Harrow COUNCIL LONDON

Report for:	**Cabinet**
Date of Meeting:	11 February 2021
Subject:	Annual Treasury Management Strategy Statement including Prudential Indicators, Minimum Revenue Provision Policy Statement, Annual Investment Strategy and Annual Capital Strategy for 2021/22
Key Decision:	Yes
Responsible Officer:	Dawn Calvert - Director of Finance and Assurance
Portfolio Holder:	Councillor Adam Swersky - Portfolio Holder for Finance and Resources
Exempt:	No
Decision subject to Call-in:	No (reserved to Council)
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** - Capital Strategy 2020/21 **Appendix H** - Glossary

Section 1 – Summary and Recommendations

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 2021/22.

Recommendation:

Cabinet is asked to:

1) Recommend to Council that the Treasury Management Strategy Statement for 2021/22 be approved, including:

   - Prudential Indicators for 2021/22
   - Minimum Revenue Provision Policy Statement for 2021/22, (see para 2.10 and Appendix C)
   - Annual Investment Strategy for 2021/22

2) Recommend to Council that the Annual Capital Strategy (Appendix G) be approved.

Reason: (for recommendations): To promote effective financial management relating to the Authority's borrowing and investment powers contained in the Local Government Act 2003, and supporting regulations and guidance detailed below:

- the Local Authorities (Capital Finance and Accounting) Regulations 2003 (as amended),
- CIPFA Prudential Code and Treasury Management Code of Practice 2017
- MHCLG Investment and MRP Guidance 2018

Section 2 – Report

1. Introduction

1.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, 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 plans. These capital plans provide 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 function 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. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

1.4 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 (2018) 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

1.10 The Council is currently required to receive and approve, as a minimum, three main treasury 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 forward looking and covers:

- the capital plans, (including prudential indicators)
- a minimum revenue provision (MRP) policy, (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
- an investment strategy, (the parameters on how investments are to be managed)

Mid-Year Treasury Management Review Report – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.

An Annual Treasury Outturn Report – This is a backward-looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Capital Strategy

1.11 The CIPFA 2017 Prudential and Treasury Management Codes require all local authorities to prepare a capital strategy report which 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

1.12 The aim of this 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. The Capital Strategy Report is set out in Appendix G.

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 2021/22

1.15 The strategy for 2021/22 covers the following areas:

Capital Issues (Section 2)

- Capital Financing Summary
- Capital Programme and Capital Prudential Indicators 2019/20 to 2023/24
- 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 12Treasury management consultants

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.

2. Capital Issues

2.1 The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

2.2 The figures and tables in this report are based on the final Capital Programme which is set out in a separate report to Cabinet.

Capital Expenditure

2.3 This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

2.4 As part of the 2021/22 budget cycle and in light of the current financial situation coupled with slippage on schemes in previous years, Service Directorates carried out a review of the Capital Programme using a bottom up approach to ensure the capital programme represents capital investment that is necessary up to financial year 2023/24. Revised estimates for 2020/21 have also been included in the review due to the impact of the pandemic on this years capital programme.

2.5 Table 1 & 2 below show the planned capital expenditure and how it will be funded:

Table 1: Capital Expenditure 2019/20 to 2023/24

Capital expenditure £'000	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
- Resources and Commercial	36,269	14,981	14,731	2,550	1,850
- People's	4,464	5,010	22,803	9,071	0
- Community	40,369	52,271	48,092	37,663	32,465
General Fund	**81,102**	**72,263**	**85,626**	**49,285**	**34,315**
HRA	**9,483**	**21,478**	**90,823**	**53,548**	**23,039**
Total	**90,585**	**93,741**	**176,449**	**102,833**	**57,354**

Table 2: Financing of Capital Expenditure 2019/20 to 2023/24

Financing of capital expenditure £'000	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
General Fund					
Capital Receipts	2,530	2,133	2,641	2,550	2,550
Capital Grants	13,170	10,846	27,362	18,871	5,748
BCiL		4,321	4,027	1,750	3,410
NCiL		192	500	500	500
Section 106		1,159			
Revenue	8,770	41			
External Funding	**24,470**	**18,692**	**34,530**	**23,671**	**12,208**
Net financing need for year (GF)	**56,632**	**53,571**	**51,096**	**25,614**	**22,106**
HRA					
Capital Receipts	187	2,188	7,848	5,348	1,406
Capital Grants	3,697	7,868	21,488	9,815	3,796
Section 106	740	50	3,165	200	200
Revenue	4,860	10,010	12,143	5,914	8,008
External Funding	**9,483**	**20,115**	**44,644**	**21,278**	**13,410**
Net financing need for year (HRA)	**0**	**1,363**	**46,179**	**32,270**	**9,629**
Total net financing need for year	**56,632**	**54,933**	**97,274**	**57,884**	**31,735**

The Council’s borrowing need (Capital Financing Requirement)

2.6 The second prudential indicator is the Council’s Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council’s indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

2.7 The CFR includes any other long term liabilities (e.g. PFI or 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 £18.5m of such schemes within the CFR.

2.8 The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life, and so charges the economic consumption of capital assets as they are used.

2.9 The Council is asked to approve the CFR projections below:

Table 3: Capital Financing Requirement

Capital Financing Requirement £'000	**2019/20 Actual**	**2020/21 Estimate**	**2021/22 Estimate**	**2022/23 Estimate**	**2023/24 Estimate**
CFR – General Fund	410,978	442,348	467,891	465,556	459,831
CFR – HRA	150,683	152,046	198,224	230,494	240,123
Total CFR	**561,661**	**594,393**	**666,115**	**696,050**	**699,954**
Movement in CFR	**44,129**	**32,732**	**71,721**	**29,935**	**3,904**

Movement in CFR represented by					
Net financing need for the year (table 2)	56,632	54,933	97,274	57,884	31,735
Less MRP/VRP and other financing movements	-21,986	-22,201	-25,553	-27,949	-27,831
Movement in CFR	**34,646**	**32,732**	**71,721**	**29,935**	**3,904**

Minimum revenue provision (MRP) policy statement

2.10 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.

2.11 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.

2.12 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.

2.13 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 (VRP) 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. As at 31st March 2020 the balance of VRP was £7.8m.

Core funds and expected investment balances

2.14 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.).

2.15 The cash investment balance will be kept initially 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 plans set out in Table 1 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

Current portfolio position

3.2 The overall treasury management portfolio as at 31 March 2020 and for the position as at 31 December 2020 are shown below for both borrowing and investments.

