
REPORT FOR: CABINET

Date of Meeting:	13 th February 2020
Subject:	Annual Treasury Management Strategy Statement including Prudential Indicators, Minimum Revenue Provision Policy Statement, Annual Investment Strategy and Annual Capital Strategy for 2020/21
Key Decision:	Yes
Responsible Officer:	Dawn Calvert, Director of Finance
Portfolio Holder:	Councillor Adam Swersky, Portfolio Holder for Finance and Resources
Exempt:	No
Decision subject to Call-in:	No
Wards affected:	All
Enclosures:	Appendix A - Legislation and Regulations Impacting on Treasury Management Appendix B - Treasury Management Delegations and Responsibilities Appendix C - Minimum Revenue Provision (MRP) Policy Statement Appendix D - Interest Rate Forecasts 2020/23 Appendix E - Economic Background Appendix F – Counterparties Appendix G - Affordability Prudential Indicators Appendix H - Capital Strategy 2020/21 Appendix I - Glossary

Summary

This report sets out the Council's Annual Treasury Management Strategy Statement including Prudential Indicators, Minimum Revenue Provision Policy Statement the Annual Investment Strategy and the Annual Capital Strategy for 2020/21.

Recommendation

Cabinet is asked to recommend to Council that they approve the Treasury Management Strategy Statement for 2020/21 including:

- Prudential Indicators for 2020/21
- Minimum Revenue Provision Policy Statement for 2020/21, (see para xx)
- Annual Investment Strategy for 2020/21

Cabinet is asked to recommend to Council that they approve the Capital Strategy 2020/21. (Appendix H)

Reason

To promote effective financial management and comply with the Local Authorities (Capital Finance and Accounting) Regulations 2003 and other relevant guidance.

Section 2 – Report

1. INTRODUCTION

Background

- 1.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. The first main function of the treasury management service is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested with approved low risk counterparties or in instruments commensurate with the Council's low risk appetite current investment strategy, providing adequate liquidity initially before considering investment return.
- 1.2 The second main function of the Treasury Management service is the funding of the Council's Capital Programme. This programme provides a guide to the borrowing need of the Council, essentially the longer term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans or using longer term cash flow surpluses. On occasion when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.
- 1.3 The contribution the treasury management service makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects.
- 1.4 The Chartered Institute of Public Finance and Accountancy (CIPFA) defines Treasury Management as:

“The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”
- 1.5 The Local Government Act 2003 and supporting regulations require the Council to 'have regard to' the Prudential Code (The Prudential Code for Capital Finance in Local Authorities [CIPFA 2017 Edition]) and Treasury Management Code (Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes [CIPFA 2017 Edition]), in setting Treasury and Prudential Indicators for the next three years and in ensuring that the Council's capital investment programme is affordable, prudent and sustainable.
- 1.6 The Act, the Codes and Department for Communities and Local Government Investment Guidance (2010) require the Council to set out its Treasury Strategy for Borrowing and to prepare an Annual Investment Strategy that establishes the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. A summary of the relevant legislation, regulations and guidance is included as Appendix A.
- 1.7 The budget for each financial year includes the revenue costs that flow from capital financing decisions. Under the Treasury Management Code, increases in capital

expenditure should be limited to levels whereby increases in interest charges and running costs are affordable within the Council's budget.

- 1.8 The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.
- 1.9 The Council recognises that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

Reporting requirements and Scrutiny

- 1.10 As introduced above, the Council and/or Cabinet are required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

Treasury Management Strategy Statement report (this report) - The first, and most important report is presented to the Council in February and covers:

- The Capital Programme (including Prudential Indicators);
- Minimum Revenue Provision Policy (MRP) (how residual capital expenditure is charged to revenue over time);
- The Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- The Investment Strategy (how the parameters on investments are to be managed).

Mid-year Review report – This is presented to Cabinet in the autumn and updates Members on the progress of the investment and borrowing position, reporting on Prudential Indicators and recommending amendments when necessary, identifying whether the treasury strategy is meeting the objectives and whether any policies require revision.

Treasury Management Outturn report – This is presented to Cabinet in June/July and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the Treasury Strategy.

1.11 Capital Strategy

The CIPFA Treasury Management Code (the Code) recognises that organisations may make investments for policy reasons outside normal treasury management activity. Non-financial, or non-treasury investments tend to relate to expenditure powers under Section 1 of the Act and are subject to the guiding principles outlined separately in the Capital Strategy and are outside the scope of the Treasury Management Strategy. The aim of the Capital Strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

- 1.12 The Capital Strategy Report which is set out in Appendix H will provide the following:
 - a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services

- an overview of how the associated risk is managed
- the implications for future financial sustainability

1.13 The above reports are required to be adequately scrutinised, normally before being recommended to Cabinet / Council, with the role being undertaken by the Governance, Audit, Risk Management and Standards Committee (GARMSC).

1.14 The Council has delegated responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Section 151 Officer. The Section 151 Officer chairs the Treasury Management Group (TMG), which monitors the treasury management activity and market conditions. Further details of responsibilities are given in Appendix B.

Treasury Management Strategy for 2020/21

1.15 The Treasury Management Strategy covers:-

Capital Issues (Section 2)

- Capital Financing Summary
- Capital Programme and Capital Prudential Indicators 2020 to 2022/23
- Council's Borrowing Need (Capital Financing Requirement)
- Capital Financing Requirement
- Minimum Revenue Provision (MRP) Policy Statement
- Core funds and expected investment balances

Borrowing (Section 3)

- Current and estimated portfolio position
- Treasury indicators: limits to borrowing activity
- Prospects for interest rates and economic commentary
- Borrowing strategy
- Treasury management limits on activity
- Policy on borrowing in advance of need
- Debt rescheduling
- New financial institutions as a source of borrowing and / or types of borrowing (if applicable)
- Approved sources of long and short term borrowing

Annual Investment Strategy (Section 4)

- Investment policy
- Creditworthiness policy
- Country limits
- Annual Investment Strategy
- Investment risk benchmarking
- End of year investment report

Other Treasury Issues (Section 5)

- Policy on the use of financial derivatives
- Brokers
- Member and Officer Training
- Policy on use of external service providers

- 1.16 These Treasury Management elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, Ministry of Housing, Communities and Local Government (MHCLG) MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance. This Annual Treasury Management Strategy covers only those investments arising from the Council's cash flows and debt management activity. In accordance with the Code and recognised best practice guidelines, the security and liquidity of funds are placed ahead of investment return/yield. The power to invest is set out in the Local Government Act, Section 12.
- 1.17 It is not considered necessary to produce a separate treasury management strategy for the Housing Revenue Account (HRA) in light of the co-mingling of historic debt and investments between HRA and the General Fund. Where appropriate, details of allocations of balances and interest to HRA are contained in this report.

Options Considered

- 1.18. No options were considered beyond those discussed in the report due to the statutory and risk management constraints inherent in treasury management.

2. CAPITAL ISSUES

Capital Financing Summary

- 2.1 The Council's Capital Programme is the key driver of treasury management activity. The output of the programme is reflected in the Prudential Indicators, which are required by the Prudential Code and are designed to assist Members' overview. The values shown in the tables for 2018/19 and 2019/20 are actual and estimated outturn respectively and not the strategy for those years. The figures and tables in this report are based on the final Capital Programme which is set out in a separate report to Cabinet.
- 2.2. In previous years the Council has deferred the requirement to take external borrowing to finance the Capital Programme by using internal borrowing; reducing cash balances to finance capital expenditure to minimise the cost of borrowing. For 2019/20 total borrowing of £86.51m is required to finance the spend on the approved capital programme. As at 31st December 2019, £120 million long-term borrowing has been taken to finance capital expenditure not funded from other sources and to replace short term borrowing taken in 2018/19.
- 2.3 The borrowing strategy reflects an unexpected 1% increase in the cost of new PWLB borrowing. This decision was made by HM Treasury with immediate effect from 9th October 2019. The Council is now seeking other sources of affordable funding to be able to deliver the Capital Programme within current budget provision.
- 2.4. The Council's total estimated borrowing requirement for 2020/21 is £201.385m .This includes slippage of £186.136m from 2019/20, including property investment slippage of £93.5m.
- 2.5 Wherever practical annuity loans will be taken to ensure that the loan is repaid over the lifetime of the asset to manage the on-going debt burden on the Council.

2.6 Shown below are the capital financing costs that are already factored into the existing MTFs from 2019/20 to 2021/22 in relation to existing and historic capital programmes expressed as a proportion of the 2019/20 net revenue budget of £167m:

Capital Financing Costs as % of the Net Revenue Budget

	Capital Financing Costs*	Capital financing costs as % of 2019/20 Net Budget
	£m	%
2018/19	24.6	15%
2019/20	32.6	19%
2020/21	33.8	20%
2021/22	35.7	21%

* This is the position for the 2019/20 Budget setting and does not factor in 2020/21 changes

2.7. The above figures are gross capital financing costs. Where schemes are included in the Capital Programme on a cost neutral basis (i.e. capital financing costs are covered by income generation or savings) the income or saving will be included elsewhere in the budget.

Capital Programme and Capital Prudential Indicators 2018/19 to 2020/23.

2.8 Table 1 below sets out a summary of the Council’s capital expenditure based on the approved Capital Programme and the way in which it will be financed.

Amendments may be necessary in the light of decisions taken during the budget cycle:

Table 1 Capital Expenditure and Funding HRA and Non HRA

	2018/19	2019/20	2020/21	2021/22	2022/23
	Actual	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Expenditure :-					
People Services	5,690	8,749	1,746	-	-
Environment and Commission	-	49,512	28,433	32,210	28,928
Regeneration & Enterprise	35,198	2,119	1,201	-	-
Regeneration Programme	-	3,257	5,193	510	-
Resources & Commercial	9,802	40,845	6,200	2,163	1,244
HRA	7,091	20,011	36,297	58,697	43,896
Total Expenditure	57,781	124,493	79,070	93,580	74,068
Funding:-					
Capital grants	13,063	15,995	21,626	16,351	15,014
Capital receipts	1,120	3,116	5,113	3,934	2,437
Regeneration Capital Receipts	-	-	-	-	-
Revenue financing	6,190	12,095	7,089	6,699	6,744
Section 106 / Section 20/ CIL	337	6,777	7,493	3,157	1,480
Total Funding	20,710	37,983	41,321	30,141	25,675
Net financing need for the year (Borrowing)	37,071	86,510	37,749	63,439	48,393
Borrowing - Slippage from 19/20	-	-	186,136	-	-
Total - Net financing need inc Slippage	37,071	86,510	223,885	63,439	48,393

The net financing need for commercial activities/non-financial investments is included in the above table.

Capital Financing Requirement

2.9 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). The CFR arises directly from the capital activity of the Council and the resources applied to fund the capital spend, and represents the unfinanced element of capital expenditure. Any new capital expenditure, which has not immediately been paid for, will increase the CFR.

2.10 The CFR includes any other long term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a funding facility and so the Council is not required to borrow separately for them. The Council currently has £15.5m of such schemes within the CFR.

CFR projections are included in the table 2 below.

