Mole Valley District Council

Agenda Item 9

Report to be considered by Audit Committee on 7th February 2019

Strategic Leadership Team Lead Officer	Nick Gray, Deputy Chief Executive (Section 151 Officer)
Author	Graham Whiting, Principal Accountant Paul Taylor, Interim Principal Accountant
Telephone	01306 879148 01306 879383
Email	Graham.Whiting@molevalley.gov.uk Paul.Taylor@molevalley.gov.uk
Date	7th February 2019
Ward(s) affected	None specifically
Subject	Treasury Management Strategy 2019/20 to 2021/22

Recommendations

The Audit Committee is asked to recommend to Council:

(i) To approve the Prudential Indicators for 2019/20 to 2021/22 contained within Appendix 2 and Appendix 3 to the main report, and paragraphs 10.8 to 10.9 of Annexe B, (Asset Investment Strategy);

(ii) To approve the Minimum Revenue Provision (MRP) Statement contained within Appendix 2;

(iii) To approve the 2019/20 Investment Policy contained in the Treasury Management Strategy (Appendix 3) and the detailed criteria included in Appendix 4;

(iv) To approve the Capital Strategy set out at Annexe A;

(v) To note the implementation of the Asset Investment Strategy, and the future management arrangements for the property portfolio arising from it, set out at Annexe B.

Corporate Priority Outcomes

Strong governance arrangements require resources to be directed in accordance with the agreed strategies and according to prudential indicators and operating boundaries, as set out in the Treasury Management Strategy.

It is important that there is sound and inclusive decision making and that there is clear accountability for the use of those resources in order to achieve desired outcomes for communities and service users.

The Audit Committee has the authority to determine the Recommendations.

Executive Summary

In the spring of 2018, the Government issued new guidance on Local Government's responsibilities for achieving accountability and transparency in relation to borrowing and investments. This was partly in response to an increasing level of investment in non-financial assets, often funded by borrowing.

The main changes brought about by the guidance, to which the Council has to 'have regard' from April 2019 are:

- An increase in the number of 'Prudential Indicators' to cover non-financial as well as financial investments;
- A requirement to produce a Capital Strategy, setting out how the Council evaluates, decides upon and manages capital spending, (including borrowing for investment purposes);
- A requirement to produce an Investment Strategy, setting out how the Council evaluates, decides upon and manages spending specifically for the purpose of financial return, ('investment').

This report meets the requirements of the new guidance, by producing the new indicators, alongside a Capital Strategy and a report on the implementation and future management of MVDC's Asset Investment Strategy.

However, the report needs to be seen as 'work in progress'. The Government guidance is extremely short on detail, and there is currently a wide interpretation of what is required, across different local authorities. This will be narrowed down as best practice is identified and potentially additional guidance issued.

This report will consequently evolve over time, and both its structure and content are likely to be materially different next year.

The structure of this report is:

- Treasury Management Strategy (the 'usual' report plus some additional Prudential Indicators). Appendices include the proposed Prudential Indicators for 2019/20, the Minimum Revenue Provision Statement, and the detailed Treasury Management Strategy for 2019/20 to 2021/22.
- Annexe A – Capital Strategy - the proposed Capital Strategy for 2019/20.
- Annexe B – Asset Investment Strategy – setting out the implementation of the Asset Investment Strategy and ongoing management arrangements for the resulting property portfolio.

1. Background

1.1 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.

1.2 Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, arising usually from capital expenditure, and are separate from the day to day treasury management activities.

1.3 Revised reporting is required for the 2019/20 reporting cycle due to revisions of the MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is being reported separately.

Treasury Management

1.4 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 risk appetite, providing adequate liquidity initially before considering investment return.

1.5 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.

1.6 On 20 February 2018, the Council agreed a proposal to inject a further £51m into the Asset Investment Strategy, thus doubling the total capital cost to £100m.

1.7 Legislation does not permit the Council to purchase assets purely for commercial purposes, and therefore the Council incorporated a holding company and subsidiary in 2016 (MOVA Property Ltd and MOVA Holdings Ltd) - both wholly owned by MVDC. The Council will borrow funds in order to invest in these companies to facilitate the acquisition of suitable low risk property assets.

1.8 The Capital expenditure programme for the three years ended 2021/22 indicates that the expenditure can be met from existing capital and revenue reserves, should the Council decide to increase the capital expenditure programme, it will be necessary to borrow additional funds or sell an asset and use the capital proceed to purchase the new asset.

1.9 The Treasury Management Strategy sets out the appropriate indicators, authorities, and boundaries within the Prudential Code, to enable the Council to borrow to fund its approved capital programme. The Code requires that these indicators are set and approved before the start of the financial year.

1.10 The Treasury Management Strategy fulfils four key legislative requirements, comprising the four sections listed below.

(i) Prudential Indicators – to demonstrate overall control of capital expenditure and that the level of expenditure is sustainable and affordable. They are required by legislation to be set and approved before the start of the year, monitored during the year and reported on at year end. They address:-

- Plans for capital expenditure – the projected capital expenditure for each of the next three years and the source of funding.
- Capital Financing Requirement – the anticipated need for borrowing where capital cannot be financed by existing resources.
- Comparison of borrowing estimate and capital financing requirement, to confirm that borrowing is intended for capital purposes only.
- Operational Boundary for external debt – is based on the Authority's estimate of most likely, ie prudent, but not worst case scenario for external debt.
- Authorised Limit for external debt – is the maximum amount of debt that the Authority can legally owe. The Authorised Limit provides headroom over and above the Operational Boundary for unusual cash movements.
- Debt to net service expenditure (NSE) ratio – gross debt as a percentage of net service expenditure, where net service expenditure is a proxy for the size and financial strength of a local authority.
- Commercial income to NSE ratio – dependence on non-fees and charges income to deliver core services. Fees and charges should be netted off gross service expenditure to calculate NSE.
- Investment cover ratio – the total net income from property investments, compared to the interest expense.
- Loan to value ratio – the amount of debt compared to the total asset value.
- To preserve liquidity, the maximum value of investments for more than one year.
- To assess interest rate exposure, the upper limit on variable, as opposed to fixed, interest rates for debt as well as investments.
- The maturity structure of fixed interest rate borrowing, to regulate the Council's exposure to large repayment requirements.