Table 4: Borrowing Portfolio

Borrowing Portfolio £'000	31-Mar-20			31-Dec-20		
	Principal	Average Rate (%)	Average Life (yrs)	Principal	Average Rate (%)	Average Life (yrs)
- PWLB	348,461	3.45%	37.04	348,461	3.45%	36.28
- Market	73,800	2.84%	42.69	73,800	2.84%	41.93
Total borrowing	422,261	3.34%	38.02	422,261	3.34%	37.27

Table 5: Investment Portfolio

Investment Portfolio £'000	31-Mar-20			31-Dec-20		
	Principal	Average Rate (%)	Average Life (days)	Principal	Average Rate (%)	Average Life (days)
- MMFs	1,615	0.35%	1	1,616	0.01%	1
- Banks	62,917	0.18%	4	84,515	0.01%	3
Total Investments	64,532	0.19%	4	86,131	0.01%	3

3.3 The Council maintains upper and lower limits with respect to the maturity structure of its borrowing. This Prudential Indicator, reflecting the earliest date at which a lender can require payment is set to ensure refinancing risk is managed regarding the concentration of loan maturities in any one period. Table 6 below illustrates the actual position as at 31st March 2020 and 31st December 2020, compared to the upper and lower limits in place.

Table 6: Maturity Structure of Borrowing

Maturity structure of borrowing 2021/22	Lower Limit	Upper Limit	Actual 31.03.20	Actual 31.12.20
Under 12 months	0%	40%	10%	10%
12 months to 2 years	0%	30%	0%	1%
2 years to 5 years	0%	30%	1%	0%
5 years to 10 years	0%	40%	5%	5%
10 years and above	30%	100%	84%	84%

3.4 The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing. The expected change in borrowing has been calculated on the basis of maintaining an under borrowing position of £150m.

Table 7: Gross Debt v Capital Financing Requirement

£'000	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
External Debt					
Borrowing at 1 April	422,261	422,261	422,261	499,895	530,980
Expected change in borrowing	0		77,634	31,085	5,054
Other long-term liabilities (OLTL)	15,501	18,520	17,370	16,220	15,070
Expected change in OLTL	3,019	-1,150	-1,150	-1,150	-1,150
Actual gross debt at 31 March	**440,781**	**439,631**	**516,115**	**546,050**	**549,954**
CFR	**561,661**	**594,393**	**666,115**	**696,050**	**699,954**
Under / (over) borrowing	**120,880**	**154,762**	**150,000**	**150,000**	**150,000**

3.5 Within the range of 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 2021/22 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 or speculative purposes.

3.6 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 plans, and the proposals in this budget report.

3.7 The Prudential Code framework is a principles-based system whereby the Council should demonstrate that its capital plans are prudent, affordable and sustainable. One of the Prudential Indicators of affordability is the ratio of financing costs to net revenue stream, assessing the actual and estimated cost of capital against the income of the Authority. Table 8 provides the expected trends based on the forthcoming capital programme, for both the General Fund and HRA.

Table 8: Ratio of Financing Costs to Net Revenue Stream

Ratio of financing costs to net revenue stream %	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
General Fund	18%	18%	20%	20%	20%
HRA	20%	20%	21%	24%	25%
Total	19%	18%	20%	21%	20%

Treasury Indicators: limits to borrowing activity

The operational boundary

3.8 This is the limit beyond 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.

Table 9: Operational Boundary

Operational boundary £'000	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Borrowing	432,771	594,393	666,115	696,050	699,954
Other long term liabilities	15,501	18,520	17,370	16,220	15,070
Total	**448,272**	**612,913**	**683,485**	**712,270**	**715,024**

The authorised limit for external debt.

3.9 This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council.

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' plans, or those of a specific council, although this power has not yet been exercised.

3.11 The Council is asked to approve the following authorised limit:

Table 10: Authorised Limit

Authorised limit £'000	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Borrowing	587,820	624,393	696,115	726,050	729,954
Other long term liabilities		28,520	28,520	28,520	28,520
Total	**587,820**	**652,913**	**724,635**	**754,570**	**758,474**

Prospects for Interest Rates

PWLB Consultation

3.12 In response to concerns about commercial activity being undertaken by local authorities supported through borrowing from the PWLB HM

Treasury increase the margin over the Gilt applied to all PWLB borrowing on the 9th October 2019 from 0.8% to 1.8% above the Gilt.

3.13 In March 2020 HM Treasury reversed this for HRA borrowing (with reference to the HRA CFR) and announced a consultation on the future lending terms of the PWLB. The Governments response to the consultation was published in November 2020, and reversed the additional 1% margin imposed on General Fund borrowing subject to local authority's confirming that they have no purely commercial activity within their three year capital programme, which will come from data submissions of the capital programme accompanied by an assurance from the s151 officer. Subject to this criteria being met borrowing for both the General Fund and HRA is now back at a margin of 80bps above the Gilt.

3.14 The Council's Treasury Management Adviser, Link Asset Services, has provided the following interest rate forecast. Additional commentary on the prospects for interest rates, (Appendix D) and economic background, (Appendix E) are contained within the appendices to this report.

Table 11: Link Asset Services Interest Rate Forecast 2021-2024

	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5yr PWLB	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 yr PWLB	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 yr PWLB	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60

3.15 As the interest forecast table above illustrates, there is expected to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment, (as shown on 9th November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

Borrowing strategy

3.16 As shown in paragraph 3.2 as at 31 December 2019 the Council had a debt portfolio of £422.261m and with an average maturity of 37.3 years. Despite historical low borrowing costs there remains a short-term cost of carrying excessive debt due to the differential between investment and borrowing costs.

3.17 The Council is currently maintaining an under-borrowed position, estimated to be £155m as at 31st March 2021. 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 is kept under review by the Director of Finance.

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).

3.19 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 unlikely.

3.20 Against this background and the risks within the economic forecast, caution will be adopted in the 2021/22 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, the Council's Treasury Management Advisers:

- *if it was felt that there was a significant risk of a sharp FALL in borrowing rates, then borrowing will be postponed.*

- *if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast, perhaps arising from an acceleration 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.*

3.21 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.

Policy on borrowing in advance of need

3.22 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 Capital Financing Requirement estimates 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.

3.23 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

3.24 Rescheduling of current borrowing in our debt portfolio is unlikely to occur due to the differential in PWLB new borrowing and premature redemption rates and the premiums quoted by market providers in respect of the Councils remaining LOBO loans.

3.25 Any debt rescheduling opportunities will be reviewed and assessed in respect of providing a benefit to the Authority over the remaining life of the loan(s).

3.26 All rescheduling will be reported to Cabinet at the earliest meeting following the exercise.

Approved Sources of Long and Short term Borrowing

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's investment policy has regard to the following: -

- *MHCLG's Guidance on Local Government Investments ("the Guidance")*
- *CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")*
- *CIPFA Treasury Management Guidance Notes 2018*

4.2 The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return). The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite.

4.3 The above 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: -

1. Where relevant , 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.

2. **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.

3. **Other information sources** used will include the financial press, share price and other such information pertaining to the financial sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4. 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 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.