Table 2 Capital Financing Requirement

	2018/19	2019/20	2020/21	2021/22	2022/23
	Actual	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
CFR as at 31 March					
Non – HRA	366,849	420,897	617,526	621,045	620,013
HRA	150,683	161,345	166,102	202,221	227,847
TOTAL	517,532	582,242	783,627	823,267	847,860
Movement in CFR	37,071	64,710	201,385	39,639	24,593

Movement in CFR represented by					
Net financing need for the year	37,071	86,510	223,885	63,439	48,393
Less Minimum/Voluntary revenue provision and other financing movements	-	- 21,800	- 22,500	- 23,800	- 23,800
Movement in CFR	37,071	64,710	201,385	39,639	24,593

2.11 A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any commercial activity in relation to the authority's overall financial position. The Councils commercial property investments made to 31 March 2020 totals £47m which represents 7.7% of the Non-HRA CFR, and shows that the scale of commercial activity is proportionate to the Authority's remaining activity.

2.12 The Non-HRA CFR moves from £420.897m in 2019/20 to an estimated £620.013m in 2022/23, reflecting the increased borrowing and MRP provision required to finance capital investment.

Minimum Revenue Provision (MRP) Policy Statement

2.13. Capital expenditure is generally defined as expenditure on assets that have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. The accounting approach is to spread the cost over the estimated useful life of the asset. The mechanism for spreading these costs is through an annual MRP. The MRP is the means by which capital expenditure, which is financed by borrowing or credit arrangements, is funded by Council Tax.

- 2.14 Regulation 28 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended) require the Council to approve an MRP Statement setting out what provision is to be made in the General Fund for the repayment of debt, and how the provision is to be calculated. The purpose of the Statement is to ensure the provision is prudent, allowing the debt to be repaid over a period reasonably commensurate with that over which the capital expenditure benefits. The Council is recommended to approve the statement as detailed in Appendix C.
- 2.15 There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made.
- 2.16 MRP Overpayments - A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory MRP, voluntary revenue provision (VMRP) or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, it is recommended to disclose the cumulative overpayment made each year in a disclosure statement to full Council. In 2018/19 £5.447m was reclaimed from the VMRP leaving a balance of £5.193m as at 31 March 2019.

Core funds and expected investment balances

- 2.17 The application of resources (grants, capital receipts etc.) to finance capital expenditure or budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.).
- 2.18 The cash investment balance will be kept at approximately £30m. The working capital and borrowing position will be managed to maintain this level of cash balances.

3. BORROWING

- 3.1 The capital expenditure programme set out in Table 1 provides 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 the activities of the Council. This involves both the organisation of the cash flow and, where the Capital Programme requires it, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury indicators, the current and projected debt positions and the annual investment strategy.

Current and estimated portfolio position

3.2 The Council's borrowing position at 31 December 2019 is summarised below.

Table 3 Summary Borrowing and Investment Position at 31 December 2019

	Principal		Ave. rate
	£'000	£'000	%
Fixed rate funding	PWLB	348,461	3.46
	Market	73,800	
Temporary borrowing		-	0
Other long term liabilities (PFI & leases)		-	
Total Debt		422,261	
Total Investments at 31.12.2019		57,479	

3.3 The Council has borrowed £20.8m under Lender Option, Borrower Option (LOBO) structures maturing in 2077. In exchange for an interest rate that was below that offered on long term debt by the PWLB, the lender has the option at the end of five years (and half yearly thereafter) to reset the interest rate. If the rate of interest changes the Council is permitted to repay the loan at no additional cost.

3.4 The Council's borrowing position with forward projections is summarised below. Table 4 shows the actual external debt, against the underlying capital borrowing need, highlighting any under or over borrowing.

3.5 The expected change in debt in reflects the anticipated borrowing necessary to meet the Capital Programme described in Table 1. Debt outstanding should not exceed CFR.

Table 4 Changes to Gross Debt

	2018/19	2019/20	2020/21	2021/22	2022/23
	Actual	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
External Debt					
Debt at 1 April	324,261	346,261	432,771	656,656	720,096
Expected change in Debt	22,000	86,510	223,885	63,439	48,393
Other long-term liabilities (OLTL) 1st April	16,175	15,501	14,827	14,153	13,479
Expected change in OLTL	-	674	674	674	674
Actual gross debt at 31 March	362,436	447,598	670,809	733,574	781,294
Capital financing requirement	517,532	587,820	811,705	875,145	923,538
Under / (Over) borrowing	155,096	140,222	140,896	141,571	142,244

3.6 Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2019/20 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

3.7 The Director of Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing programmes and the proposals in the budget report.

Treasury indicators: limits to borrowing activity

The Operational Boundary

3.8 This is the limit which external debt is not normally expected to exceed. The boundary is based on the Council's programme for capital expenditure, capital financing requirement and cash flow requirements for the year.

The Authorised Limit for External Debt

3.9 This is a further key prudential indicator which represents a control on the maximum level of borrowing. It represents a limit beyond which external debt is prohibited. It relates to the financing of the Capital Programme by both external borrowing and other forms of liability, such as credit arrangements.

3.10 This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' programmes, or those of a specific council, although this power has not yet been exercised.

**Table 5 Operational boundary and authorised limit
(Non HRA and HRA)**

	2018/19	2019/20	2020/21	2021/22	2022/23
	Actual	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt					
Borrowing and finance leases	517,532	587,820	811,705	875,145	923,538
Operational Boundary for external debt					
Borrowing	346,261	432,771	656,656	720,096	768,489
Other long term liabilities	16,175	15,501	14,827	14,153	13,479
Total	362,436	448,272	671,483	734,249	781,968
Upper limit for fixed interest rate exposure					
Net principal re fixed rate borrowing	346,261	432,771	656,656	720,096	768,489
Upper limit for variable rate exposure					
Net principal re variable rate borrowing	0	0	0	0	0
Upper limit for principal sums invested over 364 days	60,000	60,000	60,000	60,000	60,000

3.11 Due to the Council's current under borrowing position it is considered sufficient to set the Authorised limit at the same level as the CFR.

3.12 As shown in Table 5 above and in Appendix F: Counterparties, the Council may wish to make additional investments of over 365 days. The current limit for such investments is £60m.

HRA Debt Limit

3.13. In October 2018 the Government announced the lifting of the HRA debt cap for new build only, with effect from 29.10.18. The increase in the HRA Total CFR from 2019/20 shown in Table 6 reflects the increase in planned new build.

Table 6 HRA CFR

	2018/19	2019/20	2020/21	2021/22	2022/23
CFR as at 31 March	Actual	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
HRA	150,683	161,345	166,102	202,221	227,847
Movement in CFR		10,662	4,757	36,120	25,625

Prospects for interest rates and economic commentary

3.14 The Treasury Management Adviser has provided a commentary on the prospects for interest rates, (Appendix D) and an economic background, (Appendix E).

Borrowing strategy

3.15 As shown in Table 3 as at 31 December 2019 the Council had a debt portfolio of £422.261m and with an average maturity of 32.5 years. Cash balances held as at 31 December 2019 were £57.479m. With the investment portfolio yielding 0.52% and the likely average cost of new long term borrowing currently at 2.9%, there is a substantial short term cost of carrying excessive debt.

3.16 The Council is currently maintaining an under-borrowed position. This means that the capital financing requirement has not been fully funded with external loan debt as internal cash balances have been used to finance the capital programme. This strategy was prudent with investment returns low and counterparty risk is still an issue to be considered.

3.17 For 2019/20 as at 31st December total external borrowing of £120m has been taken to finance the approved capital programme and to refinance maturing loans. External borrowing has been taken in 2019/20 as internal balances have been used and the remaining cash balances are required for operational (revenue) expenditure.

3.18 In terms of future borrowing, the Council has a range of funding sources available and will need to base its decisions on optimum borrowing times and periods taking into account current interest rates and likely future movements and the "cost of carry" (difference between rates for borrowing and rates for investments). The Council will consider using 'forward-starting loans' (where the interest rate is fixed in advance but the cash is received in later years) This helps give certainty of cost and reduces the cost of carry.

3.19 It is also possible, but unlikely, that replacement long term borrowing in the next three years might be required if the remaining LOBO loan has to be refinanced early.

3.20 It may be necessary to use temporary borrowing either from the money markets or from other local authorities to cover mismatches in timing between capital grants and payments. However, with several Government grants now paid early in the financial year and robust daily monitoring of the cash flow position, the facility is not very likely.

- 3.21 To accelerate the repayment of debt, where practicable annuity loans will be taken in future to ensure the equal instalment of principle over the life time of the loan.
- 3.22 Against this background and the risks within the economic forecast, caution will be adopted in the 2020/21 treasury management operations. The Treasury Management Group will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances. This includes taking advice from Link Treasury Management Advisers.:
- If it was felt that there was a significant risk of a sharp fall in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed. There is limited scope for debt rescheduling because of the high cost of early redemption of debt.
 - If it was felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.
- 3.23 The Council has previously adopted a single pooled approach for debt. Allocations to HRA are based on its CFR, with interest charged to HRA at the average rate on all external borrowing. Longer term, the HRA's ability to repay borrowing will depend on future revenues and the capital expenditure programme. New HRA debt taken from 2019/20 is maintained in a separate pool.

Treasury management limits on activity

- 3.24 There are two debt related treasury activity limits. The purpose of these is to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs and improve performance.

Upper limit on variable interest rate exposure

- 3.25 This identifies a maximum limit for variable interest rates based upon the debt position net of investments. As shown in Table 5, the Council does not expect to undertake any borrowing on this basis.

Upper limit on fixed interest rate exposure

- 3.26 This identifies a maximum limit for fixed interest rates based upon the debt position net of investments. The Council's proposed limits are shown in Table 7 below:

Table 7 Maturity Structure of Fixed Rate Borrowing

	As at 31.12.2019 %	Upper limit %	Lower limit %
Under 12 months	5%	40	0
12 months to 23 months	0%	30	0
24 months to under 5 years	1%	30	0
5 years to under 10 years	5%	40	0
10 years and over	89%	100	30

Maturity Structure of Borrowing

- 3.27 These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.
- 3.28 The Council has no variable rate borrowing and the comments below relate only to its fixed rate portfolio.
- 3.29 In Table 7, the maturity structure for the LOBO debt, in accordance with CIPFA Guidance, is shown as the first date that the interest rate can be increased.

Policy on borrowing in advance of need

- 3.30 The Council will not borrow more than, or in advance of, its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved CFR estimates and future authorised limits, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.
- 3.31 Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

Debt rescheduling

- 3.32 The decision by the PWLB on 9 October 2019 to increase their margin over gilt yields by 100 basis points (1%) to 180 basis points on loans lent to local authorities applies to new borrowing rates only and not to premature debt repayment levels. Therefore rescheduling of current PWLB borrowing in the debt portfolio is unlikely to occur as it is not affordable at present.
- 3.33 Should the LOBO loan (£20.8m) with interest rate reset dates in 2019/20 require refinancing, the most likely source would be external borrowing.
- 3.34 All rescheduling will be reported to Cabinet at the earliest meeting following the exercise.

New financial institutions as a source of borrowing

- 3.35 Following the decision by the PWLB on 9 October 2019 to increase their rates, consideration will also need to be given to sourcing funding at cheaper rates from the following:
- Local authorities (primarily shorter dated maturities)
 - Financial institutions (primarily insurance companies and pension funds but also some banks, out of spot or forward dates)
 - Municipal Bonds Agency (no issuance at present but there is potential)

Approved Sources of Long and Short term Borrowing

3.36 The Council's approved sources of borrowing are set out below

On Balance Sheet	Fixed	Variable
PWLB	●	●
Municipal bond agency	●	●
Local authorities	●	●
Banks	●	●
Pension funds	●	●
Insurance companies	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Market (LOBOs)	●	●
Stock issues	●	●
Local temporary	●	●
Local Bonds	●	
Local authority bills	●	●
Overdraft		●
Negotiable Bonds	●	●
Internal (capital receipts & revenue balances)	●	●
Commercial Paper	●	
Medium Term Notes	●	
Finance leases	●	●

4. ANNUAL INVESTMENT STRATEGY

Investment policy

4.1 The Council holds invested funds, representing income received in advance of expenditure, plus balances and reserves held. The Secretary of State recommends that each local authority produce and publish an Annual Investment Strategy, approved by the Council and revised in year as required. The following investment strategy sets out the Council's policies for managing investments and for giving priority to the security and liquidity of those investments. It outlines which instruments the Council may use for investment purposes, making a distinction between specified and non-specified investments. This strategy also determines limits in respect of their overall levels.