(ii) Minimum Revenue Provision

This sets out how the Council will calculate an appropriate amount to set aside towards the principal repayment of the borrowing incurred.

(iii) Treasury Management Strategy Statement

The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice. This statement sets out the parameters of day to day treasury management and the limitations on activity determined by the Prudential Indicators above.

(iv) Financial Investment Strategy

This sets out the Council's criteria for selecting investment counterparties and limiting its exposure to the risk of loss.

Investment in non-financial investments

1.11 Investment in non-financial investments, especially in property, do not generally form part of treasury management activities carried out by the treasury management team.

1.12 Treasury management investments represent the placement of cash in relation to the s12 Local Government Act 2003 Act investment powers, so the residual cash held in the bank resulting from the Council's day-to-day activities. These are invested under SLY (Security, Liquidity, Yield) principles.

1.13 Non-financial, or non-treasury investments tend to relate to s1 expenditure powers under the Act and be either of the following:

- Policy type investments, whereby capital or revenue cash is advanced for a specific council objective and will be approved directly through committee. This may be an advance to a third party for economic regeneration, or enable care facilities etc.
- Commercial type investments, whereby the objective is primarily to generate capital or revenue resources. These resources generated would then help facilitate council services.

1.14 **Financial Implications**

Are covered in the body of this report.

1.15 **Legal Implications**

In addition to the statutory requirements mentioned in the report, the prudential indicators, the treasury management strategy and annual plan must be approved before the start of the new financial year, in this case, 1st April, 2019.

2. Corporate Implications

Monitoring Officer commentary

The Monitoring Officer confirms that all relevant legal implications have been taken into account.

S151 Officer commentary

The S151 Officer confirms that all financial implications have been taken into account.

Risk Implications

The risks and the mitigation measures inherent in investing the Council's money in traditional treasury management investments have been well-rehearsed in previous TMS reports. Much of the content of the TMS is focussed on that risk. The strategy sets out the required reporting and approval of the Prudential Indicators, the requirement for affordable, sustainable and prudent capital plans, restrictions on the credit rating and nationality of counterparties, benchmarking of security, liquidity and yield and the related content of the Council's standing orders.

The risks relating to investment in non-financial assets are different and require a separate layer of mitigation measures. The procedures for selecting assets for purchase, the pre-purchase due diligence processes and the post purchase governance, review and monitoring are set up to address the risks in this area. They are explained within the Capital Strategy that is included elsewhere on this agenda.

Equalities Implications

There are no equalities implications arising as a direct consequence of this report.

Employment Issues

None identified in this report.

Sustainability Issues

None identified in this report

Consultation

Link Asset Services, Treasury Solutions are the Council's treasury management advisors and their views have been incorporated within this report.

Background Papers

CIPFA – The Prudential Code for Capital Finance in Local Authorities (2017).

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

CIPFA Treasury Management Guidance Notes (2018).

Link Asset Services Model Treasury Management Strategy Statement 2019/20.

The Council's latest Medium Term Financial Plan (MTFP).

MHCLG - Guidance on Local Government Investments ('the Guidance') (2018).

MHCLG Guidance on Minimum Revenue Provision 2012 (revised 2018).

Treasury Management (Internally Managed Funds) System Document – including Treasury Management Practices (TMPs).

List of Appendices

Appendix 1	List of 2019/20 Capital Prudential and Treasury Indicators
Appendix 2	The Capital Prudential Indicators 2019/20 – 2021/22 and the Minimum Revenue Provision (MRP) Statement
Appendix 3	Treasury Management Strategy 2019/20 – 2021/22 (including treasury management indicators)
Appendix 4	Treasury Management Practice (TMP) 1 – Credit and Counterparty Risk Management
Appendix 5	Security, Liquidity and Yield Benchmarking
Appendix 6	Approved countries for investments
Appendix 7	Treasury Management Clauses to form part of Standing Orders / Financial Regulations / Constitution
Appendix 8	Interest Rate Forecasts 2019-2022
Appendix 9	Economic Background

List of Annexes

Annexe A	Capital Strategy
Annexe B	Asset Investment Strategy

APPENDIX 1

2019/20 CAPITAL PRUDENTIAL AND TREASURY INDICATORS

The Indicators demonstrate overall control of capital expenditure and that the level of expenditure is sustainable and affordable. They are required by legislation to be set and approved before the start of the year, monitored during the year and reported on at the year end.

They address:-

1. Plans for capital expenditure – the projected capital expenditure for each of the next three years and the source of funding.

2. Capital Financing Requirement – the anticipated need for borrowing where capital cannot be financed by existing resources.

3. Affordability Indicator – the ratio of capital financing costs to the net revenue budget.

4. Comparison of borrowing estimate and capital financing requirement, to confirm that borrowing is intended for capital purposes only.

5. Operational Boundary for external debt – is based on the Authority's estimate of most likely - i.e. prudent, but not worst case scenario for external debt.