  The Council acknowledges that both specified and non-specified investments may be subject to valuation changes, both positive and negative, prior to maturing. The Director of Finance will take all reasonable steps to ensure that day to day liquidity does not rely on the sale of such investments prior to maturity, and therefore that the Council is not exposed to realising any losses. Moreover, the Director will take measures to ensure that any potential unrealised gains or losses are proportionate to revenue budgets and reserves.

4.4 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

4.5 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:

4.6 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.

4.7 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 criteria detailed in Appendix F and will revise the criteria and submit any changes 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.

4.8 Where more than one rating is available the lowest common denominator will be used, unless in the opinion of the Director of Finance, or a delegated manager authorised under the Financial Services and Markets Act 2000 (FSMA), there is an overriding reason to favour or disregard a particular agency's view.

4.9 Credit rating information is supplied by the Treasury Management Adviser on all active counterparties that comply with the prescribed criteria detailed in Appendix F. 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.

4.10 The Council's criteria for an institution to become counterparty are detailed in Appendix F.

Country Limits

4.11 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 sovereign 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

4.12 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).

4.13 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.

4.14 As a result of the Council's strategy, cash balances available to invest and the interest rates available the only counterparties actively in use during 2020/21 have been Lloyds, Royal Bank of Scotland Group and Handelsbanken in addition to 2 MMFs Deutsche and Fidelity. The investment portfolio has inevitably remained concentrated with RBS and Lloyds with 90% of the total portfolio invested with them on 31st December 2020. When opportunities arise consistent with the Council's policies diversification will be sought.

4.15 As a route to diversification, along with additional improved service resilience, economies of scale and improved returns, the Council is considering joining a collective investment arrangement as part of a shared service with the GLA, managed by the GLA's investment subsidiary, London Treasury Limited, which is authorised and regulated by the Financial Conduct Authority.

4.16 The draft pooled investment strategy for this arrangement is included within Appendix F but is subject to the agreement of all participating authorities; the Director of Finance is authorised, having taken proper advice from Link or other suitably qualified advisor, to agree amendments to this, provided that the underlying exposures of any amended strategy do not breach the limits set out in Appendix F.

4.17 Authority has previously been given to place funds in 'non-standard investments' up to a value of £10m. This has been replaced by a 10% allocation to strategic investments.

Investment returns expectations

4.18 Link Asset Services Interest Rate Forecast suggests that Bank Rate is unlikely to rise from 0.10% for a considerable period and therefore investment earnings from money market-related instruments will be sub 0.50% for the foreseeable future.

4.19 The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

- 2020/21: 0.10%
- 2021/22: 0.10%
- 2022/23: 0.10%
- 2023/24: 0.25%
- 2024/25: 0.75%

4.20 Link Asset Services further advise that:

- The overall balance of risks to economic growth in the UK is probably relatively even but is subject to major uncertainty due to the pandemic and market reaction to the Brexit agreement.

- There is relatively little UK domestic risk of increases or decreases in Bank Rate and shorter term PWLB rates until 2023/24 at the earliest

Negative investment rates

4.21 While the Bank of England said in August / September 2020 that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the COVID crisis; this has caused some local authorities to have sudden large increases in cash balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

4.22 As for money market funds (MMFs), yields have continued to drift lower. Fund managers have resorted to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a surfeit of money swilling around at the very short end of the market. This has seen a number of market operators, including the DMADF, offer nil or negative rates for short term maturities. This is not universal, and MMFs are still offering a marginally positive return, as are a number of financial institutions for investments at the very short end of the yield curve.

4.23 Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government.

Investment treasury indicator and limit - total principal funds invested for greater than 365 days

4.24 These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment and are based on the availability of funds after each year-end.

4.25 The Council is asked to approve the following treasury indicator and limit:

Table 12: Limit for sums invested over 365 days

Upper limit for principal sums invested for longer than 365 days			
£'000	**2021/22**	**2022/23**	**2023/24**
Principal sums invested for longer than 365 days	£60,000	£60,000	£60,000

Investment performance / risk benchmarking

4.26 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 Link Asset Services on a monthly basis.

4.27 The Council is appreciative that the provision of LIBOR and associated LIBID rates is expected to cease at the end of 2021. It will work with its advisors in determining suitable replacement investment benchmark(s) ahead of this cessation and will report back to members accordingly.

End of year investment report

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

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).

5.2 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

5.3 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

5.4 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.

Training

5.5 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.

5.6 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 Advisors

5.7 The Council has engaged Link Asset Services Treasury Solutions as its external Treasury Management Adviser.

5.8 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.

5.9 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.

7. Procurement Implications

7.1 There are no procurement implications arising from this report.

8. Legal Implications

8.1 The Local Government Act 2003 requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. These are contained within this report. The Act requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy. This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. This report assists the Council in fulfilling its statutory obligation under the Local Government Act 2003 to monitor its borrowing and investment activities.

9. Financial Implications

In addition to supporting the Council's revenue and capital programmes the Treasury Management interest budget is an important part of the revenue budget. Any savings achieved, or overspends incurred, have a direct impact on the financial performance of the budget.

10. Performance Issues

10.1 The Council meets the requirements of the CIPFA Code of Practice for Treasury Management and therefore is able to demonstrate best practices for the Treasury Management function.

10.2 As part of the Code the Council must agree a series of prudential indicators and measure its performance against them. These indicators and performance are detailed in the report and reported to Council

11. Environmental Impact

11.1 There are no direct environmental impacts.

12. Risk Management Implications

12.1 Risk included on corporate or directorate risk register? **Yes**. Contained on Resources Directorate risk register Risk 9: Loss of an investment/deposit

12.2 Separate risk register in place? **No**

12.3 The relevant risks contained in the register are attached/summarised below. **Yes/No**

12.4 The following key risks should be taken onto account when agreeing the recommendations in this report:

Risk Description	**Mitigations**	**RAG Status**
Cash not available when needed	▪ Working capital and borrowing position designed to maintain the required level of cash balances ▪ The balance of debt and investment operations ensure liquidity ▪ The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy.	Green
Sums invested result in a loss	▪ The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return). The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite.	Amber
Council's capital investment programme is not affordable, prudent or sustainable	▪ One of the Prudential Indicators of affordability is the ratio of financing costs to net revenue stream, assessing the actual and estimated cost of capital against the income of the Authority. Table 8 ▪ Limits on borrowing activity ▪ The Council is currently maintaining an under-borrowed position, estimated to be £155m as at 31st March 2021.	Green
VFM is not achieved	▪ The Council 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.	Green

Provision made in the General Fund for debt is not prudent	▪ 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. Appendix C.	Green
Too many loans mature in one period impacting on ability to refinance risk	▪ The Council maintains upper and lower limits with respect to the maturity structure of its borrowing. This Prudential Indicator, reflecting the earliest date at which a lender can require payment is set to ensure refinancing risk is managed regarding the concentration of loan maturities in any one period.	Green
Borrowing is undertaken for revenue or speculative purposes	▪ Within the range of 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 2021/22 and the following two financial years	Green
Exceptional levels of volatility in PWLB rates	▪ The Council's Treasury Management Adviser, Link Asset Services, has provided an interest rate forecast (Table 11). ▪ There is expected to be little upward movement in PWLB rates over the next two years however from time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment, (as shown on 9th November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.	Amber
Default on Council Loans	▪ The risk of default attached to the Council's portfolio is reported by Link Asset Services on a monthly basis. ▪	Green

12.5 The identification, monitoring and control of risk are central to the achievement of the treasury objectives. Potential risks are identified, mitigated and monitored in accordance with treasury practice notes approved by the Treasury Management Group.