4.2 The Council has regard to the Ministry of Housing, Communities and Local Government (HMCLG) guidance on Local Government Investments as cited under section 15(1) (a) of the Local Government Act 2003 and the CIPFA Code of Practice on Treasury Management in Public Services. All investments will be made in accordance with the Council's investment policies and prevailing legislation and regulations. Non-financial investments essentially the purchase of income yielding assets (e.g. property) are covered in the Capital Strategy

4.3 The prime objective of the Council's investment strategy is to ensure prudent Investment of surplus funds. The Council's investment priorities are as follows, in order of priority:

- Security of capital,

- Liquidity of investments,
- Secure optimum performance (yield)

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

- Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
- **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as “**credit default swaps**” and overlay that information on top of the credit ratings.

4.5 This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in Appendix F Counterparties, under the categories of ‘specified’ and ‘non-specified’ investments:

- **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
- **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

4.6 However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, regular monitoring of investment performance will be carried out during the year.

Creditworthiness policy

4.7. The primary principle governing the Council’s investment criteria is the security of its investments, although the return on the investment is also a key consideration. After this main principle, the Council will ensure that:

4.8. It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and

4.9 It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council’s prudential indicators covering the maximum principal sums invested. The Director of Finance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to those which determine which types of investment instrument are either specified or non-specified as they

provide an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

- 4.10 The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Council's criteria, the other does not, and the institution will fall outside the lending criteria.
- 4.11 Credit rating information is supplied by the Treasury Management Adviser on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.
- 4.12 The Council's criteria for an institution to become counterparty are detailed in Appendix F.

Country Limits

- 4.13 The Council has determined that it will only use approved counterparties from the UK or from countries with a minimum sovereign credit rating of AA-. The current UK rating is AA or equivalent. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

Investment Strategy

In-house funds.

- 4.14. The Council's funds are mainly cash derived primarily from the General Fund and HRA. Balances are also held to support capital expenditure. Investments are made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).
- 4.15. Since April 2011, pension fund cash balances have been held separately from those of the Council. However, a separate investment strategy has not been developed for the pension fund and all its cash is held on overnight call account with RBS and in separate money market funds.

Investment returns expectations.

- 4.16 On the assumption that the UK and EU agree a Brexit deal including the terms of trade by the end of 2020 or soon after then Bank Rate is forecast by Link Asset Services to increase only slowly over the next few years to reach 1.00% by quarter 1 2023. Bank Rate forecasts for financial year ends (March) are:

Q1 2021 0.75%

Q1 2022 0.75%

Q1 2023 1.00%

4.17 Link Asset Services suggest that budgeted investment earnings rates for returns on investments placed for periods of up to three months during each financial year are as follows:

2019/20	0.75%
2020/21	0.75%
2021/22	1.00%
2022/23	1.25%
2023/24	1.50%
2024/25	1.75%

4.18 Link Asset Services further advise that;

- The overall balance of risks to economic growth in the UK is probably to the downside due to weight of uncertainties over Brexit as well as a softening global economic picture.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.

4.19 Investment treasury indicator and limit - total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment. The Council's limit for investments of over 365 days is currently £60m.

4.20 As a result of the Council's strategy and the interest rates available the only counterparties actively in use during 2019/20 have been Lloyds, Royal Bank of Scotland Group and Handelsbanken. The investment portfolio has inevitably remained concentrated with RBS and Lloyds with 90.0% of the total portfolio invested with them on 31st December 2019. When opportunities arise consistent with the Council's policies diversification will be sought but it is not anticipated that there will be any significant change during 2020/21.

4.21 Authority has previously been given to place funds in 'non-standard investments' up to a value of £10m. Officers are considering what investment opportunities and counterparties should be included to utilise this facility.

Investment risk benchmarking

4.22 This Council uses the current LIBOR rates as a benchmark to assess the investment performance of its investment portfolio. In addition the Council is a member of a Link Asset Services investment portfolio benchmarking group through which performance is measured against peer London authorities. The risk of default attached to the Council's portfolio is reported by Capita on a monthly basis.

End of year investment report

4.23 At the end of the financial year the Council will report on its investment activity as part of the Treasury Management Outturn Report.

5. OTHER TREASURY ISSUES

Policy on the Use of Financial Derivatives

5.1 A financial derivative is a contract, whose value is based on, or 'derived' from, an underlying financial instrument such as a loan. Local Authorities have previously been able to make use of financial derivatives embedded into loans and investments, both to reduce interest rate risk (e.g. forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans).

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 requires local authorities to clearly detail their policy in the use of derivatives in the annual strategy.

The Council does not intend to use standalone financial derivatives (such as swaps, forwards, futures and options). No change in strategy will be made without Full Council approval.

Brokers

5.2 The Council uses four brokers on a regular basis, as well as dealing directly with leading institutions. Wherever possible the Council will spread its business amongst them on a regular basis, though this may not always be possible. Brokers currently being used are:

- RP Martins
- Tradition
- BGC Sterling
- Imperial Treasury

The limited function performed by brokers is acknowledged; however the Council would expect to be informed if a broker had any doubts about an organisation that we were dealing with.

Prudential Indicators

5.3 Previous sections cover the overall capital and control of borrowing Prudential Indicators but within this framework Prudential Indicators are also required to assess the affordability of the capital investment programme. These provide an indication of the impact of the programme on the Council's overall finances and are shown in detail in Appendix G.

Training

5.4 The Treasury Management Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in this area. This especially applies to Members responsible for scrutiny.

5.5 The training needs of Treasury Management officers are periodically reviewed as part of the Learning and Development programme with appropriate training and support provided.

External Treasury Management Service Adviser

- 5.6 The Council has engaged Link Asset Services Treasury Solutions as its external Treasury Management Adviser.
- 5.7 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council ensures that the terms of their appointment and the methods by which their value is assessed are properly agreed and documented, and subjected to regular review.
- 5.8 However, the Council recognises that responsibility for treasury management decisions remains with itself at all times and will ensure that undue reliance is not placed upon external service providers.

6 Implications of the recommendations

- 6.1 The recommendations primarily relate to the requirements for the Council to comply with statutory duties. However, the content of the report, covering borrowing and investment strategy, has implications for the Council's ability to fund its capital projects and revenue activities.
- 6.2 The recommendations do not directly affect the Council's staffing/workforce

7 Performance issues

- 7.1 The Council meets the requirements of the CIPFA Treasury Management Code and, therefore, is able to demonstrate best practice for the Treasury Management function.
- 7.2 As part of the Code the Council must agree a series of prudential indicators and measure its performance against them. Success is measured by compliance with the indicators and the accuracy of future estimates so far as they are within the control of the Treasury Management function.

8 Environmental implications

- 8.1 There are no direct environmental implications.

9 Risk management implications

- 9.1 The identification, monitoring and control of risk are central to the achievement of treasury management objectives and to this report. Potential risks are identified, mitigated and monitored in accordance with Treasury Management Practice Notes approved by the Treasury Management Group.
- 9.2 Risks are included in the Directorate Risk Register as part of the overall MTFS risk.

10 Legal Implications

10.1 The purpose of this report is to comply with the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 and other relevant guidance referred to in the report.

11 Procurement Implications

11.1 There are no procurement implications arising from this report.

12 Financial implications

12.1 Financial matters are integral to the report.

13 Equalities implications / Public sector equality duty

13.1 Officers have considered possible equalities impact and consider that there is no adverse equalities impact as there is no direct impact on individuals.

14 Council priorities

14.1. This report deals with the Treasury Management Strategy which plays a significant part in supporting the delivery of all the Council's corporate priorities.

Section 3 - Statutory Officer Clearance

Name: Dawn Calvert	<input checked="" type="checkbox"/>	Director of Finance
Date 5 February 2020		
Name: Caroline Eccles	<input checked="" type="checkbox"/>	on behalf of the Monitoring Officer
Date: 5 February 2020		
Name: Nimesh Mehta	<input checked="" type="checkbox"/>	Head of Procurement
Date: 5 February 2020		
Name: Charlie Stewart	<input checked="" type="checkbox"/>	Corporate Director
Date: 5 February 2020		

Ward Councillors notified:	No
EqIA carried out:	No
EqIA cleared by:	N/A

Section 4 - Contact Details and Background Papers

Contact: Iain Millar (Treasury and Pensions Manager)
Tel: 020-8424-1432/ Email: iain.millar@harrow.gov.uk

Background Papers: N/A

<p>Call-in Waived by the Chairman of Overview and Scrutiny Committee</p> <p>NO</p>
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LEGISLATION AND REGULATIONS IMPACTING ON TREASURY MANAGEMENT

The following items numbered 1 - 4 show the sequence of legislation and regulation impacting on the treasury management function. The sequence begins with primary legislation, moves through Government guidance and Chartered Institute of Public Finance and Accountancy (CIPFA) codes of practice and finishes with implementation through the Council's own Treasury Management Practices.

1. Local Government Act 2003

Link below

[Local Government Act 2003](#)

Below is a summary of the provisions in the Act dealing with treasury management.

In addition the Secretary of State is empowered to define the provisions through further regulations and guidance which he has subsequently done through statutory instruments, Department of Communities and Local Government Guidance and CIPFA codes of practice.

Power to borrow

The Council has the power to borrow for purposes relevant to its functions and for normal treasury management purposes – for example, to refinance existing debt.

Control of borrowing

The main borrowing control is the duty not to breach the prudential and national limits as described below.

The Council is free to seek loans from any source but is prohibited from borrowing in foreign currencies without the consent of Treasury, since adverse exchange rate movements could leave it owing more than it had borrowed.

All of the Council's revenues serve as security for its borrowing. The mortgaging of property is prohibited.

It is unlawful for the Council to 'securitise', that is, to sell future revenue streams such as housing rents for immediate lump-sums.

Affordable borrowing limit

The legislation imposes a broad duty for the Council to determine and keep under review the amount it can afford to borrow. The Secretary of State has subsequently defined this duty in more detail through the Prudential Code produced by CIPFA, which lays down the practical rules for deciding whether borrowing is affordable.

It is for the Council (at a meeting of the full Council) to set its own 'prudential' limit in accordance with these rules, subject only to the scrutiny of its external auditor. The Council is then free to borrow up to that limit without Government consent. The Council is free to vary the limit during the year, if there is good reason.

Requirements in other legislation for the Council to balance its revenue budget prevent the long-term financing of revenue expenditure by borrowing.

However the legislation does confer limited capacity to borrow short-term for revenue needs in the interests of cash-flow management and foreseeable requirements for temporary revenue borrowing are allowed for when borrowing limits are set by the Council.

The Council is allowed extra flexibility in the event of unforeseen needs, by being allowed to increase borrowing limits by the amounts of any payments which are due in the year but have not yet been received.