6. Authorised Limit for external debt – is the maximum amount of debt that the Authority can legally owe. The Authorised Limit provides headroom over and above the Operational Boundary for unusual cash movements.

7. Debt to net service expenditure (NSE) ratio – gross debt as a percentage of net service expenditure, where net service expenditure is a proxy for the size and financial strength of a local authority.

8. Commercial income to NSE ratio – dependence on non-fees and charges income to deliver core services. Fees and charges should be netted off gross service expenditure to calculate NSE.

9. Investment cover ratio – the total net income from property investments, compared to the interest expense.

10. Loan to value ratio – the amount of debt compared to the total asset value.

11. To preserve liquidity, the maximum value of investments for more than one year.

12. To assess interest rate exposure, the upper limit on variable, as opposed to fixed, interest rate investments and debt.

13. The maturity structure of fixed interest rate borrowing, to regulate the Council's exposure to large repayment requirements.

APPENDIX 2

The Capital Prudential Indicators 2019/20-2021/22

Introduction

1. The Local Government Act 2003 requires the Council to adopt the CIPFA Prudential Code and produce prudential indicators. Each indicator either summarises the expected capital activity or introduces operating boundaries upon that activity, and reflects the outcome of the Council's underlying capital appraisal systems. The Council is asked to approve the prudential indicators set out below for the period up to 2021/22. The prudential indicators are revised and updated annually, so the figures for the second and third years are indicative at this stage.

2. Within this overall prudential framework there is an impact on the Council's treasury management activity, as it will directly impact on borrowing or investment activity. The treasury management strategy for 2019/20–2021/22 is included in Appendix B to complement these indicators. Some of the prudential indicators are shown in the treasury management strategy to aid understanding.

The Capital Expenditure Plans

3. The Council's capital expenditure plans are the key driver of treasury management activity and are reflected in the prudential indicators.

4. The Council's capital expenditure plans are summarised overleaf and this forms the first of the prudential indicators. The figures represent forecasts of capital expenditure in the year. This shows individual capital schemes and their projected full cost in the year in which they are scheduled to start. A certain level of capital expenditure is grant supported by the Government (e.g. for Mole Valley, grants towards disability adaptations). Any decisions by the Council to spend above this level will be "unsupported" capital expenditure. This unsupported capital expenditure needs to have regard to:

    - Service objectives (e.g. strategic planning);
    - Stewardship of assets (e.g. asset management planning);
    - Value for money (e.g. option appraisal);
    - Prudence and sustainability (e.g. implications for external borrowing and whole life costing);
    - Affordability (e.g. implications for the council tax and rents);
    - Practicality (e.g. the achievability of the Corporate Plan).

5. The revenue consequences of unsupported capital expenditure will need to be paid for from the Council's own resources.

6. This capital expenditure can be paid for immediately (by applying capital resources such as capital receipts, capital grants or revenue resources), but if these resources are insufficient any residual capital expenditure will add to the Council's borrowing need.

7. A key risk to the plans is that the level of Government support may be subject to change. Similarly, some estimates for other sources of funding, such as capital receipts, may also be subject to change over this timescale. For instance, slow down or a lack of developer contributions, implementation of the Community Infrastructure Levy (CIL) arrangements or due to Government legislation amendments e.g. the change in policy in November

2014 which reduced the developer contributions towards affordable housing on small-scale developments.

8. The Council is asked to approve the summary capital expenditure projections below. The levels of expenditure for 2018/19 to 2021/22 include the Asset investment Strategy (AIS). For the purpose of these indicators, it is also assumed that investment of the AIS funding may happen at any time from the day after its approval to the end of its three year duration. The assumption is applied across all indicators and ensures consistency. Due to the potential movement in interest rates and possible volatility in the property market the balance of £7m from the AIS will remain unspent.

Prudential Indicator 1 – Capital Expenditure Plans

Capital	**2017/18 Actual**	**2018/19 Forecast Outturn £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**
Capital Expenditure	48.792	59.467	3.071	2.324	2.374
Financed by:					
Capital reserves	-2.000	-3.147	-1.171	-0.409	-0.459
Government grants	-0.665	-0.665	-0.665	-0.665	-0.665
Other grants and contributions	-2.588	-0.310	-0.565	-0.750	-0.750
Revenue	-0.313	-0.620	-0.670	-0.500	-0.500
Net financing need for the year	**43.226**	**54.725**	**0.000**	**0.000**	**0.000**

The Council's Borrowing Need (the Capital Financing Requirement)

9. The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is that element of historic capital expenditure which has not yet been paid for through capital or revenue resources. It therefore reflects the underlying need to finance capital expenditure by borrowing or other long-term liability arrangements

10. In addition to the proposed borrowing, some of our contract arrangements are deemed to constitute 'finance leases' and are therefore long-term liabilities for the purpose of these regulations.

11. The Council is asked to approve the CFR projections below:

Prudential Indicator 2 – CFR Projections

	2017/18 Actual £m	2018/19 Forecast Outturn £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
Capital Financing Requirement (CFR)	57.619	111.326	109.251	107.176	105.101

Net financing need for the year (above)	43.486	54.725	0.000	0.000	0.000
Less MRP and other financing movements	-0.260	-1.018	-2.075	-2.075	-2.075
Movement in CFR	43.226	53.707	-2.075	-2.075	-2.075

12. The Council is required to pay off an element of the accumulated capital spend each year (the CFR) through a revenue charge (the Minimum Revenue Provision - MRP).

13. The Council is recommended to approve the following MRP Statement.

MRP Statement

The Council will use the Asset Life Method as its main method of applying MRP - i.e. MRP will be based on the estimated life of the assets – in equal instalments.