13. Equalities Implications/Public Sector Equality Duty

13.1 There is no direct equalities impact.

14. Corporate 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:

- Improving the environment and addressing climate change
- Tackling poverty and inequality
- Building homes and infrastructure
- Addressing health and social care inequality
- Thriving economy

Section 3 - Statutory Officer Clearance

Statutory Officer: Dawn Calvert
Signed by the Chief Financial Officer
Date: 08/02/2021

Statutory Officer: Chris Cuckney
Signed on behalf of the Monitoring Officer
Date: 08/02/2021

Chief Officer: Charlie Stewart
Signed off by the Corporate Director
Date: 08/02/2021

Head of Procurement: Nimesh Mehta
Signed by the Head of Procurement
Date: 08/02/2021

Head of Internal Audit: Susan Dixson
Signed by the Head of Internal Audit

Date: 08/02/2021

Mandatory Checks

Ward Councillors notified: NO, as it impacts on all Wards

EqIA carried out: NO

EqIA cleared by:

Section 4 - Contact Details and Background Papers

Contact: Dawn Calvert, Director of Finance and Assurance,
dawn.calvert@harrow.gov.uk

Background Papers: None

Call-in waived by the Chair of Overview and Scrutiny Committee

NOT APPLICABLE (decisions reserved to Council)

APPENDIX A

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: **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, Ministry of Housing, 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' authorised 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.

Guidance
The Act contains a requirement for the Council to have regard to guidance:

- Issued directly by the Secretary of State
    - *MHCLG Investment Guidance*
    - *MHCLG MRP Guidance*
- Other guidance the Secretary of State may refer to through regulations
    - The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003
        - *CIPFA Prudential Code*
        - *CIPFA Treasury Management Code of Practice*

2. Ministry of Housing, Communities and Local Government Investment Guidance (2018)

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. Ministry of Housing, Communities and Local Government Minimum Revenue Provision Guidance (2018)

Minimum Revenue Provision (MRP) is the mechanism by which capital expenditure funded though prudential borrowing is charged to revenue over time. The aim of MRP is to align the charge to revenue over a period which the capital expenditure provides benefit.

Before the start of each financial year the Council is required to approve an MRP Policy Statement specifying how it will make prudent MRP during that year. Subject to full Council approval, the MRP Policy Statement can be revised during the year.

4. Treasury Management in the Public Services: CIPFA Code of Practice (2017) and Guidance Notes (2018)

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 Statement - 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.

5. CIPFA Prudential Code (2017) and Guidance Notes (2018)

The CIPFA Prudential Code is a framework developed to support local strategic planning, asset management and options appraisal. The objectives of the Prudential Code are to ensure that the Council's capital expenditure plans are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice and in full understanding of the risks involved.

The Prudential Code sets out a number of indicators which demonstrate the impact of the approved capital programme. The latest published version in 2017 introduced a new requirement for local authorities to produce an annual Capital Strategy, which sets out the long-term context in which capital expenditure and investment decisions are made.

APPENDIX B

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 responsibility 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);
- 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

APPENDIX C

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. As at March 2020, the VRP is £7.8m.
- 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.

APPENDIX D: Link Asset Services: Interest Rate Forecasts 2020 – 2024.

	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 yr PWLB	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 yr PWLB	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60

Interest Rate Forecasts

Brexit. The interest rate forecasts provided by Link above were predicated on an assumption of a reasonable agreement being reached on trade negotiations between the UK and the EU by 31.12.20. There is therefore no need to revise these forecasts now that a trade deal has been agreed. Brexit may reduce the economy's potential growth rate in the long run. However, much of that drag is now likely to be offset by an acceleration of productivity growth triggered by the digital revolution brought about by the COVID crisis.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably now skewed to the upside, but is still subject to some uncertainty due to the virus and the effect of any mutations, and how quick vaccines are in enabling a relaxation of restrictions.
- There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, could impact gilt yields, (and so PWLB rates), in the UK.

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

- **UK government** takes too much action too quickly to raise taxation or introduce austerity measures that depress demand and the pace of recovery of the economy.
- **UK - 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.** The ECB has taken monetary policy action to support the bonds of EU states, with the positive impact most likely for "weaker" countries. In addition, the EU agreed a €750bn fiscal support package. These actions will help shield weaker economic regions for the next two or three years. However, in the case of Italy, the cost of the virus crisis has added to

its already huge debt mountain and its slow economic growth will leave it vulnerable to markets returning to taking the view that its level of debt is unsupportable. There remains a sharp divide between northern EU countries favouring low debt to GDP and annual balanced budgets and southern countries who want to see jointly issued Eurobonds to finance economic recovery. This divide could undermine the unity of the EU in time to come.

- Weak capitalisation of some **European banks**, which could be undermined further depending on extent of credit losses resultant of the pandemic.
- **German minority government & general election in 2021.** 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. Angela Merkel has stepped down from being the CDU party leader but she will remain as Chancellor until the general election in 2021. This then leaves a major question mark over who will be the major guiding hand and driver of EU unity when she steps down.
- **Other minority EU governments.** Italy, Spain, Austria, Sweden, Portugal, Netherlands, Ireland 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, and they had threatened to derail the 7 year EU budget until a compromise was thrashed out in late 2020. There has also been a rise in anti-immigration sentiment in Germany and France.
- **Geopolitical risks,** for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe haven flows.

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

- **UK -** a significant rise in inflationary pressures e.g. caused by a stronger than currently expected recovery in the UK economy after effective vaccines are administered quickly to the UK population, leading to a rapid resumption of normal life and return to full economic activity across all sectors of the economy.
- 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 rapid series of increases in Bank Rate to stifle inflation.

