE FUND	SHORT BOND	201,598	2,042,836	2,044,771	1,935	13,568	1.0	0.09%	0.66%
ROYAL LONDON ENHANCED CASH PLUS FUND	CASH PLUS	2,002,018	2,000,024	1,992,008	-8,016	24,937	1.0	-0.40%	1.25%
Cash Plus and Short Bond Funds			6,061,688	6,056,735	-4,952	44,714	1.0	-0.08%	0.74%
M&G GLOBAL DIVIDEND FUND	EQUITY - GLOBAL	616,096	1,287,974	1,416,227	128,253	38,649	1.0	9.96%	3.00%
M&G STRATEGIC CORPORATE BOND FUND	BOND	93,089	1,024,818	1,049,319	24,501	37,256	1.0	2.39%	3.64%
SCHRODER INCOME MAXIMISER FUND	EQUITY - UK	2,013,287	1,080,128	1,086,772	6,644	80,272	1.0	0.62%	7.43%
THREADNEEDLE GLOBAL EQUITY INCOME FUND	EQUITY - GLOBAL	907,899	1,321,446	1,391,718	70,271	48,406	1.0	5.32%	3.66%
UBS MULTI ASSET INCOME FUND	MULTI ASSET	3,928,254	1,954,307	1,990,054	35,747	78,565	1.0	1.83%	4.02%
Bond, Equity and Property Funds			6,668,673	6,934,089	265,416	283,148	1.0	3.98%	4.25%
GRAND TOTAL			12,730,361	12,990,824	260,464	327,862	1.0	2.05%	2.58%
		Capital gains and losses under one year are not annualised				**Annualised Returns:**		2.05%	2.58%

Non-Treasury Investments

Investment Property	**Valuation 31 March 2017 £ million**
UNION STREET, WOODSTOCK	0.022
BROOKHILL GARAGES, WOODSTOCK	0.067
GREYSTONES IND EST, C/NORTON	0.272
OLD PRINTHOUSE, WITNEY	0.189
37/37a HIGH STREET,WITNEY	0.589
WOOLGATE CDA, WITNEY	2.600
MARRIOTTS CLOSE (DEVT)	2.550
21 BETWEEN TOWNS ROAD	3.869
CHAWLEY PARK OFFICE ACCOM UNIT, CUMNOR	2.030
TALISMAN CENTRE, BISCESTER	12.800
MILL WALK, WITNEY	0.712
3A GALLEYS ISLAND, BRAINTREE (PIZZA HUT)	1.124
15 ALVESCOT ROAD, WITNEY	1.000
30/31 MARKET SQ, WITNEY (BARCLAYS BANK)	1.610
59 YARROW ROAD, POOLE	1.890
35 HIGH STREET, WITNEY	1.000
EDEN HOUSE, AV.4, STATION LANE	0.451
HEXAGON BUILDING, AV.4, STATION LANE	0.542
CARTERTON IND EST	2.740
INDUSTRIAL PREMISES, WITNEY (AMBIC	1.002
PURCHASE OF DE ROCHE SQUARE	6.250
Total	**43.3**

Other requirements for capital strategy to be developed during 2018/19 once sectoral guidance notes have been published.

- **Risk Management Schedule;**
- **Performance measurement and management;**
- **Reporting and management information;**
- **Financial Guarantees – Working note - how will these be regularly assessed? – New action as part of year-end processes?**

Reconciled to financial instrument disclosures within the Statement of Accounts

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