<u>Loans Made to Companies Wholly Owned By the Council</u>

The amount of MRP to be set aside in respect of loans for capital purposes made to companies wholly owned by the Council will be assessed on the basis of the degree of certainty that such loans will be repaid in full. The Council will, annually, obtain evidence from the company that:

(i) the value of any assets against which the senior loan(s) are secured exceed the value of the loan(s) outstanding, and

(ii) in the case of unsecured junior loan(s) the Council must determine whether the assets of the company would be sufficient to repay these loans once all outstanding secured, senior loans have been repaid.

This evidence, and any other relevant factors, will be used by the Council to assess the certainty of repayment.

For 201920, given the strength of the company's finances and the value of the assets recently obtained, the Council will set aside MRP equivalent to 2% of the total value of each outstanding loan made for capital purposes as a provision against future repayment uncertainty.

Where the Council has any doubt about the company's ability to repay each loan in full, they will consider a range of options to mitigate this risk, including setting aside additional amounts of MRP in respect of the amounts that are expected not to be recovered over the residual period of the loans outstanding. The Council will be able to take into account any amounts of

MRP already set aside in respect of future repayment uncertainty relating to each loan.

Where loans for capital purposes are made to companies wholly owned by the Council, no MRP will be charged if the company is making annual loan repayments to the Council. The Council will treat these repayments as capital receipts which will be set aside to redeem debt.

Finance leases

In the case of Finance Leases, the MRP requirement is regarded as met by a charge equal to the rent or charge (as applicable) element of the write down of the liability.

14. The application of resources (capital reserves (receipts), other reserves etc.) to either finance capital expenditure or other 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.). Detailed below are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

	2017/18 Actual £m	**2018/19 Forecast Outturn £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**
Fund Balances/Reserves	3.497	2.282	2.282	2.282	2.282
Capital Reserves	2.754	2.360	2.474	3.165	3.806
Earmarked Reserves	10.071	10.071	10.071	10.071	10.071
Total Core Funds	**16.322**	**14.713**	**14.827**	**15.518**	**16.159**
Working Capital *	2.000	2.000	2.000	2.000	2.000
Expected Investments	**18.322**	**16.713**	**16.287**	**17.518**	**18.159**
Investments Change	**-3.595**	**-1.609**	**-0.426**	**1.231**	**0.641**

* Working capital balances shown are estimated year end, these may be higher mid-year.

Affordability Prudential Indicators

15. The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

16. **Ratio of financing costs to net revenue stream** – This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

Prudential Indicator 3 – Ratio of financing costs to net revenue stream

	2017/18 Actual £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
Net Financing Cost (Borrowing)	0.636	0.337	1.248	1.244	1.204
Net Financings (TM Investments)	-0.374	-0.325	-0.325	-0.325	-0.325
Revenue Budget	9.630	9.068	9.533	8.743	9.060
Ratio	**2.72%**	**0.13%**	**9.68%**	**10.51%**	**9.70%**

17. The estimates of financing costs include current commitments and proposals to be included in the 2019/20 budget report.

Appendix 3

Treasury Management Strategy 2019/20 – 2021/22

1. This Authority adopts the following form of words to define the policies and objectives of its treasury management activities:

   This Authority defines its treasury management activities as:

   - The management of the 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.
   - This Authority 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 Authority.
   - This Authority acknowledges 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.

2. The treasury management service is an important part of the overall financial management of the Council's affairs. The prudential and treasury indicators identified in Appendix A consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital framework. The treasury service considers the effective funding of these decisions. Together they form part of the processes that ensure the Council meets its balanced budget requirement under the Local Government Act 2003.
3. The Council's treasury activities are strictly regulated by statutory requirements (the Local Government Finance Act 2003, the CIPFA Prudential Code, CLG MRP and investment guidance) and a professional code of practice (the CIPFA Code of Practice on Treasury Management – revised 2017).
4. As a result of adopting the Code the Council also adopted a Treasury Management Policy Statement. The Treasury Management Policy Statement is appended at Appendix 7.
5. The Council's Constitution requires an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks and the management of the risks associated with the treasury service. A further treasury report is produced monitoring the mid-year position as well as a report after the year-end detailing the actual activity for the year. The above reports are required to be adequately scrutinised before being recommended to Council. The scrutiny role is undertaken by the Audit Committee.
6. This Strategy covers:
   - Debt and investment projections (including the Operational Boundary);
   - Limits to borrowing activity (including the Authorised Limit for external debt);
   - Expected movement in interest rates;
   - Borrowing strategy;
   - Investment strategy;
   - Economic investment considerations;

- Sensitivity to interest rate movements;
- Treasury management limits on activity;
- Additional treasury issues.

Debt and Investment Projections 2018/19 – 2020/21

Prudential Indicator 4 - Gross Borrowing and Long-term Liabilities and the Capital Financing Requirement (CFR).

7. In order to ensure that borrowing will only be for a capital purpose, the Council should ensure that gross external borrowing does not, except in the short-term, exceed the total CFR (ie the underlying capital borrowing need).

	2017/18 Actual £m	2018/19 Forecast Outturn £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
External debt					
Debt at 1st April	10.000	50.000	102.850	102.850	102.850
Expected change in debt	40.000	52.850	0.000	0.000	0.000
Other long-term liabilities (OLTL) at 1st April	1.752	1.734	1.716	1.698	1.680
Expected change in OLTL	-0.018	-0.018	-0.018	-0.018	-0.018
Actual gross debt at 31st March	51.734	104.566	104.548	104.530	104.512
Capital Financing Requirement	57.619	111.326	109.251	107.176	105.101
Under/(over) borrowing	-5.885	6.760	4.703	2.646	589
Gross Debt Exceeds CFR	Yes	No	No	No	No

Treasury Indicators: Limits to Borrowing Activity

8. Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well-defined boundaries

9. One of these is that the Council needs to ensure that its total borrowing 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 2018/19 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

10. The Deputy Chief Executive (Section 151 Officer) 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 proposals that will be included in the 2018/19 budget report.