APPENDIX E

Economic Background

- **UK.** The key quarterly meeting of the Bank of England Monetary Policy Committee kept **Bank Rate** unchanged on 5.11.20. However, it revised its economic forecasts to take account of a second national lockdown from 5.11.20 to 2.12.20 which is obviously going to put back economic recovery and do further damage to the economy. It therefore decided to do a further tranche of **quantitative easing (QE) of £150bn**, to start in January when the current programme of £300bn of QE, announced in March to June, runs out. It did this so that “announcing further asset purchases now should support the economy and help to ensure the unavoidable near-term slowdown in activity was not amplified by a tightening in monetary conditions that could slow the return of inflation to the target”.
- Its forecasts appeared, at that time, to be rather optimistic in terms of three areas:
    - The economy would recover to reach its pre-pandemic level in Q1 2022
    - The Bank also expected there to be excess demand in the economy by Q4 2022.
    - CPI inflation was therefore projected to be a bit above its 2% target by the start of 2023 and the “inflation risks were judged to be balanced”.
- Significantly, there was no mention of **negative interest rates** in the minutes or Monetary Policy Report, suggesting that the MPC remains some way from being persuaded of the case for such a policy, at least for the next 6 -12 months. However, rather than saying that it “stands ready to adjust monetary policy”, the MPC this time said that it will take “whatever additional action was necessary to achieve its remit”. The latter seems stronger and wider and may indicate the Bank’s willingness to embrace new tools.
- One key addition to **the Bank’s forward guidance in August** was a new phrase in the policy statement, namely that “it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably”. That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years’ time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. Our Bank Rate forecast currently shows no increase, (or decrease), through to quarter 1 2024 but there could well be no increase during the next five years as it will take some years to eliminate spare capacity in the economy, and therefore for inflationary pressures to rise to cause the MPC concern. **Inflation** is expected to briefly peak at just over 2% towards the end of 2021, but this is a temporary short lived factor due to base effects from twelve months ago falling out of the calculation, and so is not a concern. Looking further ahead, it is also unlikely to be a problem for some

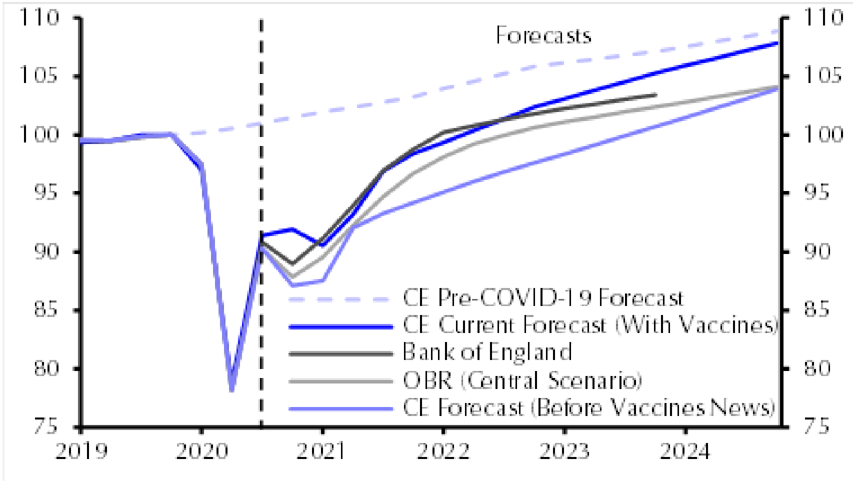
years as it will take a prolonged time for spare capacity in the economy, created by this downturn, to be used up.

- **Public borrowing** was forecast in November by the Office for Budget Responsibility (the OBR) to reach £394bn in the current financial year, the highest ever peace time deficit and equivalent to 19% of GDP. In normal times, such an increase in total gilt issuance would lead to a rise in gilt yields, and so PWLB rates. However, the QE done by the Bank of England has depressed gilt yields to historic low levels, (as has similarly occurred with QE and debt issued in the US, the EU and Japan). This means that new UK debt being issued, and this is being done across the whole yield curve in all maturities, is locking in those historic low levels through until maturity. In addition, the UK has one of the longest average maturities for its entire debt portfolio, of any country in the world. Overall, this means that the total interest bill paid by the Government is manageable despite the huge increase in the total amount of debt. The OBR was also forecasting that the government will still be running a budget deficit of £102bn (3.9% of GDP) by 2025/26. However, initial impressions are that they have taken a pessimistic view of the impact that vaccines could make in the speed of economic recovery.
- Overall, **the pace of recovery** was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp after quarter 1 saw growth at -3.0% followed by -18.8% in quarter 2 and then an upswing of +16.0% in quarter 3; this still left the economy 8.6% smaller than in Q4 2019. While the one month second national lockdown that started on 5th November caused a further contraction of 5.7% m/m in November, this was much better than had been feared and showed that the economy is adapting to new ways of working. This left the economy 'only' 8.6% below the pre-crisis level.

- **Vaccines – the game changer.** The Pfizer announcement on 9th November of a successful vaccine has been followed by approval of the Oxford University/AstraZeneca and Moderna vaccines. The Government has a set a target to vaccinate 14 million people in the most at risk sectors of the population by 15th February; as of mid-January, it has made good, and accelerating progress in hitting that target. The aim is to vaccinate all adults by September. This means that the national lockdown starting in early January, could be replaced by regional tiers of lighter restrictions, beginning possibly in Q2. At that point, there would be less reason to fear that hospitals could become overwhelmed any more. Effective vaccines have radically improved the economic outlook so that it may now be possible for GDP to recover to its pre-virus level as early as Q1 2022. These vaccines have enormously boosted confidence that **life could largely return to normal during the second half of 2021**. With the household saving rate having been exceptionally high since the first lockdown in March, there is plenty of pent-up demand and purchasing power stored up for when life returns to normal.

- Provided that both monetary and fiscal policy are kept loose for a few years yet, then it is still possible that in the second half of this decade, the economy may be no smaller than it would have been if COVID-19 never happened. The significant risk is if another mutation of COVID-19 appears that defeats the current batch of vaccines. However, now that science and technology have caught up with understanding this virus, new vaccines ought to be able to be developed more quickly to counter such a development, and vaccine production facilities are being ramped up around the world.

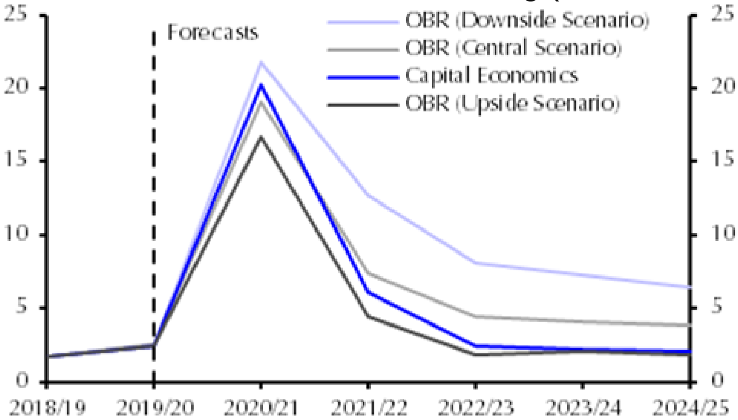
Chart: Level of real GDP (Q4 2019 = 100)



(if unable to print in colour…... the key describing each line in the above graph is in sequential order from top to bottom in parallel with the lines in the graph.