Imposition of borrowing limits

The Government has retained reserve power to impose 'longstop' limits for national economic reasons on all local authorities' borrowing and these would override authorities' self-determined prudential limits. Since this power has not yet been used the potential impact on the Council is not known.

Credit arrangements

Credit arrangements (e.g. property leasing, PFI and hire purchase) are treated like borrowing and the affordability assessment must take account not only of borrowing but also of credit arrangements. In addition, any national limit imposed under the reserve powers would apply to both borrowing and credit.

Power to invest

The Council has the power to invest, not only for any purpose relevant to its functions but also for the purpose of the prudential management of its financial affairs.

2. Department for Communities and Local Government Investment Guidance (March 2010)

The Local Government Act 2003 requires a local authority ".....to have regard (a) to such guidance as the Secretary of State may issue....." and the current guidance became operative on 1 April 2010.

The Guidance recommends that for each financial year the Council should prepare at least one investment Strategy to be approved before the start of the year. The Strategy must cover:

- **Investment security**

Investments should be managed prudently with security and liquidity being considered ahead of yield

Potential counterparties should be recognised as "specified" and "non-specified" with investment limits being defined to reflect the status of each counterparty

- **Investment risk**

Procedures should be established for monitoring, assessing and mitigating the risk of loss of invested sums and for ensuring that such sums are readily accessible for expenditure whenever needed.

The use of credit ratings and other risk assessment processes should be explained

The use of external advisers should be monitored. The training requirements for treasury management staff should be reviewed and addressed

Specific policies should be stated as regards borrowing money in advance of need

- **Investment Liquidity**

The Strategy should set out procedures for determining the maximum periods for which funds may prudently be committed

The Strategy should be approved by the full Council and made available to the public free of charge. Subject to full Council approval, or approved delegations, the Strategy can be revised during the year.

3. Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (CIPFA 2017)

The primary requirements of the Code are:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices ("TMPs") that set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by the full Council or Cabinet of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Half-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body.

4. CIPFA Code of Practice on Treasury Management 2017

- CIPFA Prudential Code 2017
- CIPFA Treasury Management in the Public Services Guidance Notes 2018
- CIPFA statement 17.10.18 on borrowing in advance of need and investments in commercial properties
- CIPFA Bulletin 02 Treasury and Capital Management Update October 2018
- Statutory investment guidance where it has been updated in 2018 (*English local authorities*)
Statutory MRP guidance 2018; the main objective of the above was to respond to the major expansion of local authority investment activity over the last few years into the purchase of non-financial investments, particularly property. This development has raised several concerns: -
- A local authority should define its risk appetite and its governance processes for managing risk.
- A local authority should assess the risks and rewards of significant investments over the long term, as opposed to the usual three to five years that most local authority financial planning has been conducted over, in order to ensure the long term financial sustainability of the authority. (CIPFA has not defined what longer term means but it is likely to infer 20-30 years in line with the financing time horizon and the expected life of the assets, while medium term financial planning, at a higher level of detail, is probably aimed at around a 10 year time frame and to focus on affordability in particular.)
- The Prudential Code has also expressed concern that local authorities should ensure that an authority's approach to commercial activities should be proportional to its overall resources.

- A local authority should have access to the appropriate level of expertise to be able to operate safely in all areas of investment and capital expenditure, and to involve members adequately in making properly informed decisions on such investments.

The, Prudential Code 2017 introduced a new requirement for local authorities to produce an annual Capital Strategy.

Compliance with the objectives of the Code by the Council should ensure that:

- a. Capital expenditure plans are affordable in terms of their implications on Council Tax and housing rents
- b. External borrowing and other long term liabilities are within prudent and sustainable levels
- c. Treasury management decisions are taken in accordance with good professional practice

As part of the two codes of practice above the Council is required to:

- agree a series of prudential indicators against which performance is measured
- produce Treasury Management Practice Notes for officers which set out how treasury management policies and objectives are to be achieved and activities controlled.

TREASURY MANAGEMENT DELEGATIONS AND RESPONSIBILITIES

The respective roles of the Council, Cabinet, GARMSC, the Section 151 officer, the Treasury Management Group the Treasury and Pensions Manager and the Treasury Team are summarised below. Further details are set out in the Treasury Management Practices.

Council

Under the Constitution, the Council is responsible for “decisions relating to the control of the Council’s borrowing requirement.”

It agrees the annual Treasury Management Strategy Statement including Prudential Indicators, Minimum Revenue Provision Policy Statement and Annual Investment Strategy.

Cabinet

Under the Constitution, the Cabinet “will exercise all of the local authority functions which are not the responsibility of any other part of the local authority, whether by law or under this Constitution.”

It considers and recommends to Council the annual Treasury Management Strategy Statement and receives a mid-year report and annual outturn report on Treasury Management activities.

Governance, Audit, Risk Management and Standards Committee

GARMSC reviews the Treasury Management Strategy and monitors progress on treasury management in accordance with CIPFA codes of practice.

Director of Finance (Section 151 Officer)

Under S151 of the Local Government Act 1972 the Council “shall make arrangements for the proper administration of their financial affairs and shall secure that one of their officers has responsibility for the administration of those affairs.” At Harrow, this responsibility is exercised by the Director of Finance.

The Director is responsible for implementing the policies agreed by the Council and Cabinet.

Under the Local Government Finance Act 1988 and the Local Government Act 2003 the Director also has responsibilities in respect of budget arrangements and the adequacy of resources. In terms of Treasury Management this means that the financing costs of the Capital Programme are built into the Revenue Budget as are any assumptions on investment income.

The Director chairs the Treasury Management Group and agrees major treasury management decisions, specifically including any borrowing decisions, delegated to officers.

Treasury Management Group

Comprises Director of Finance, Head of Strategic and Technical Finance (Deputy S151 Officer), Treasury and Pensions Manager, Senior Finance Officer and is responsible for:

- Monitoring treasury management activity against approved strategy, policy, practices and market conditions;
- Ensuring that capital expenditure plans are continually reviewed in line with budget assumptions throughout the year to forecast when borrowing will be required.
- Approving changes to treasury management practices and procedures;
- Reviewing the performance of the treasury management function using benchmarking data on borrowing and investment provided by the Treasury Management Adviser (Link Asset Services Asset Services);
- Monitoring the performance of the appointed Treasury Management Adviser and recommending any necessary actions
- Ensuring the adequacy of treasury management resources and skills and the effective division of responsibilities within the treasury management function;
- Monitoring the adequacy of internal audit reviews and the implementation of audit recommendations

Treasury and Pensions Manager

Responsible for the execution and administration of treasury management decisions, acting in accordance with the Council's Treasury Management Strategy Statement and CIPFA's "Standard of Professional Practice on Treasury Management"

Treasury Team

Headed by Senior Finance Officer with responsibility for day-to-day treasury and investment and borrowing activity in accordance with approved Strategy, policy, practices and procedures and for recommending changes to the Treasury Management Group

Minimum Revenue Provision (MRP) Policy Statement

- For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be the equal annual reduction of 2% of the outstanding debt at 1 April 2015 for the subsequent 50 years.
- For all capital expenditure financed from unsupported (prudential) borrowing (including PFI and finance leases), MRP will be based upon an asset life method in accordance with Option 3 of the guidance.
- In some cases where a scheme is financed by prudential borrowing it may be appropriate to vary the profile of the MRP charge to reflect the future income streams associated with the asset, whilst retaining the principle that the full amount of borrowing will be charged as MRP over the asset's estimated useful life.
- The regulations allow the Council to charge VMRP, which can be used to reduce future MRP by the same amount. A change introduced by the revised MHCLG MRP Guidance is that the voluntary MRP must be disclosed in a statement to the full council in order to reclaim it in future years as deemed necessary and prudent. Up until 31 March 2018, the total VMRP was £10.6m.
- Estimated life periods and amortisation methodologies will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.
- Freehold land cannot properly have a life attributed to it, so for the purposes of Asset Life method it will be treated as equal to a maximum of 50 years. But if there is a structure on the land which the authority considers to have a life longer than 50 years, that same life estimate will be used for the land.
- As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.
- Repayments included in annual PFI or finance leases are applied as MRP.
- Where borrowing is undertaken for the construction of new assets, MRP will only become chargeable once such assets are completed and operational.
- Under Treasury Management best practice the Council may decide to defer borrowing up to the capital financing requirement (CFR) and use internal resources instead. Where internal borrowing has been used, the amount chargeable as MRP may be adjusted to reflect the deferral of actual borrowing.

Provided by Link Asset Services Asset Services November 2019

Interest Rate Forecasts 2019 – 2023

We do not currently think that the MPC would increase Bank Rate before any clearing of the fog on Brexit and agreement being reached on a UK/EU trade deal. We have moved back our forecast for the first increase from quarter 4 2020 to quarter 1 2021 and the second increase from quarter 1 2021 to quarter 2 2021.

Forecasts for average investment earnings beyond the three year time horizon will be heavily dependent on economic and political developments.

Gilt yields and PWLB rates

The general situation is for volatility in bond yields to endure as investor fears and confidence ebb and flow between favouring relatively more “risky” assets i.e. equities, or the “safe haven” of government bonds. The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently, although there are likely to also be periods of sharp volatility from time to time.

Our forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU, (apart from the departure of the UK), within our forecasting time period, despite the major challenges that are looming up, and that there are no major ructions in international relations, especially between the US and China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

We would, as always, remind clients of the view that we have expressed in our previous interest rate revision newsflashes of just how volatile PWLB rates and bond yields are at present. Our revised forecasts are based on the Certainty Rate (minus 20 bps) which has been accessible to most authorities since 1st November 2012.

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

Provided by Link Asset Services Asset Services at 23 December 2019

ECONOMIC BACKGROUND

UK. Brexit. 2019 has been a year of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on 31 October 2019, with or without a deal. However, MPs blocked leaving on that date and the EU agreed an extension to 31 January 2020. In late October, MPs approved an outline of a Brexit deal to enable the UK to leave the EU on 31 January. Now that the Conservative Government has gained a large overall majority in the **general election** on 12 December, this outline deal will be passed by Parliament by that date. However, there will still be much uncertainty as the detail of a trade deal will need to be negotiated by the current end of the transition period in December 2020, which the Prime Minister has pledged he will not extend. This could prove to be an unrealistically short timetable for such major negotiations that leaves open two possibilities; one, the need for an extension of negotiations, probably two years, or, a no deal Brexit in December 2020.

GDP growth has taken a hit from Brexit uncertainty during 2019; quarter three 2019 surprised on the upside by coming in at +0.4% q/q, +1.1% y/y. However, the peak of Brexit uncertainty during the final quarter appears to have suppressed quarterly growth to probably around zero. The economy is likely to tread water in 2020, with tepid growth around about 1% until there is more certainty after the trade deal deadline is passed.

While the Bank of England went through the routine of producing another **quarterly Inflation Report**, (now renamed the Monetary Policy Report), on 7 November, it is very questionable how much all the writing and numbers were worth when faced with the uncertainties of where the UK will be after the general election. The Bank made a change in their Brexit assumptions to now include a deal being eventually passed. Possibly the biggest message that was worth taking note of from the Monetary Policy Report, was an increase in concerns among MPC members around weak global economic growth and the potential for Brexit uncertainties to become entrenched and so delay UK economic recovery. Consequently, the MPC voted 7-2 to maintain Bank Rate at 0.75% but two members were sufficiently concerned to vote for an immediate Bank Rate cut to 0.5%. The MPC warned that if global growth does not pick up or Brexit uncertainties intensify, then a rate cut was now more likely. Conversely, if risks do recede, then a more rapid recovery of growth will require gradual and limited rate rises. The speed of recovery will depend on the extent to which uncertainty dissipates over the final terms for trade between the UK and EU and by how much global growth rates pick up. The Bank revised its inflation forecasts down – to 1.25% in 2019, 1.5% in 2020, and 2.0% in 2021; hence, the MPC views inflation as causing little concern in the near future.