11. The borrowing requirement comprises the expected movement in the CFR and any maturing debt that will need to be re-financed. The table below shows this effect on the treasury position over the next three years.

The Prudential Indicator that specifies the **Operational Boundary** is an indicator based on the expected maximum external debt during the course of the year and focuses on day-to-day treasury management activity. It is not a limit in the strictest sense in that it may be breached. The Operational Boundary represents a level of short-term indebtedness that the Deputy Chief Executive (Section 151 Officer) considers would be prudent to cover any unforeseen circumstance that may arise in the management of the Council's day-to-day cash flow activities. The Council has a policy of never going into overdraft. The Council intend to keep the Operational boundary at £129.5m for the three years to 2021/22. This upper boundary is lower than the Authorised Limit (Prudential Indicator, below) which allows cash flow activities to lead to occasional, but not sustained, breaches of the Operational Boundary.

12. Both the Operational Boundary and the Authorised Limit are set at levels in excess of £120m for the next three years. This reflects the inclusion of £100m expenditure for Asset Investment in the capital programme. The Operational Boundary links directly to the Council's estimates of the CFR and estimates of other cash flow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent, but not worst case scenario but without the additional headroom included within the Authorised Limit.

13. The Deputy Chief Executive (Section 151 Officer) has the authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on consideration of the risk the Council may be exposed to in the course of pursuing its responsibilities and it is considered the current spread of the Council's investment portfolio provides sufficient capacity to counteract any adverse economic news regarding security of financial institutions. Any movement between these separate limits would be reported to the Audit Committee.

Prudential Indicator 5 – Operational Boundary

Operational Boundary	2017/18 Actual £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
Debt	48.226	107.951	112.951	117.951	122.951
Other long-term liabilities	1.752	1.734	1.716	1.698	1.680
Total	**49.978**	**109.685**	**114.667**	**119.649**	**124.631**

14. **Prudential Indicator: The Authorised Limit for External Debt** – A further key indicator represents a control on the overall level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by full Council. It reflects the level of external debt that, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

15. 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 no control has yet been exercised.

16. The Council is asked to approve the following Authorised Limit:

Prudential Indicator 6 – Authorised Limit

Authorised Limit	2017/18 Actual £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2022/22 Estimate £m
Debt	53.226	112.951	117.951	122.951	127.951
Other long term liabilities	1.930	1.910	1.890	1.870	1.850
Total	**55.156**	**114.861**	**119.841**	**124.821**	**129.801**

17. Borrowing in advance of need – The Council has some flexibility to borrow funds in year for use in future years. The Deputy Chief Executive (Section 151 Officer) may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. Whilst the Deputy Chief Executive (Section 151 Officer) will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme.

18. Risks associated with any advance borrowing activity will be subject to appraisal in advance and subsequent reporting through the mid-year or annual reporting mechanism.

19. **Prudential Indicator 7 - Debt to net service expenditure (NSE) ratio**

Debt to net service Expenditure (NSE) ratio	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Gross debt to net service expenditure	15.47:1	16.86:1	16.27:1

20. **Prudential Indicator 8 - Commercial income to NSE ratio**

Commercial income to NSE ratio	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Dependence on non-fee and charges income to deliver core services	10.55:1	10.34:1	10.14:1

21. **Prudential Indicator 9 - Investment cover ratio**

Investment cover ratio	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Investment Cover Ratio	3.63	3.63	3.63

22. **Prudential Indicator 10 - Loan to value ratio**

Loan to value ratio	2019/20	2020/21	2021/22

	Estimate	Estimate	Estimate
Total debt compared to total asset value	33.77%	33.6%	33.42%

Borrowing Strategy 2019/20 – 2021/22

23. The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing in any particular year.

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

25. **Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer term stability of the debt portfolio. With interest rates currently low, the Council has fixed its borrowing for the longer term to give certainty of cost. However for future borrowings it may be more cost effective to borrow for a shorter period and then renew or to use internal resources where available.

26. In addition, the Council may borrow short-term loans (normally for up to one month) to cover unexpected cash flow shortages.

27. **Sources**: The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except Surrey Pension Fund)
- UK Municipal Bond agency Plc, such as the LGA bond company, created to enable local Council bond issues
- Local Enterprise Partnership

28. In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- operating and finance leases
- hire purchase
- Private Finance Initiative (PFI)
- sale and leaseback

29. The Council will generally raise all of its long-term borrowing from the PWLB but will continues to investigate other sources of finance, such as local Council loans and bank loans, that may be available at more favourable rates. Currently the Council has borrowed £102.85m from the PWLB.

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

31. **Debt Rescheduling**: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

32. The Council commenced borrowing to fund the capital programme during 2016/17, and going forward it will be necessary to fund at least part or all future capital programmes from borrowing. This is reflected in the revised Operational Boundary and Affordable Limits set out above.

Annual Investment Strategy

Investment Policy

33. The Council's Investment Policy has regard to the Ministry of Housing, Communities and Local Government's (MHCLG) Guidance on Local Government Investments ('the Guidance') and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ('the CIPFA Treasury Management (TM) Code').

34. In accordance with the above guidance from the MHCLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk.

35. Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the short-term and long-term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.