This recovery of growth which eliminates the effects of the pandemic by about the middle of the decade, would have major repercussions for public finances as it would be consistent with the government deficit falling to around 2.5% of GDP without any tax increases. This would be in line with the OBR's most optimistic forecast in the graph below, rather than their current central scenario which predicts a 4% deficit due to assuming much slower growth. However, Capital Economics forecasts assumed that politicians do not raise taxes or embark on major austerity measures and so, (perversely!), depress economic growth and recovery.

Chart: Public Sector Net Borrowing (as a % of GDP)



(if unable to print in colour…... the key describing each line in the above graph is in sequential order from top to bottom in parallel with the lines in the graph.

- There will still be some **painful longer term adjustments** as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever, even if vaccines are fully successful in overcoming the current virus. There is also likely to be a **reversal of globalisation** as this crisis has exposed how vulnerable long-distance supply chains are. On the other hand, **digital services** are one area that has already seen huge growth.

- **Brexit.** The final agreement of a trade deal on 24.12.20 has eliminated a significant downside risk for the UK economy. The initial agreement only covers trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. As the forecasts in this report were based on an assumption of a Brexit agreement being reached, there is no need to amend these forecasts.

- **Monetary Policy Committee meeting of 17 December.** All nine Committee members voted to keep interest rates on hold at +0.10% and the Quantitative Easing (QE) target at £895bn. The MPC commented that the successful rollout of vaccines had reduced the downsides risks to the economy that it had highlighted in November. But this was caveated by it saying, "Although all members agreed that this would reduce downside risks, they placed different weights on the degree to which this was also expected to lead to stronger GDP growth in the central case." So, while vaccines are a positive development, in the eyes of the MPC at least, the economy is far from out of the woods in the shorter term. The MPC, therefore, voted to extend the availability of the Term Funding Scheme, (cheap borrowing), with additional incentives for small and medium size enterprises for six months from 30.4.21 until 31.10.21. (The MPC had assumed that a Brexit deal would be agreed.)

- **Fiscal policy.** In the same week as the MPC meeting, the Chancellor made a series of announcements to provide further support to the economy: -
  - An extension of the COVID-19 loan schemes from the end of January 2021 to the end of March.
  - The furlough scheme was lengthened from the end of March to the end of April.
  - The Budget on 3.3.21 will lay out the "next phase of the plan to tackle the virus and protect jobs". This does not sound like tax rises are imminent, (which could hold back the speed of economic recovery).

- The **Financial Policy Committee** (FPC) report on 6.8.20 revised down their expected credit losses for the banking sector to "somewhat less than £80bn". It stated that in its assessment, "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

- **US.** The Democrats gained the presidency and a majority in the House of Representatives in the November elections: after winning two key Senate seats in Georgia in elections in early January, they now also have a very slim majority in the Senate due to the vice president's casting vote.

President Biden will consequently have a much easier path to implement his election manifesto. However, he will not have a completely free hand as more radical Democrat plans may not be supported by all Democrat senators. His initial radical plan for a fiscal stimulus of $1.9trn, (9% of GDP), is therefore likely to be toned down in order to get through both houses.

- **The economy** had been recovering quite strongly from its contraction in 2020 of 10.2% due to the pandemic with GDP only 3.5% below its pre-pandemic level and the unemployment rate dropping below 7%. However, the rise in new cases during quarter 4, to the highest level since mid-August, suggests that the US could be in the early stages of a fourth wave. The latest upturn poses a threat that the recovery in the economy could stall. This is **the single biggest downside risk** to the shorter term outlook – a more widespread and severe wave of infections over the winter months, which is compounded by the impact of the regular flu season and, as a consequence, threatens to overwhelm health care facilities. Under those circumstances, individual states might feel it necessary to return to more draconian lockdowns.

- The restrictions imposed to control the spread of the virus are once again weighing on the economy with employment growth slowing sharply in November and declining in December, and retail sales dropping back. The economy is set for further weakness into the spring. **GDP growth** is expected to rebound markedly from the second quarter of 2021 onwards as vaccines are rolled out on a widespread basis and restrictions are loosened.

- After Chair Jerome Powell unveiled the **Fed's adoption of a flexible average inflation target** in his Jackson Hole speech in late August 2020, the mid-September meeting of the Fed agreed by a majority to a toned down version of the new inflation target in his speech - that *"it would likely be appropriate to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation had risen to 2% and was on track to moderately exceed 2% for some time."* This change was aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary “trap” like Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade, (and this year), so financial markets took note that higher levels of inflation are likely to be in the pipeline; long-term bond yields duly rose after the meeting. The FOMC’s updated economic and rate projections in mid-September showed that officials expect to leave the fed funds rate at near-zero until at least end-2023 and probably for another year or two beyond that. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal.

- The Fed’s meeting on **5 November** was unremarkable - but at a politically sensitive time around the elections. At its **16 December** meeting the Fed tweaked the guidance for its monthly asset quantitative easing purchases with the new language implying those purchases could continue for longer than previously believed. Nevertheless, with officials still projecting that **inflation** will only get back to 2.0% in 2023, the vast majority expect the Fed funds rate to be still at near-zero until 2024 or later. Furthermore, officials think the balance of risks surrounding that median inflation forecast are firmly skewed to the downside. The key message is still that policy will remain unusually accommodative – with near-zero rates and asset purchases – continuing for several more years. This is likely to result in keeping Treasury yields low – which will also have an influence on gilt yields in this country.

- **EU.** In early December, the figures for Q3 GDP confirmed that the economy staged a rapid rebound from the first lockdowns. This provides grounds for optimism about growth prospects for next year. In Q2, GDP was 15% below its pre-pandemic level. But in Q3 the economy grew by 12.5% q/q leaving GDP down by "only" 4.4%. That was much better than had been expected earlier in the year. However, growth is likely to stagnate during Q4 and in Q1 of 2021, as a second wave of the virus has seriously affected many countries. The €750bn fiscal support package eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support, and quickly enough, to make an appreciable difference in the countries most affected by the first wave.

- With **inflation** expected to be unlikely to get much above 1% over the next two years, **the ECB** has been struggling to get inflation up to its 2% target. It is currently unlikely that it will cut its central rate even further into negative territory from -0.5%, although the ECB has stated that it retains this as a possible tool to use. The ECB's December meeting added a further €500bn to the PEPP scheme, (purchase of government and other bonds), and extended the duration of the programme to March 2022 and re-investing maturities for an additional year until December 2023. Three additional tranches of TLTRO, (cheap loans to banks), were approved, indicating that support will last beyond the impact of the pandemic, implying indirect yield curve control for government bonds for some time ahead. The Bank's forecast for a return to pre-virus activity levels was pushed back to the end of 2021, but stronger growth is projected in 2022. The total PEPP scheme of €1,850bn of QE which started in March 2020 is providing protection to the sovereign bond yields of weaker countries like Italy. There is therefore unlikely to be a euro crisis while the ECB is able to maintain this level of support. However, as in the UK and the US, the advent of highly effective vaccines will be a game changer, although growth will struggle before later in quarter 2 of 2021.