The **MPC meeting of 19 December** repeated the previous month's vote of 7-2 to keep Bank Rate on hold. Their key view was that there was currently 'no evidence about the extent to which policy uncertainties among companies and households had declined' i.e. they were going to sit on their hands and see how the economy goes in the next few months. The two members who voted for a cut were concerned that the labour market was faltering. On the other hand, there was a clear warning in the minutes that the MPC were concerned that "domestic unit labour costs have continued to grow at rates above those consistent with meeting the inflation target in the medium term".

If economic growth were to weaken considerably, the MPC has relatively little room to make a big impact with Bank Rate still only at 0.75%. It would therefore, probably suggest that it would be up to the Chancellor to provide help to support growth by way of a **fiscal boost** by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy. The Government has already made moves in this direction and it made significant promises in its election manifesto to increase government spending by up to £20bn p.a., (this would add about 1% to GDP growth rates), by investing primarily in infrastructure. This is likely to be announced in the next Budget, probably in February 2020. The Chancellor has also amended the fiscal rules in November to allow for an increase in government expenditure.

As for **inflation** itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell again in both October and November to a three-year low of 1.5%. It is likely to remain close to or under 2% over the next two years and so, it does not pose any immediate concern to the MPC at the current time. However, if there was a hard or no deal Brexit, inflation could rise towards 4%, primarily because of imported inflation on the back of a weakening pound.

With regard to the **labour market**, growth in numbers employed has been quite resilient through 2019 until the three months to September where it fell by 58,000. However, there was an encouraging pick up again in the three months to October to growth of 24,000, which showed that the labour market was not about to head into a major downturn. The unemployment rate held steady at a 44-year low of 3.8% on the Independent Labour Organisation measure in October. Wage inflation has been steadily falling from a high point of 3.9% in July to 3.5% in October (3-month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.0%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The other message from the fall in wage growth is that employers are beginning to find it easier to hire suitable staff, indicating that supply pressure in the labour market is easing.

USA. President Trump's massive easing of fiscal policy in 2018 fuelled a temporary boost in consumption in that year which generated an upturn in the rate of growth to a robust 2.9% y/y. **Growth** in 2019 has been falling after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2 and then 2.1% in quarter 3. The economy looks likely to have maintained a growth rate similar to quarter 3 into quarter 4; fears of a recession have largely dissipated. The strong growth in employment numbers during 2018 has weakened during 2019, indicating that the economy had been cooling, while inflationary pressures were also weakening. However, CPI inflation rose from 1.8% to 2.1% in November, a one year high, but this was singularly caused by a rise in gasoline prices.

The Fed finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not intended to be seen as the start of a series of cuts to ward off a downturn in growth. It also ended its programme of quantitative tightening in August, (reducing its holdings of treasuries etc.). It then cut rates by 0.25% again in September and by another 0.25% in its October meeting to 1.50 – 1.75%. At its September meeting it also said it was going to **start buying Treasuries again**, although this was not to be seen as a resumption of quantitative easing but rather an exercise to relieve liquidity pressures in the repo market. Despite those protestations, this still means that the Fed is again expanding its balance sheet holdings of government debt. In the first month, it will buy \$60bn, whereas it had been reducing its balance sheet by \$50bn per month during 2019. As it will be buying only short-term (under 12 months) Treasury bills, it is technically correct that this is not quantitative easing (which is purchase of long term debt). The Fed left rates unchanged in December. However, the accompanying statement was more optimistic about the future course of the economy so this would indicate that further cuts are unlikely.

Investor confidence has been badly rattled by the progressive ramping up of increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This **trade war** is seen as depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China. However, in November / December, progress has been made on agreeing a phase one deal between the US and China to roll back some of the tariffs; this gives some hope of resolving this dispute.

EUROZONE. **Growth** has been slowing from +1.8 % during 2018 to around half of that in 2019. Growth was +0.4% q/q (+1.2% y/y) in quarter 1, +0.2% q/q (+1.2% y/y) in quarter 2 and then +0.2% q/q, +1.1% in quarter 3; there appears to be little upside potential in the near future. German GDP growth has been struggling to stay in positive territory in 2019 and fell by -0.1% in quarter 2; industrial production was down 4% y/y in June with car production down 10% y/y. Germany would be particularly vulnerable to a no deal Brexit depressing exports further and if President Trump imposes tariffs on EU produced cars.

The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which then meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by quantitative easing purchases of debt. However, the downturn in EZ growth in the second half of 2018 and into 2019, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the ECB to take new measures to stimulate growth. At its March meeting it said that it expected to leave interest rates at their present levels “at least through the end of 2019”, but that was of little help to boosting growth in the near term. Consequently, it announced a **third round of TLTROs**; this provides banks with cheap borrowing every three months from September 2019 until March 2021 that means that, although they will have only a two-year maturity, the Bank was making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of a bank’s eligible loans. However, since then, the downturn in EZ and world growth has gathered momentum; at its meeting on 12 September it cut its deposit rate further into negative territory, from -0.4% to -0.5%, and announced a **resumption of quantitative easing purchases of debt for an unlimited period**. At its October meeting it said these purchases would start in November at €20bn per month - a relatively small amount compared to the previous buying programme. It also increased the maturity of the third round of TLTROs from two to three years. However, it is doubtful whether this loosening of monetary policy will have much impact on growth and, unsurprisingly, the ECB stated that governments would need to help stimulate growth by ‘growth friendly’ fiscal policy.

There were no policy changes in the December meeting, which was chaired for the first time by the new President of the ECB, Christine Lagarde. However, the outlook continued to be down beat about the economy; this makes it likely there will be further monetary policy stimulus to come in 2020. She did also announce a thorough review of how the ECB conducts monetary policy, including the price stability target. This review is likely to take all of 2020.

On the political front, Austria, Spain and Italy have been in the throes of **forming coalition governments** with some unlikely combinations of parties i.e. this raises questions around their likely endurance. The latest results of German state elections has put further pressure on the frail German CDU/SDP coalition government and on the current leadership of the CDU. The results of the Spanish general election in November have not helped the prospects of forming a stable coalition.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and shadow banking systems. In addition, there still needs to be a greater switch from investment in industrial capacity, property construction and infrastructure to consumer goods production.

JAPAN - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

WORLD GROWTH. Until recent years, world growth has been boosted by increasing **globalisation** i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products. It is achieving this by massive financial support, (i.e. subsidies), to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, likely that we are heading into a

period where there will be a **reversal of world globalisation and a decoupling of western countries** from dependence on China to supply products. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation. **Central banks are, therefore, likely to come under more pressure to support growth by looser monetary policy measures and this will militate against central banks increasing interest rates.**

The trade war between the US and China is a major concern to **financial markets** due to the synchronised general weakening of growth in the major economies of the world, compounded by fears that there could even be a recession looming up in the US, though this is probably overblown. These concerns resulted in **government bond yields** in the developed world falling significantly during 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US). There are also concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks and the use of negative central bank rates in some countries. The latest PMI survey statistics of economic health for the US, UK, EU and China have all been predicting a downturn in growth; this confirms investor sentiment that the outlook for growth during the year ahead is weak.

INTEREST RATE FORECASTS

The interest rate forecasts provided by Link Asset Services in paragraph 3.3 are **predicated on an assumption of an agreement being reached on Brexit between the UK and the EU.** On this basis, while GDP growth is likely to be subdued in 2019 and 2020 due to all the uncertainties around Brexit depressing consumer and business confidence, an agreement on the detailed terms of a trade deal is likely to lead to a boost to the rate of growth in subsequent years. This could, in turn, increase inflationary pressures in the economy and so cause the Bank of England to resume a series of gentle increases in Bank Rate. Just how fast, and how far, those increases will occur and rise to, will be data dependent. The forecasts in this report assume a modest recovery in the rate and timing of stronger growth and in the corresponding response by the Bank in raising rates.

- In the event of an **orderly non-agreement exit in December 2020**, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall.
- If there were a **disorderly Brexit**, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. Quantitative easing could also be restarted by the Bank of England. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably even, but dependent on a successful outcome of negotiations on a trade deal.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.
- In the event that a Brexit deal was agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

- A resurgence of the **Eurozone sovereign debt crisis**. In 2018, Italy was a major concern due to having a populist coalition government which made a lot of anti-austerity and anti-EU noise. However, in September 2019 there was a major change in the coalition governing Italy which has brought to power a much more EU friendly government; this has eased the pressure on Italian bonds. Only time will tell whether this new coalition based on an unlikely alliance of two very different parties will endure.
- Weak capitalisation of some **European banks**, particularly Italian banks.
- **German minority government**. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The CDU has done badly in recent state elections but the SPD has done particularly badly and this has raised a major question mark over continuing to support the CDU. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until 2021.
- **Other minority EU governments**. Austria, Finland, Sweden, Spain, Portugal, Netherlands and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU. There has also been rising anti-immigration sentiment in Germany and France.
- In October 2019, the IMF issued a report on the World Economic Outlook which flagged up a synchronised slowdown in world growth. However, it also flagged up that there was **potential for a rerun of the 2008 financial crisis**, but this time centred on the huge debt binge accumulated by corporations during the decade of low interest rates. This now means that there are corporates who would be unable to cover basic interest costs on **some \$19trn of corporate debt in major western economies**, if world growth was to dip further than just a minor cooling. This debt is mainly held by the shadow banking sector i.e. pension funds, insurers, hedge funds, asset managers etc., who, when there is \$15trn of corporate and government debt now yielding negative interest rates, have been searching for higher returns in riskier assets. Much of this debt is only marginally above investment grade so any rating downgrade could force some holders into a fire sale, which would then depress prices further and so set off a spiral down. The IMF's answer is to suggest imposing higher capital charges on lending to corporates and for central banks to regulate the investment operations of the shadow banking sector. In October 2019, the deputy Governor of the Bank of England also flagged up the dangers of banks and the shadow banking sector lending to corporates, especially highly leveraged corporates, which had risen back up to near pre-2008 levels.
- **Geopolitical risks**, for example in North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- **Brexit** – if agreement was reached all round that removed all threats of economic and political disruption between the EU and the UK.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- **UK inflation**, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

**Counterparties
Specified Investments**

These are sterling investments of a maturity period of not more than 365 days, or those which could be for a longer period but where the lender has the right to be repaid within 365 days if it wishes. These are low risk assets where the possibility of loss of principal or investment income is negligible. The instruments and credit criteria to be used are set out in the table below.

Table 8 Specified Investments

Instrument	Minimum Credit Criteria	Use
Debt Management Agency Deposit Facility	Government backed	In-house
Term deposits – other LAs	Local Authority issue	In-house
Term deposits – banks and building societies	AA- Long Term F1 Short-term UK or AA- Sovereign	In-house
Money Market Funds (CNAV), (LVNAV) and (VNAV)	AAA	In-house

Non-Specified Investments

Non-specified investments are any other type of investment (i.e. not defined as Specified above). They normally offers the prospect of higher returns but carry a higher risk. The identification and rationale supporting the selection of these other investments are set out in the table below.