36. As with previous practice, ratings will not be the sole determinant of the quality of an institution and that 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 this end 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.

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

38. Investment instruments identified for use in the financial year are listed in Appendix 4 under the 'specified' and 'non-specified' investment categories.

39. **Key Objectives -** The Council's primary objectives for its investment strategy are safeguarding the repayment of the principal and interest of its investments on

time first and ensuring adequate liquidity second. The investment return being a third objective. Following the economic background (Appendix 9), the current investment climate has one over-riding risk consideration that of counterparty security risk.

40. **Risk Benchmarking** – A development in the revised Codes and the Ministry of Housing, Communities and Local Government (MHCLG) is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are fairly new requirements to the Member reporting, although the application of these is more subjective in nature. Additional background in the approach taken is attached at Appendix 5.

41. These benchmarks are broad limits and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers' will monitor the current and trend position and amend the operational strategy depending on any changes. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

42. **Security** - The Council's maximum security risk benchmark for the current portfolio, when compared to historic default tables, is:

    - 0.05% historic risk of default when compared to the whole portfolio.

    Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

43. **Liquidity** – In respect of this area the Council seeks to maintain:

    - Bank overdraft - £100,000
    - Liquid short-term deposits of at least £1m available with a week's notice.

44. **Yield** - Local measures of yield benchmarks are:
    - Investments – Internal returns above the 7-day LIBID (London Interbank BID) rate.

45. **Creditworthiness policy** - The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure:

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

46. The Deputy Chief Executive (Section 151 Officer) will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. The criteria is separate to that which chooses Specified and Non-Specified investments as it provides an overall pool of counterparties considered high quality that the Council may use rather than defining what its investments are.

47. Credit rating information is supplied by our treasury consultants on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) 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.

48. The criteria for providing a pool of high quality investment counterparties both Specified and Non-Specified investments are; (refer to Appendix 4 for a definition of each)

- Banks 1 - Good Credit Quality – the Council will only use banks which:

  (a) are UK banks (it should be noted that 'Banks 1' criteria <u>does not</u> rely upon the UK sovereign rating remaining at AA); and/or

  (b) are non-UK and domiciled in a country which has a minimum sovereign long term rating of AAA (see Appendix 6).

  And have, as a minimum, the following credit ratings (where rated):

  (a) Short Term – F1/P-2/A-1 (Fitch/Moody's/Standard and Poor's)

  (b) Long Term – A/A3/A (Fitch/Moody's/Standard and Poor's)

- Banks 2 – Guaranteed Banks with suitable Sovereign Support – In addition, the Council will use banks whose ratings fall below the criteria specified above if all of the following conditions are met:

  (a) wholesale deposits in the bank are covered by a government guarantee;

  (b) the government providing the guarantee is rated 'AAA' by all three major rating agencies (Fitch, Moody's and Standard & Poor's); and

  (c) the Council's investments with the bank are limited to amounts and maturities within the terms of the stipulated guarantee.

- Banks 3 – Part nationalised UK bank – Royal Bank of Scotland. This bank can be included provided it continues to be part nationalised or it meets the ratings in Banks 1 above.

- Banks 4 – The Council's own banker, National Westminster Bank, for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time invested.

- Building Societies – the Council may use all UK Societies which:

  - have assets in excess of £1 billion

- Money Market Funds (MMFs) – any AAA rated fund

- UK Government (including gilts and the DMADF (Debt Management Account Deposit Facility)).

- Supranational bonds

- Local Authorities, Parish Councils etc – the maximum permitted investment with any one bank/building society/fund is £7.5million (as agreed by Council – 22nd February 2011).

A upper boundary of 60% will be applied to the use of Non-Specified investments.

49. **Country and sector considerations** - Due care will be taken to consider the country, group and sector exposure of the Council's investments. In part the country selection will be chosen by the credit rating of the Sovereign state in Banks 1 above. In addition:

- no more than 20% will be placed with any non-UK country at any time;

- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

50. **Use of additional information other than credit ratings** – Additional requirements under the Code of Practice now requires the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps (CDS), negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

51. **Time and monetary limits applying to investments** - The time and monetary limits for institutions on the Council's Counterparty List are as follows (these will cover both Specified and Non-Specified Investments):

	Fitch (or equivalent)	**Money Limit**	**Time Limit**
Upper Limit Category – UK Banks and Building Societies	A (Minimum long-term credit rating)	£7.5m	5 years
Middle Limit Category – UK Banks and Building Societies	F1 (Minimum short-term credit rating)	£7.5m	1 year
Lower Limit Category – UK Banks and Building Societies	F1 (Minimum short-term credit rating)	£7.5m	1 year
Group Limit (Parent Companies and all subsidiaries)	F1 (Minimum short-term credit rating)	£7.5m	1 year
Other Institution Limits (see note below)	-	£7.5m	1 year
Guaranteed Organisations*	**-**	£7.5m	*****

* Guaranteed institutions will be restricted to the terms of the guarantee.

Note: The Upper and Middle Limit categories - If these are for greater than 1 year, they will include relatively high rated institutions (A). The Lower Limit Category will normally just be used for unrated subsidiaries and building societies. In all cases building societies will have a minimum asset base of £1bn. The Other Institution Limit will be for other local authorities, the Debt Management Account Deposit Facility (DMADF), Money Market Funds and Gilt and Supranational investments. These are all considered high quality names – although not always rated – and therefore will likely have the same limit as the Upper Category.

52. The proposed criteria for Specified and Non-Specified investments are shown in Appendix 4 for approval.

53. In the normal course of the Council's cash flow operations it is expected that both Specified and Non-Specified investments will be utilised for the control of liquidity as both categories allow for short-term investments.