- **China.** After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and then into Q3 and Q4; this has enabled China to recover all of the contraction in Q1. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth. At the same time, China's economy has benefited from the shift towards online spending by consumers in developed markets. These factors help to explain its comparative outperformance compared to western economies. However, this was achieved by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns in the longer term. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.

- **Japan.** A third round of fiscal stimulus in early December took total fresh fiscal spending this year in response to the virus close to 12% of pre-virus GDP. That's huge by past standards, and one of the largest national fiscal responses. The budget deficit is now likely to reach 16% of GDP this year. Coupled with Japan's relative success in containing the virus without draconian measures so far, and the likelihood of effective vaccines being available in the coming months, the government's latest fiscal effort should help ensure a strong recovery and to get back to pre-virus levels by Q3 2021 – around the same time as the US and much sooner than the Eurozone.

- **World growth.** World growth will has been in recession in 2020 and this is likely to continue into the first half of 2021 before recovery in the second half. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

- 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.

Summary

Central banks are, therefore, likely to support growth by maintaining loose monetary policy through keeping rates very low for longer. Governments could also help a quicker recovery by providing more fiscal support for their economies at a time when total debt is affordable due to the very low rates of interest. They will also need to avoid significant increases in taxation or austerity measures that depress demand and the pace of recovery in their economies.

If there is a huge surge in investor confidence as a result of successful vaccines which leads to a major switch out of government bonds into equities, which, in turn, causes government debt yields to rise, then there will be pressure on central banks to actively manage debt yields by further QE purchases of government debt; this would help to suppress the rise in debt yields and so keep the total interest bill on greatly expanded government debt portfolios within manageable parameters. It is also the main alternative to a programme of austerity.

Counterparties and approved investments

Specified Investments

These are sterling investments with high credit quality 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.

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 Director of Finance will make best efforts to maintain at least 50% of all investments in the form of Specified Investments.

Table 1 sets out the range of specified and non-specified investments permitted by the Council. This has been expanded from previous years to give the Council flexibility to join a collective investment arrangement with the GLA should this be agreed. The table uses the following key:

S = Specified
NS = Non Specified
NS* = Non Specified, only used under delegation to a professional manager properly authorised under the Financial Services and Markets Act.

The draft GLA collective investment strategy is as follows:

		Allocation	Expected Rate
Core Liquidity: Managed with a weighted average life of 90 days	Overnight liquidity	10%	0.00%
	Local Authority <12mths	15%	0.10%
	Banks <12mths	30%	0.10%
Medium term: Weighted average life < 3years	Senior RMBS	35%	0.70%
Long term core balance	Other Strategic Investments	10%	4.00%
		100%	0.69%

This is subject to collective agreement by the participating authorities, currently the GLA, the London Fire Commissioner (LFC), the Mayor’s Office for Policing and Crime (MOPAC), the London Legacy Development Corporation (LLDC) and the London Pensions Fund Authority (LPFA). Should the Council join, agreeing the strategy with the other participants is delegated to the Director of Finance, provided the limits in Table 1 are not exceeded.

Subject to the above, this strategy authorises the Director of Finance to invest up to 100% of cash alongside the GLA and also delegates the legal form of such investment to the Director, provided the underlying risk and reward reflects approved instruments.

Investment type	Eligibility criteria	≤ 1 year to maturity at time of investment	> 1 year to maturity at time of investment	Maximum total exposure as a proportion of forecast daily balance
Senior Unsecured Debt, e.g. • **Deposits** • **Call Accounts** • **Notice Accounts** • **Certificates of Deposit** • **Loans** • **Commercial Paper** • **UK Gilts and T-Bills** • **All other senior unsecured bonds**	Issuer (and security where separately rated) Investment Grade (IG) defined per **Table 3** OR UK Government (including the Debt Management Account Deposit Facility, Local Authorities and bodies eligible for PWLB finance) OR Issuer not meeting general criteria but instruments explicitly guaranteed by IG entity or sovereign national government meeting acceptable sovereign	S	NS	Aggregate 100%, individual limits determined by tables

Investment type	Eligibility criteria	≤ 1 year to maturity at time of investment	> 1 year to maturity at time of investment	Maximum total exposure as a proportion of forecast daily balance
	ratings per **Table 2**.			
Money Market Funds	Fitch AAA_{mmf} or above See **Table 3** for equivalents from other agencies. Daily liquidity	S	*N/A*	100% *Not more than 20% per fund*
Other Collective Investment Schemes e.g. Enhanced Cash Funds	Fitch AAA_f or equivalent from other agencies per **Table 3.**	NS	*N/A*	20%
Senior UK Prime or Buy to Let Residential Mortgage Backed Securities (RMBS)	Bond rating Fitch $AA+_{sf}$ or above or equivalent from other agencies per **Table 3**.	NS*	NS*	35%
Covered bonds	Bond rating Fitch $AA+_{sf}$ or equivalent from other agencies per **Table 3** AND Issuer rated Fitch A- or above or equivalent from other agencies per **Table 3**	NS*	NS*	20%
Repurchase Agreements (Repo)	Counterparty meets senior unsecured criteria AND proposed	S* – UK gilts or T-Bills AND Counterparty meets	*Not permitted.*	S – 100% NS – 20%, and not more than 10%

Investment type	Eligibility criteria	≤ 1 year to maturity at time of investment	> 1 year to maturity at time of investment	Maximum total exposure as a proportion of forecast daily balance
	collateral (Min 100%) itself meets permitted investment criteria Or Collateralisation is >102% with UK Gilts / T-Bills	senior unsecured criteria NS* – other		with counterparties not meeting senior unsecured criteria.
Other strategic investments (only to be held within authorised and regulated funds)	Any sterling-denominated investment with risk and return characteristics appropriate to the collective investment arrangement and mutually agreed by all participants.	NS*	NS*	10%

<u>Credit Ratings and Country Limits</u>

Maximum exposures to non-UK financial institutions apply by country, based on the relevant sovereign ratings outlined in the table below:

Table 2 – Country Limits

Max. Aggregate Exposure (%)	Fitch Sovereign Rating	S&P Sovereign Rating	Moody's Sovereign Rating
25	AAA	AAA	Aaa
15	AA+	AA+	Aa1
5	A	A	A

Note: for non-UK, non-financial institutions, or in circumstances such as an instrument being issued through a subsidiary domiciled in one country but

guaranteed or otherwise secured by a parent in another, the risks and appropriate country limit (if any, in the case of multinational corporations) in which to aggregate the exposure will be considered on a case by case basis and determined by the Director of Finance or delegated manager.
Table 3 sets out the range of investment grade ratings used by the Council and its investment managers.