Table 9 Non - Specified Investments

	Minimum Credit Criteria	Use	Max total investment	Max. maturity period
Banks and building societies (excluding Lloyds / HBOS)	A- Long Term F1 Short-term UK or AA- Sovereign	In-house	50%	3 months
Lloyds / HBOS	A- Long Term F1 Short-term	In-house	50%	12 months
Callable Deposits	A- Long Term F1 Short term UK or AA- Sovereign	In-house	50%	3 months
Council's Bank/(RBS)	F2 Short-term	In-house	60%	36 months
Enhanced Cash Funds	AAA	In-house	25% (maximum £10 million per fund)	Minimum monthly redemption
Corporate bonds pooled funds, other non-standard investments and gilts		In house	£10m in total	Dependent on specific agreement
HB Public Law Ltd		In house	£0.1m	Dependent on specific agreement
Investment Property Strategy		In house	£145.0m	Dependent on specific agreement
Concilium Group Startup capital		In house	£0.702m	60 months

	Minimum Credit Criteria	Use	Max total investment	Max. maturity period
Concilium Group 5% Long Term Investment		In house	£1.5m	Dependent on specific agreement
Concilium Assets LLP		In house	£0.425m	Dependent on specific agreement

Affordability Prudential Indicators

1 Ratio of Financing Costs to Revenue Stream

This indicator identifies the trend in the cost of capital (borrowing, depreciation, impairment and other long term obligation costs net of investment income) against the net revenue stream. Tables 10 and 11 below show the current position for the General Fund and HRA respectively.

Table 10 Ratio of Financing Costs to Revenue Stream – General Fund

	2018/19	2019/20	2020/21	2021/22	2022/23
	Actual	Estimate	Estimate	Estimate	Estimate
Net revenue stream (£'000)	164,987	167,081	174,103	172,746	172,746
Interest costs - finance leases (£'000)	1,717	1,700	1,700	1,700	1,700
Interest and investment income (£'000)	-1,296	-1,512	-1,300	-1,300	-1,300
Capital Financing Costs (£'000)	18,234	32,600	33,800	35,700	35,700
Total financing costs (£'000)	18,655	32,788	34,200	36,100	36,100
Ratio of total financing costs against net revenue stream (%)	11.3	19.6	19.6	20.9	20.9

The ratio of total financing costs against net revenue stream increases significantly between 2019/20 and 2022/23 due to the impact of the increased borrowing requirement to finance the Capital Programme and the required increase in MRP.

Table 11 Ratio of Financing Costs to Revenue Stream – HRA

HRA - Ratio of Financing Costs	2018/19	2019/20	2020/21	2021/22	2022/23
£'000	Actual	Estimate, Qtr 3	Estimate	Estimate	Estimate
Gross revenue stream	31,553	31,838	31,785	32,801	34,123
Interest costs of self-funding borrowing	6,155	6,195	6,061	6,035	6,012
Interest costs of other borrowing	0	0	422	1,054	1,960
Interest and investment income	40	5	3	3	3
Depreciation	7,534	7,768	7,275	7,231	7,316
Impairment	100	0	0	0	0
Total financing costs	13,829	13,968	13,761	14,323	15,291
Ratio of total financing costs (excluding depreciation and impairment) against net revenue stream (%)	19.6	19.5	20.4	21.6	23.4

The ratio of total financing costs (excluding depreciation and impairment) against net revenue stream shows a gradual increase due largely to the mandatory reduction in dwelling rent and the reduction of interest income due to reducing balances on the revenue account and Major Repairs reserve.

2 Incremental Impact of Capital Investment Decisions on Council Tax and Housing Rents

This indicator identifies the revenue costs associated with proposed Capital Programme and the impact on Council Tax and Housing Rents.

Table 12 Incremental Impact of Capital Investment Decisions – Council Tax

	2018/19	2019/20	2020/21	2021/22	2022/23
	Actual	Estimate	Estimate	Estimate	Estimate
Net Financing need (£'000)	34,769	31,966	19,712	24,075	23,470
Borrowing @ 25-50years PWLB rate (£'000)	869	927	591	722	704
MRP @ 2% (£'000)	695	639	394	482	469
Total increased costs (£'000)	1,565	1,566	986	1,204	1,174
Ctax base (£'000)	84,466	86,250	87,667	88,160	88,160
% Increase	1.9	1.8	1.1	1.4	1.3
Band D Council Tax	1,395	1,464	1,523	1,523	1,523
Overall increase £ pa	31.28	26.59	17.12	20.79	20.27

Table 13 Incremental Impact of Capital Investment Decisions – Housing Rents

Incremental Impact of Capital Investment Decisions – Housing Rents	2018/19	2019/20	2020/21	2021/22	2022/23
£'000	Actual	Estimate, Qtr 3	Estimate	Estimate	Estimate
Net Financing need (£'000)	0	8,323	5,443	36,691	23,679
Borrowing @ 2% (25-50years PWLB rate)	0	166	109	734	474
Depreciation @ 2%	-	-	-	-	-
Total increased costs	0	166	109	734	474
Number of dwellings (average)	4,788	4,795	4,826	4,840	4,933
Increase in average housing rent per week £	£0.00	£0.67	£0.43	£2.92	£1.85

Increase required in rental income appears high due to increased borrowing required for new build. Expenditure financed from a range of sources including revenue, capital receipts, contributions and grant as well as borrowing.

Local HRA indicators

The Council should also be aware of the following ratios when making its treasury management decisions.

Table 14 HRA Ratios

HRA Ratios	2018/19	2019/20	2020/21	2021/22	2022/23
	Actual	Estimate, Qtr 3	Estimate	Estimate	Estimate
£m					
Debt (CFR) @ 31 March	150.68	161.34	166.10	202.22	225.33
Gross Revenue Stream	31.55	31.84	31.78	32.80	34.12
Ratio of Gross Revenue Stream to Debt (%)	21	20	19	16	15
Average Number of Dwellings	4,788	4,795	4,826	4,840	4,933
Debt outstanding per dwelling (£)	31,471	33,649	34,418	41,781	45,678

Rents in the Housing Revenue Account are projected to reduce by 1% each year for four years commencing in 2016/17, in line with the provisions of the Welfare Reform and Work Act. The reduction in income is expected to be mitigated over the next two years by additional rent income generated as a result of an increase in HRA property numbers from the Council's HRA new build and purchase and repair programmes.

CAPITAL STRATEGY 2020-21

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Section 1 – Principles of the CAPITAL STRATEGY

1. Introduction

In December 2017, the Chartered Institute of Public Finance & Accountancy issued a revised Prudential and Treasury Management Code, requiring all local authorities to produce a Capital Strategy report from 2019/20 onwards to show:

- a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

This capital strategy meets the requirement by setting out the Council's capital investment programme and how it contributes to the achievement of strategic priorities being refreshed through the Borough Plan, while considering resource availability and the wider financial context. It is intended to be supportive of the Council's other strategy framework documents.

2. Objectives

The strategy details show how the Council sets out its priorities for Capital investment including links to existing delivery plans and strategy documents. It also considers the ways in which capital expenditure may be financed, including the impact that the Strategy has on the budgets of both the General Fund and the Housing Revenue Account (HRA). The strategy will also set out the links with Treasury Management objectives and determine the authority's approach to risk in those objectives.

This document is part of the Council's business planning process from both a financial and service perspective. It sets out a framework whereby the authority's capital resources can be effectively allocated to those projects which may help the Council achieve wider corporate objectives, protect existing assets and support financial sustainability.

Principles of the Capital Strategy

1. Capital Investment is a vital tool in delivering strategic priorities.
2. The Capital Programme will include only those schemes in accordance with the agreed criteria.
3. The Council will consider schemes purely to generate a commercial return to support the budget.
4. The evaluation of capital schemes for inclusion on the programme will follow an agreed process which allows scrutiny whilst not limiting innovation and adaptability.
5. The funding of the Capital Programme must be considered alongside the revenue budget and balance sheet position as part of the Council's Medium Term Financial Strategy (MTFS).
6. Capital projects will be monitored and reported to Cabinet on a quarterly basis.

3. Background

As part of its wider treasury management objectives the Council must have regard to the “Prudential Code for Capital Finance in Local Authorities” (henceforth to be referred to as the Prudential Code), as produced by the Chartered Institute of Public Finance & Accountancy (CIPFA). The 2018 revision of the Prudential Code introduces the requirement for authorities to produce a Capital Strategy from 2019/20. It is a live document underpinning the Council’s Capital Programme and therefore will be subject to amendment.

4. Capital Expenditure

Capital Expenditure is that which is incurred on the acquisition, creation or enhancement of an asset. These assets can be tangible such as buildings or vehicles, as well as intangible such as software products.

5. The Link between Revenue and Capital

Capital and revenue expenditure are separate components of local authority budgets and funding for each is considered separately. However, a vital component of successful financial planning is that revenue and capital budgets are intrinsically linked as the impact of capital expenditure must be reflected in revenue budgets. Therefore this capital strategy should be deemed to form a key part of the authority’s medium term financial planning process.

The impact and affordability of capital expenditure must be considered in the assessment of capital projects at the business case stage. Effective financial planning must fully reflect the impact of capital plans in the revenue budget.

The following table sets out some of the key impacts of capital expenditure upon the revenue budget.

Revenue Savings

- Direct Income from assets
- Reduced maintenance costs of new or improved assets
- Savings in labour costs

Revenue Costs

- Running costs of new assets
- Minimum Revenue Provision (loan principal)
- Interest costs from borrowing

As an indication of the current cost of the existing capital programme, table below shows the capital financing costs that are already factored into the existing MTFS for 2018/19 to 2021/22 in relation to the existing and historic capital programmes:

	2018/19	2019/20	2020/21	2021/22
General Fund	£000	£000	£000	£000
Capital Financing Costs	24,600	32,600	33,800	35,700
Capital Financing Costs as % of 2019/20 Net Budget	15%	19%	20%	21%

6. The Purpose of Capital Investment

Investment through capital expenditure may serve a number of purposes; these can typically be classified as being related to service priorities and commercial investments.

Commercial investments are those which are entered into with the explicit objectives of returning a surplus for Council and therefore improving the financial sustainability of the Council. These may include:

- Acquisition of Property to deliver a commercial return, usually through rental
- Investments in outside organisations with the view to making a return
- Investments which neither deliver a financial return nor achieve a service objective for the Council should not be considered for inclusion on the Capital Programme.

7. Existing Capital Priorities

Service directorates were invited to bid for capital resources, as part of their service proposals for 2020/21 to 2022/23.

In view of the current financial climate and reduced external funding service directorates were asked to limit new capital proposals to the following categories:

- a. Life and Limb/Health and Safety.
- b. Statutory Requirement/legislation.
- c. Schemes fully funded by external sources.
- d. Invest to Save Schemes (the capital expenditure must generate a revenue stream to cover the capital financing costs and make a net contribution to the MTFS).

The update Capital Programme 2020/21 to 2022/23 will be approved by Cabinet/Council in February 2020.

8. Use of Commercial Investment

The Council took its Investment Property Strategy to Council in December 2015. Under this strategy the Council has incurred £47m to 31 March 2020 on commercial investments. In July 2019 the Council approved an additional £100m Capital Programme borrowing to finance long term commercial investment as part of the 2 Year Budget Strategy 2021/22 to 2021/22 .As at 31 March 2020 £6.4m of the £100m approval had been applied to the purchase of commercial property.