54. The use of longer-term instruments (greater than one year from inception to repayment) will fall in the Non-Specified Investment category. These instruments will only be used where the Council's liquidity requirements are safeguarded. This will also be limited by the longer-term investment limits.

55. **Country Limits** - The Council currently limits its investment criteria to entities domiciled in the UK, although the Strategy does allow use of foreign banks as long as they meet the minimum long-term credit rating of A and sovereign rating of AAA. When combined with the prudent credit criteria, this means that potential financial institutions will be limited. Given the expected total investments this means that the current £7.5m limit may force the Council to either invest with other local authority bodies or direct with the UK government via the Debt Management Office (DMO) deposit facility. Both of these options will likely act as a drag on overall investment performance.

Economic Investment Considerations

56. **In-house funds** – investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (ie rates of investments up to 12 months). During the first six months of 2016/17 funds were moved from short-term investments where interest rates were performing at historically low levels. These funds were re-invested in, better performing, property purchases that generated a rental income. This trend has continued in 2018/19 leaving only a sufficient level of funds to meet day to day cash flow requirements.

57. **Investment returns expectations** - the Bank Rate was increased by 0.25% to 0.75% on 2nd August 2018. Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1 2022. Bank Rate forecasts for financial year ends (March) are:

- 2018/19 0.75%
- 2019/20 1.25%
- 2020/21 1.50%
- 2021/22 2.00%

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

- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.50%

- 2021/22 1.75%
- 2022/23 1.75%
- 2023/24 2.00%
- Later years 2.50%

The overall balance of risks to economic growth in the UK is probably neutral.

The balance of risks to increases in Bank Rate and shorter term PWLB rates, are proabably also even and are dependent on how strong GDP growth turns out, how slowly inflation pressures subside and how quickly the Brexit negotiations move forward positively.

58. **Investment treasury indicator and limit** - total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

Prudential Indicator 11 – Principal Sums Invested > 365 days

59. Total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment and are based on the availability of funds after each year end.

Maximum principal sums invested > 365 days			
	2019/20	**2020/21**	**2021/22**
Principal sums invested > 365 days	£10m	£10m	£10m

Sensitivity to Interest Rate Movements

60. Future Council accounts will be required to disclose the impact of risks on the Council's treasury management activity. Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is discussed but not quantified. The table below highlights the estimated impact of a 1% increase/decrease in all interest rates to the estimated treasury management costs/income for next year. That element of the debt and investment portfolios which are of a longer term, fixed interest rate nature, will not be affected by interest rate changes.

Revenue Budgets	**2019/20 Estimated + 1%**	**2019/20 Estimated - 1%**
Interest on borrowing	£850,000	£850,000
Investment income	£250,000	£250,000

Treasury Management Boundaries on Activity

61. There are three further treasury activity boundary. The purpose of these are to contain the activity of the treasury function within certain boundaries, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. The indicators are:

- Upper boundaries on variable interest rate exposure – This identifies a maximum boundary for variable interest rates based upon the debt position net of investments.
- Upper boundaries on fixed interest rate exposure – This is similar to the previous indicator but covers a maximum boundary on fixed interest rates.
- Maturity structures of borrowing – These gross boundaries are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower boundaries.

62. The Audit Committee is asked to approve the boundaries:

Prudential Indicator 12 – Interest Rate Exposures

Interest rate exposures	**2019/20**	**2020/21**	**2021/22**
	Upper	**Upper**	**Upper**
Boundary on variable interest rates:			
• Debt only	0%	0%	0%
• Investments only	50%	50%	50%
Boundary on fixed interest rates:			
• Debt only	100%	100%	100%
• Investments only	100%	100%	100%

Prudential Indicator 13 – Fixed and Variable Interest Rate Borrowing

Maturity Structure of fixed interest rate borrowing 2019/20		
	Lower	**Upper**
Under 12 months	0%	50%
12 months to 2 years	0%	0%
2 years to 5 years	0%	0%
5 years to 10 years	0%	0%
10 years and above	0%	100%

Maturity Structure of variable interest rate borrowing 2019/20		
	Lower	**Upper**
Under 12 months	0%	0%

12 months to 2 years	0%	0%
2 years to 5 years	0%	0%
5 years to 10 years	0%	0%
10 years and above	0%	0%

Additional treasury issues

Performance Indicators

63. The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. These are:

- Investments – Internal returns above the 7 day LIBID rate

The results of these indicators will be reported in the Treasury Management Annual Report.

Treasury Management Advisors

64. The Council uses Link Asset Services, Treasury Solutions as its external treasury management advisors.

The company provides a range of services that include:

- Technical support on treasury matters and capital finance issues;
- Economic and interest rate analysis;
- Generic investment advice on interest rates, timing and investment instruments;
- Credit ratings/market information service comprising the three main credit rating agencies;
- Attendance at member/officer treasury management review meetings.

65. Whilst the advisors provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice, the final decision on treasury matters remains with the Council.

66. This service is subject to regular review.

Member and Officer Training

67. The increased Member consideration of treasury management matters and the need to ensure officers dealing with treasury management are trained and kept up to date requires a suitable training process for members and officers. This Council has addressed this important issue by:

- The training needs of treasury management officers' are periodically reviewed.
- Members' attendance at meetings with our treasury advisors.

Other issues

68. **IFRS9 (Financial Instruments)** – risk management will need to take account of the 2018/19 Accounting Code of Practice proposals for the valuation of investments.

Key considerations are:-

- Expected credit loss model (change in credit quality since initial recognition)
- As a result of the change in accounting standards for 2018/19 this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund.