Table 2 - Permitted credit ratings and equivalence mappings:

<table>
<tr><th colspan="6">Issuer and/or Senior Unsecured Bond Ratings</th></tr>
<tr><th colspan="3">Long term</th><th colspan="3">Short term</th></tr>
<tr><th>Fitch</th><th>Moody’s</th><th>S&P</th><th>Fitch</th><th>Moody’s</th><th>S&P</th></tr>
<tr><td>AAA</td><td>Aaa</td><td>AAA</td><td></td><td></td><td></td></tr>
<tr><td>AA+</td><td>Aa1</td><td>AA+</td><td></td><td></td><td></td></tr>
<tr><td>AA</td><td>Aa2</td><td>AA</td><td>F1+</td><td>P-1</td><td>A-1+</td></tr>
<tr><td>AA-</td><td>Aa3</td><td>AA-</td><td></td><td></td><td></td></tr>
<tr><td>A+</td><td>A1</td><td>A+</td><td></td><td></td><td></td></tr>
<tr><td>A</td><td>A2</td><td>A</td><td>F1</td><td>P-1</td><td>A-1</td></tr>
<tr><td>A-</td><td>A3</td><td>A-</td><td></td><td></td><td></td></tr>
<tr><td>BBB+</td><td>Baa1</td><td>BBB+</td><td></td><td></td><td></td></tr>
<tr><td>BBB</td><td>Baa2</td><td>BBB</td><td>F2</td><td>P-2</td><td>A-2</td></tr>
<tr><th colspan="6">Structured Finance Ratings</th></tr>
<tr><th colspan="2">Fitch</th><th colspan="2">Moody’s</th><th colspan="2">S&P</th></tr>
<tr><td colspan="2">AAA$_{sf}$</td><td colspan="2">Aaa (sf)</td><td colspan="2">AAA (sf)</td></tr>
<tr><td colspan="2">AA+$_{sf}$</td><td colspan="2">Aa1(sf)</td><td colspan="2">AA+ (sf)</td></tr>
<tr><th colspan="6">Money Market Fund Ratings</th></tr>
<tr><th colspan="2">Fitch</th><th colspan="2">Moody’s</th><th colspan="2">S&P</th></tr>
<tr><td colspan="2">AAA$_{mmf}$</td><td colspan="2">Aaa-mf</td><td colspan="2">AAAm</td></tr>
<tr><th colspan="6">Other Permitted Fund Ratings</th></tr>
<tr><th colspan="2">Fitch</th><th colspan="2">Moody’s</th><th colspan="2">S&P</th></tr>
<tr><td colspan="2">AAA$_{f}$</td><td colspan="2">Aaa-bf</td><td colspan="2">AAAf</td></tr>
</table>

Lower ratings are balanced be higher ones in order to maintain credit risk on rated instruments that is no greater than a 12 month deposit with AAinstituition. This is determined by assigning a credit factor to each rated investment, per **Table 4** and calculating a weighted average portfolio credit factor (PCF). This must remain below 5 and no single instrument may exceed 10.

Table 4 – Credit Factors

Credit Factors based on Issuer Default Rating (Fitch and Fitch Equivalents) Use instrument rating or if not rated, rating of Issuer.									
Days	AAA	AA+	AA	AA−	A+	A	A−	BBB+	BBB
O/N	0.01	0.01	0.01	0.01	0.02	0.03	0.04	0.07	0.10
2-7	0.02	0.04	0.06	0.10	0.15	0.20	0.30	0.50	0.80
8-30	0.10	0.15	0.25	0.40	0.60	0.75	1.30	2.10	3.50
31-60	0.20	0.30	0.50	0.80	1.20	1.50	2.60	4.20	7.00
61-90	0.25	0.50	0.75	1.25	1.50	2.50	5.00	7.50	10.00
91-120	0.35	0.65	1.00	1.50	2.30	3.30	6.60	10.00	13.50
121-150	0.40	0.80	1.25	2.10	2.90	4.20	8.30	12.50	16.50
151-180	0.50	1.00	1.50	2.50	3.50	5.00	10.00	15.00	20.00
181-210	0.60	1.20	1.75	3.00	4.00	5.80	11.70	17.50	23.50
211-240	0.70	1.30	2.00	3.30	4.70	6.60	13.30	20.00	27.00
241-270	0.75	1.50	2.25	3.75	5.25	7.50	15.00	22.50	30.00
271-300	0.80	1.70	2.50	4.20	5.80	8.30	16.70	25.00	33.50
301-330	0.90	1.85	2.75	4.60	6.50	9.20	18.50	27.50	37.00
331-397	1.00	2.00	3.00	5.00	7.00	10.00	20.00	30.00	40.00
398-730	2.70	5.30	8.00	13.00	19.00	27.00	43.00	69.00	106.00

For the purposes of the above, UK Government (including the Debt Management Account Deposit Facility, Local Authorities and bodies eligible for PWLB finance) securities are treated as AAA, reflecting the UK's highly centralised and interdependent public finance regime.
Enhanced limits apply for these counterparties and institutions covered by Link Asset Services' Colour Banding Methodology:

Table 5 – Concentration Limits

Cash Exposure Limits – applied to individual counterparties		
Band	**Overnight**	**> 1 day**
UK Sovereign	100%	100%
Yellow	50%	25%
Purple	50%	20%
Orange	25%	15%
Red	25%	10%
Green	10%	5%
No Colour	5%	5%

The Bands above are calculated based on a range of credit ratings data, including published rating Watches and Outlooks.
The Council’s own bank has an emergency overnight limit of 100%, to allow for unexpected payment events.

APPENDIX G

Capital Strategy 2021-22

Contents

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 these 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 2017 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, the table below shows the capital financing costs that are already factored into the existing MTFS for 2020/21 to 2023/24 in relation to the existing and historic capital programmes:

	2020/21	**2021/22**	**2022/23**	**2023/24**
General Fund	**£000**	**£000**	**£000**	**£000**
Capital Financing Costs	30,786	32,452	36,983	38,053
Capital Financing Costs as % of 2020/21 Net Budget	18%	19%	21%	22%

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 2023/24.

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 2023/24 will be approved by Cabinet/Council in February 2021.

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 £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. The remaining £94m has been removed from the Capital Programme as reported in the Final Capital Programme report and the Final Revenue Budget report 2021/22 which are both reported to cabinet in February 2021.

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 was 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. In 2019/20 £3.1m of capital flexibilities were applied in the budget. For 2020/21 there was no planned use of capital flexibilities set out in the budget. The 2021/22 Final budget report sets out the use of £2m for the financial year 2021/22.

Section 2 – <u>SELECTING, APPROVING AND MONITORING CAPITAL SCHEMES</u>

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 - <u>FINANCING THE CAPITAL PROGRAMME</u>

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:

- 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.

APPENDIX H

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.