9. Asset Management

Asset Management is the process by which the authority considers whether its assets are appropriate to deliver the high quality services demanded by residents. This process may identify a number of different outcomes for assets including:

- Change in use to meet the demands of a service
- Investment is required to improve the condition of an asset
- A new asset is required to better meet the Council priorities

- The need to dispose of the asset to realise its value in monetary terms

The Council will use active asset management to consider both its current asset base and its future asset base. The capital programme will be used to bridge the gap to ensure that the authority has sufficient assets in the long term.

10. Capital Disposals

The asset management process may determine that the value of an asset is best realised through disposal. Sale of assets should be through an open market process to determine the best value.

Cash received from a sale of a property is a capital receipt. The use of these funds is restricted to purchasing new assets or repayment of existing debt. The Council will not make decisions about the ring-fencing of capital receipts before amounts are known and the use of such receipts has been considered in the light of the Council's overall financial position.

The existing General Fund capital programme includes a limited amount of capital receipts in relation to two regeneration schemes – Haslam House and Waxwell Lane. The HRA capital programme includes assumptions on levels of right to buy receipts as well as other capital receipts.

11. Multi-Year Capital Projects

Capital projects deliver assets which will provide services and/or income to the Council for a number of years. As a result of the significance and complexity of a number of these projects they may take a number of years to plan and deliver.

When setting the Capital Programme Council will approve the schemes to be included, the budget for their delivery and the timescale in which they are to be achieved. Unless schemes have clearly defined development and delivery phases with separate objectives, budgets and timescales Council should be asked to approve a budget to cover the whole of the project being delivered. Approval of the entire budget at the point of inception gives certainty for the project and assists officers in ensuring delivery.

The budget for approval will include an expected cash flow projection showing how much of the anticipated project budget will be incurred in each year of the Capital Programme. Any variations in timing of cash flows between years will be reported as part of the budget monitoring process. This should be regarded as part of the normal development of a capital project.

12. Use of capital receipt flexibilities

In the Spending Review 2015, it was announced that to support local authorities to deliver more efficient and sustainable services, the government will allow local authorities to send up to 100% of their fixed asset receipts on the revenue costs of reform projects. This flexibility was initially offered for the three years 2016/17 to 2018/19, but has been extended as a part of the 2018/19 Finance settlement for a further 3 years from 2019/20 to 2021/22.

The Council signified its intent to make use of this flexibility in its final budget report to Cabinet and Council in February 2016. From November 2016, Cabinet approved a number of asset disposals and the capital receipts from these disposals are being applied within the new flexibilities. For 2019/20 £3.1m is planned within the flexibility but no provision has yet been made for 2020/21.

Section 2 – SELECTING, APPROVING AND MONITORING CAPITAL SCHEMES

13. The Importance of Capital Business Cases

The processes described in the following section are to be regarded as the authority's formal procedures for setting and monitoring capital projects. This process has been developed to ensure that the Council's Capital Programme contains schemes which are in line with objectives, meet its asset management requirements and are both affordable and deliverable. This process will give elected members confidence that decisions they are being asked to make regarding the capital programme have been based on a sound system of decision making.

All capital schemes included in the Capital Programme have been the subject of an evaluation process including a business case to ensure the Council can target its capital resources effectively.

14. Information to be considered in Capital Decision Making

When making decisions as to which schemes are included on the capital programme the presented business case must include information on these main factors.

- Financials – All anticipated costs and potential revenue streams must be set out. This should include risk analysis to show factors which may impact upon those numbers and where appropriate sensitivity analysis to show potential future scenarios.
- Strategic Objectives – As discussed capital schemes must meet Council priorities and the ability of a scheme to impact upon objectives must be clearly demonstrated. This should include the wider social and environmental impact of the capital project. This must be accompanied by evidence supporting the conclusions made.
- Capacity - All capital schemes, even those funded by external sources, require officers within the Council to implement them and this must be considered as part of the appraisal process. Where a project requires the procuring of additional resource to deliver the scheme this detail must be included in the financial analysis.
- Deliverability - The success of capital projects depends not just on the financial and non-financial resources of the Council. External factors which impact on the deliverability of the project should also be considered as part of the planning process.

15. Governance of the Capital Programme

This strategy sets out the governance relationship relating to the Capital Programme and the respective role of Members and Officers in relation to the decision making process. The roles of the various groups are as follows.

Decision making on the Capital Programme is likely to be an iterative and often circular process with information flowing both ways between these respective groups.

As an example the following timescale may be followed for producing the Capital Programme during the main budget setting process.

Council

- Formally agrees the Capital Programme
- Receives budget monitoring reports covering financial and non-financial elements of capital schemes
- Approves commercial capital investments

Capital Forum

- Allows panel a chance to comment on capital schemes before formal approval of releasing the funding approved as part of the Capital Programme

Corporate Team

- Reviews Business Cases submitted
- Performs initial sift of viable schemes
- Approves proposed list of capital schemes

Service Managers / Heads of Service

- Identify priorities and opportunities for capital investment
- Act as, or appoint, project managers to lead on schemes and complete outline business cases

16. In-Year Capital Decisions

Selecting projects to go onto the Capital Programme must remain possible outside of the usual capital budget setting process. The authority needs the flexibility to take advantage of schemes which present themselves at any stage during the year.

17. Monitoring Capital Projects

Effective monitoring of projects is a vital element of good capital governance.

Capital projects are often significant not only in terms of financial resources required but in terms of organisational capacity, impact upon Service delivery and reputational risk. It is therefore vital that there is sufficient monitoring carried out upon schemes to allow stakeholders to be informed of progress and for members and officers to make decisions as required.

In order to meet these requirements the Corporate Team prepare quarterly monitoring report showing the current spend against capital projects, the forecast for the end of the financial year include the underspend or slippage into the following year at the end of each financial quarter, with an outturn report at year-end.

Cabinet receive quarterly information on the progress of capital projects as part of the quarterly finance update.

Section 3 - FINANCING THE CAPITAL PROGRAMME

18. Capital Funding

There are a number of distinct sources of funding which can be utilised to finance capital expenditure. Some funding sources are ring fenced and can only be used for Housing Revenue Account capital expenditure, or a particular capital project. Consideration of funding must be made when projects are at the planning stage. No capital project will be put forward without funding having been identified to complete the project. Where capital schemes are in multiple phases, perhaps requiring an initial development phase to ensure funding for the final phases, this will be considered as part of the planning stage and clearly reported.

Capital funding cannot be used to fund revenue costs which may arise from a capital scheme such as consultant's costs on feasibility before a project is identified.

19. Capital Resources

Capital Receipts

The sale of assets with a value of more than £10,000 generates income known as capital receipts. Legislation requires these to be spent on either new capital investment or the repayment of existing debt. The government is allowing some flexibility in the use of capital receipts up until 31 March 2022 to fund revenue costs of transformation projects where these are expected to generate revenue savings in future years.

HRA Right to Buy compulsory sale of council houses generate receipts that may be retained to cover the cost of transacting the sales and to cover outstanding debt on the property sold, but a proportion of the remainder must be surrendered to Central Government.

All other HRA capital receipts may be retained provided they are spent on affordable housing, regeneration or paying off housing debt.

General Fund capital receipts can be retained in full. These can arise from the sale of land and buildings, vehicles, plant and equipment, and also through the repayment of loans or grants.

An active asset management planning process is needed to review the asset requirements of the Council and therefore to identify surplus assets which may be sold to generate capital receipts.

Prudential Borrowing

The Council is able to borrow money on the money market or from the Public Works Loans Board (PWLB) to fund capital schemes. A preferential Certainty Rate of interest is allocated to Councils who apply for it and it is the policy of this Council to take advantage of the certainty rate each year.

For all schemes initially funded from borrowing, the Council will have to fund the repayment and interest costs as there is no longer any central government "supported borrowing" allocations and related revenue support.

The Council is only able to borrow for Prudential Borrowing, under the guidance contained in the CIPFA Prudential Code whereby, in summary, the Council is required to ensure that all borrowing is both prudent and affordable. All schemes funded from prudential borrowing are approved by full Council. As part of the Treasury Management Strategy each year full

Council approves a limit for affordable borrowing and capital schemes will be considered in the light of that limit.

20. External Funding

Capital Grant from Government or Government Agency

Central government and government agencies provide capital grant funding that can be either ring fenced or non-ring fenced. Examples of ring fenced grants that the Council has received are disabled facilities grants (DFG's) and Heritage Lottery Fund (HLF) funding.

Community Infrastructure Levy (CIL)

Any monies received from developers for infrastructure from the Community Infrastructure Levy will not be allocated to a specific service but will be allocated under the CIL arrangements ("the Regulation 123 List") in line with Council's capital scheme priorities.

The process for allocating CIL funds will be in accordance with the process agreed by Cabinet

Community Infrastructure Levy (CIL) Funding

The Community Infrastructure Levy (CIL) enables the council to raise funds for infrastructure from new development. It is levied on the net increase in floor space arising from new developments and is paid when that development starts. The Community Infrastructure Levy (CIL) is a tool for local authorities to support the development of their area by funding the provision, improvement, replacement, operation or maintenance of infrastructure. However the focus of CIL is on the delivery of new infrastructure to meet and mitigate the impacts of new development in an area.

CIL receipts can be used to fund a wide range of infrastructure including transport, schools, health and social care facilities, libraries, play areas, green spaces and sports facilities. Harrow's list of strategic infrastructure requirements known as a Regulation 123 list is shown below:

Regulation 123 List	
The following table comprises Harrow Council's Regulation 123 List. It includes the strategic infrastructure that the Council currently considers it is likely to apply CIL revenues to. The Regulation 123 List will be kept under review and may change depending upon the following:	
<ul style="list-style-type: none"> • Changes to local or national funding streams in respect of CIL eligible infrastructure; and • The requirements of the regulations governing the level of the "meaningful proportion" of CIL that is to be passed to local communities. 	
Infrastructure currently considered likely to benefit from the application of CIL funding	
Education facilities	Early years, primary and secondary schools
Health services	GPs, acute healthcare
Social care	Supported accommodation
Emergency services	Police, Ambulance and Fire Services
Cultural and community facilities	Libraries and community halls
Improvements to public open space	Parks, natural green space, civic space and green corridors and green grid
Improvements to biodiversity	
Public recreation and leisure facilities	Neighbourhood and Youth Play space, sports and leisure centres, swimming pools and playing pitches
Cemeteries and burial space	
Strategic transport facilities	Roads, buses, cycling, rail and underground
Strategic flood mitigation	

Of all CIL monies collected, 85% is used to fund strategic borough wide infrastructure projects, which includes a 5% allowance to cover the administrative costs of CIL. The decisions on where to spend CIL at a borough-wide level is determined by the Council. The remaining 15% is allocated to Neighbourhood CIL (NCIL) and must be spent on projects that have taken account of the views of the communities in which the income was generated and these projects should support the development of the area.

A report was presented to the Major Development Panel (MDP) on 14th November 2017, recommending that the allocation of Borough and Neighbourhood CIL is included as part of the Annual Budget Setting process and included in the Capital Programme report which goes to Cabinet in draft in December and in February in its final version. The recommendations from the Major Development Panel (MDP) report were agreed by Cabinet on 7th December 2017 which agreed:

- *the allocation of the Borough Community Infrastructure Levy (CIL) be included as part of the Annual Budget Setting process and included in the Capital Programme report which is presented to Cabinet every year in December (draft budget) and February (final budget);*
- Specific projects to be funded by Neighbourhood CIL can be put forward by the relevant Directorates / Ward members and assessed against the criteria outlined in the CIL Allocations report agreed by the Major Development Panel in November 2017. The final decision on what projects are funded from the agreed NCIL allocations will be delegated to the Divisional Director – Regeneration and Planning, in consultation with the Portfolio Holders for Regeneration and Planning, and Finance and Commercialisation

. The recommendation for NCIL was as follows:

- (i) the broad allocation of Neighbourhood CIL be agreed as part of the Capital Programme (based on available funds at the time and allocated as per 3(i) and 3(ii) above), and included in the Capital Programme report which is presented to Cabinet every year in December (draft budget) and February (final budget).*
- (ii) Once the broad allocation of NCIL is agreed as part of the Capital Programme, individual projects put forward by the relevant Directorates / Ward Members be assessed against the criteria outlined in section 7 of the MDP report (including the extent of consultation and level of community support), with the final decision on what projects were funded from the agreed CIL allocations being delegated to the Divisional Director of Regeneration and Planning, following consultation with the Portfolio Holders for Regeneration and Planning, and Finance and Commercialisation.*

The Borough CIL element will be used to fund the core Capital programme and can be considered as a funding source for new capital bids as well as existing projects in the Capital programme.

In addition to the principles already reached on how CIL funding should be used to fund the capital programme, in light of the budget gaps in future years, it was recommended by

Cabinet in December 2018, that CIL should be **first** be applied to any schemes in the existing capital programme rather than applying it to new schemes. The rationale for this is that if applied to schemes that are currently funded from borrowing, by funding from CIL instead, this will reduce the existing capital financing costs.

Section 106 Agreements

Developer consents may attract Section 106 funding to spend on a particular asset or site as an alternative to CIL.

Capital contributions from partner organisation

When capital projects are devised it is open for project managers to invite funding from a range of partner organisations.

Revenue contributions Services who are leading a capital project may make savings within their revenue budgets during a particular year and in some circumstances use that saving to part-fund a capital project.

21. Policy on use of Capital Funding

The Council will look to use external funding sources where possible to meet the funding requirements of its capital programme.

Where the use of Council resources are required the authority will look to utilise reserves, revenue funding or capital receipts as these create no long term revenue cost implications on the Council.

Borrowing will be used as the last possible source of funding and should be restricted only to those schemes which generate sufficient savings or income to meet the costs of interest and the Minimum Revenue Provision.

Any borrowing incurred to support the provision of new build housing within the Housing Revenue Account must be demonstrated to be affordable over a period of 30 years.

22. Relationship between Capital Strategy and Treasury Management

Treasury management refers to the processes of managing and reporting on the Council's performance in matters of investment and borrowing.

The Council's policy on Treasury Management has numerous links to the Capital Strategy. It is not intended that this Strategy replace the reporting requirements of the Treasury Management Strategy and includes a summary of the major points of that strategy and associated governance processes.

Key Treasury decisions are the responsibility of full Council and are contained within the Treasury Management Strategy.

These include:

- Approved limits on borrowing
- Limits for investment types and counterparty limits
- Planned capital expenditure

- Estimates for the future Capital Financing Requirement
- Policy on the Minimum Revenue Provision

Detailed discussion on these matters is delegated to the GARMS Committee who then makes recommendations to Cabinet. The key impact of a capital programme using borrowing is the creation of a “Capital Financing Requirement” (CFR). The CFR represents the need to borrow external funds as a result of expenditure funded through borrowing. Having a CFR creates the need for a Minimum Revenue Provision (MRP), a sum to be put to one side each year from the General Fund for repayment of debt.

The Council’s MRP policy is to make provision for the repayment of debt equally over the life of the asset that the borrowing relates to. The Audit and Standards Committee receive at a minimum a mid-year monitoring report for Treasury management and an end of year outturn report. Where circumstances require, such as a material fall in the value of investments, a report would be prepared and presented to the next meeting of the Committee by the S151 Officer.

Section 4- RISK MANAGEMENT

23. Embedding Risk Management in the Capital Programme

The Capital Strategy must be considered alongside the principles of risk management. Risks are inevitable within a capital programme, as with all aspects of Council operations, and effective management of risk is a vital part of the capital strategy.

The types of risk the authority is exposed to in the Capital Programme are summarised below:

- Financial Risk – The risk of significant cost overruns or commercial investments not performing as expected. The authority has a low appetite for this risk as it would impact upon available resources. Mitigation will be in the form of close scrutiny of capital spending through the budget monitoring process.
- Strategic Risk – The risk of not delivering key Council priorities or projects. Mitigation will be in the form of careful selection and planning of capital projects before commencement and project managers reviewing project progress and taking corrective action where necessary. Major changes in the outcomes of schemes will be reported to the appropriate Committee.
- Governance risk – The risk of capital spending decisions not being appropriately considered and decisions not being made at the correct level. Mitigation is the governance principles contained within the capital strategy.
- Resourcing risk – The risk that insufficient funds are available to fund the capital programme or that the incorrect type of funds is applied to capital projects. This is mitigated by the financing of capital projects being reviewed by the S151 Officer as part of the budget setting and the outturn.

24. Knowledge and Skills within the organisation

The Property Services team has officers of multiple disciplines who are experienced at leading capital projects, managing the Council’s property portfolio and working within the local property market. They have experience of dealing with acquisitions, disposals, new commercial and residential development and redevelopment of brownfield sites.

The Finance team are involved in the development and monitoring of the Capital Programme. They have many years of experience in managing local authority capital programmes.

Legal Services will be provided by the Council's in-house legal team who will form a key part of the decision making around Capital projects. All solicitors are required to complete an annual Statement of Competence to the regulatory body to ensure any professional training needs are identified and addressed.

Where necessary external advice may be sought for all types of financial, property and legal advice. These costs, or at least appropriate estimates, will be included in the business cases of capital schemes.

Officers will work with members to ensure that training needs for elected members are appropriately identified. As a minimum annual training will be provided around the Treasury Management Strategy.

GLOSSARY OF TERMS

□ **Annuity** – method of repaying a loan where the payment amount remains uniform throughout the life of loan, therefore the split varies such that the proportion of the payment relating to the principal increases as the amount of interest decreases.

□ **Bail-In** – previously, in response to the banking crisis, some governments used taxpayer funds to support banks in danger of failing. The European Union's Banking Recovery and Resolution Directive (BRRD) requires that, in future, 'bail in' will be applied in such a scenario; this means that after shareholders' equity, depositors' funds comprising balances over c£85k will be used to support the bank at risk. The £85k threshold is not available to local authorities and therefore all unsecured deposits with banks and building societies will be at risk of 'bail in'.

□ **Base Rate** – minimum lending rate of a bank or financial institution in the UK

□ **Bond** – a government or public company's document undertaking to repay borrowed money usually with a fixed rate of interest.

□ **Capital Expenditure** – spend on major items e.g. land and buildings, which adds to and not merely maintains the value of existing fixed assets

□ **Capital Grants** – specific targeted grants to cover capital spend

□ **Capital Receipts** – the proceeds from the disposal of land or other assets. Capital receipts can be used to fund capital expenditure but cannot be used to finance revenue.

□ **CIPFA** – the Chartered Institute of Public Finance and Accountancy, is the professional body for accountants working in Local Government and other public sector organisations, also the standard setting organisation for Local Government Finance.

□ **Counterparty** – an institution (e.g. a bank) with whom a borrowing or investment transaction is made.

□ **Credit Rating** – an opinion on the credit-worthiness of an institution, based on judgements about the future status of that institution. It is based on any information available regarding the institution: published results, Shareholders' reports, reports from trading partners, and also an analysis of the environment in which the institution operates (e.g. its home economy, and its market sector). The main rating agencies are Fitch, Standard and Poor's and Moody's. They analyse credit worthiness under four headings:

- **Short Term Rating** – the perceived ability of the organisation to meet its obligations in the short term, this will be based on measures of liquidity.
- **Long Term Rating** – the ability of the organisation to repay its debts in the long term, based on opinions regarding future stability, e.g. its exposure to 'risky' markets.
- **Individual/Financial Strength Rating** – a view of the likelihood, in the case of a financial institution failing, that its obligations would be met, in whole or part, by its shareholders, central bank or national government.
- **Legal Support Rating** – a view of the likelihood, in the case of a financial institution failing, that its obligations would be met, in whole or part, by its shareholders, central bank, or national government.

The rating agencies constantly monitor information received regarding financial institutions, and will amend the credit ratings assigned as necessary.

□ **DMADF and the DMO** – The DMADF is the 'Debt Management Account Deposit Facility'; this is highly secure fixed term deposit account with the Debt Management Office (DMO), part of Her Majesty's Treasury.

□ **EIP** – Equal Instalments of Principal, a type of loan where each payment includes an equal amount in respect of loan principal is eroded, and so the total amount reduces with each instalment.

□ **Gilts** – the name given to bonds issued by the UK Government (i.e. the loan instrument by which the Government borrows). Gilts are issued bearing interest at a specified rate, however they are then traded on the markets like shares and their value rises or falls accordingly. The Yield on a gilt is the interest paid divided by the Market Value of that gilt, e.g. a 30 year gilt is issued in 1994 at £1, bearing interest of 8%. In 1999 the market value of the gilt is £1.45. The yield on that gilt is calculated as $8\%/1.45 = 5.5\%$.

□ **Lender Option Borrower Option (LOBO)** - LOBOs are a long term borrowing instrument commonly used by banks. It is an alternative lender option to the Government's Public Works Loan Board. In simple terms the instrument gets its name because the lender has an option to set revised interest rates at predetermined dates, and at which point the borrower has the option to accept the revised rates or pay the debt in full without penalty.

□ **LIBID** – The London Interbank Bid Rate, the rate which banks would have to bid to borrow funds from other banks for a given period. The official rate is published by the Bank of England at 11am each day based on trades up to that time. The average 7 day rate is the benchmark the Council uses for its own investment performance.

□ **Liquidity** – Relates to the amount of readily available, or short term, investment money which can be used for either day to day or unforeseen expenses. For example Call Accounts allow instant daily access to invested funds.

□ **Market** – The private sector institutions e.g. banks, building societies

□ **Maturity** - Type of loan where only payments of interest are made during the life of the loan, with the total amount of principal falling due at the end of the loan period.

□ **Minimum Revenue Provision (MRP)** – A statutory amount charged to the Council's revenue account for the provision to repay the loan principal on debt undertaken to finance the Capital Programme. For the Council this is done on a straight line basis in-line with the asset life and commences the financial year after the asset is operational.

□ **Monetary Policy Committee (MPC)** – group that sets the bank base rate for the Bank of England.

□ **Money Market Fund (MMF)** – A highly diversified pooled investment vehicle whose assets mainly comprise of short term instruments.

□ **Multilateral Development Banks (MDB)** – these are supranational institutions set up by sovereign states, which are their shareholders (e.g. European Investment Bank). Their remits reflect the development aid and cooperation policies established by these states.

- **Policy and Strategy Documents** – Documents required by the CIPFA Code of Practice on Treasury Management in Local Authorities. These set out the framework for treasury management operations during the year.

- **Public Works Loans Board (PWLB)** – a central government agency providing long and short term loans to Local Authorities. Rates are set daily at a margin over the Gilt yield (see Gilts above). Loans may be taken at fixed or variable rates and as an Annuity, Maturity, or EIP loans (see separate definitions) over periods of up to fifty years. Financing is also available from the money markets, however because of its nature the PWLB is generally able to offer better terms.

- **Yield** – The amount in cash (in percentage terms) that returns to the owners of an investment e.g. interest earned from a deposit.