The Government has recently introduced a mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds. This will be effective from this financial year, 1st April 2018. The statutory override applies for five years from this date.

69. **IFRS16 (Leasing)** – CIPFA has decided to recommend to Government that implementation of IFRS16 should be delayed by one year until 2020/21 in the public sector. This will ensure that public sector accounts will be aligned to the Whole of Government Accounts. At the time of writing this report Government have yet to give a decision on the consultation.

Treasury Management Practice (TMP) 1 – Credit and Counterparty Risk Management

The Council's investment policy has regard to MHCLG Guidance on Local Government Investments ('the Guidance') issued in 2018 and the 2017 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ('the Code') and CIPFA Treasury Management Guidance Notes (2018). The Council's investment priorities will be **security** first, **liquidity** second and finally **yield**.

The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, as managed by the treasury management team. Non-financial investments, essentially the purchase of income yielding asserts, are covered in the Capital Strategy, shown elsewhere on this agenda.

The Guidance forms the structure of the Council's policy below.

The key intention of the Guidance is to maintain the current requirement for Councils' to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the Guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code on 23rd February, 2010 and will apply its principles to all investment activity. In accordance with the Code, the Deputy Chief Executive (Section 151 Officer) has produced treasury management practices (TMPs). This part, TMP 1(1), covering investment counterparty policy requires approval each year.

Annual Investment Strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury management strategy for the following year, covering the identification and approval of the following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than 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 investment policy proposed for the Council is:

Strategy Guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified Investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments that would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account Deposit Facility, UK Treasury Bills or a Gilt with less than one year to maturity).

2. Supranational bonds of less than one year's duration.
3. A local authority, housing association, parish council or community council.
4. Pooled investment vehicles (such as money market funds) that have been AAA rated by Standard and Poor's, Moody's or Fitch rating agencies.
5. A body that is considered of a high credit quality (such as a bank or building society). Although non-rated building societies are classified as non-specified investments. For category 5 this covers bodies with a minimum short term rating of F1/P-2/A-1 as rated by Fitch, Moody's or Standard and Poor's rating agencies.

Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies. This criterion is detailed in paragraph 51 of Appendix 2.

Non-Specified Investments – Non-specified investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non-specified investments would include any sterling investments with:

	Non Specified Investment Category	**Limit**
a.	**Supranational Bonds greater than 1 year but less than 5 years to maturity** **(a) Multilateral development bank bonds** - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Investment Bank etc.). **(b) A financial institution that is guaranteed by the United Kingdom Government** (e.g. The Guaranteed Export Finance Company (GEFCO)). The security of interest and principal on maturity is on a par with the Government and so very secure, and these bonds usually provide returns above equivalent gilt-edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	£7.5m
b.	**Gilt edged securities** with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	£7.5m
c.	The **Council's own banker** (National Westminster Bank Plc) if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.	£7.5m
d.	**Building societies not meeting the basic security requirements under the specified investments**. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The Council may use such building societies which have a minimum asset size of £1 billion, but will restrict these type of investments to £7.5 million	£7.5m
e.	Any **bank or building society** that has a minimum long-term credit rating of A for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	£7.5m
f.	Any **non-rated subsidiary** of a credit rated institution included in the specified investment category. These institutions will be included as an	£5m

	investment category subject to guarantee from the parent company.	
g.	**Pooled property funds** – the use of these instruments can be deemed as capital expenditure and as such will be an application (spending) of capital resources.	£7.5m

Within categories c and d, and in accordance with the Code, the Council has developed additional criteria to set the overall amount of monies that will be invested in these bodies. This criterion is detailed in Appendix B.

The Monitoring of Investment Counterparties - The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Link Asset Services as and when ratings change and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Deputy Chief Executive (Section 151 Officer) and if required new counterparties which meet the criteria will be added to the list. Any urgent and immediate changes that are required to the Treasury Management (TM) Strategy will be directed to the Cabinet Member for Finance, Performance and Risk, Chairman of Audit Committee as well as the Deputy Chief Executive (Section 151 Officer). If all are in agreement the TM Strategy and Treasury Management Practices (TMP's) will be modified to reflect this change. Ultimately any change will be ratified at the next available Council meeting after having been considered at the first available meeting of the Audit Committee.

Use of External Fund Managers – It is the Council's policy to use external fund managers for part of its investment portfolio. On 30th June 2013 the Council invested £5m in the Charities, Churches and Local Authorities (CCLA) Property Fund. This is a high quality, well diversified managed property fund. To realise the full potential of this investment it should be considered as a medium to long term placement. Income is received quarterly and in the current economic climate good yields have been received.

The Fund Manager will use non-specified investment categories and are committed to keep to the Council's investment strategy. The performance of the Fund Manager is reviewed monthly by the Deputy Chief Executive (Section 151 Officer).

All other investments are managed by the in-house team.

Policy on the use of external service providers

The Council uses Link Asset Services, Treasury Solutions as its external treasury management advisor.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

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 will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented and subjected to regular review.

Appendix 5

Security, Liquidity and Yield Benchmarking

Benchmarking and Monitoring Security, Liquidity and Yield in the Investment Service - A development for Member reporting are the consideration and approval of security and liquidity benchmarks. These benchmarks are targets and so may be breached from time to time. Any breach will be reported, with supporting reasons in the Mid-Year or Annual Treasury Report.

Yield – These benchmarks are currently widely used to assess investment performance. Local measures of yield benchmarks are:

- Investments – internal returns above the 7-day LIBID rate

Security and liquidity benchmarks are already intrinsic to the approved treasury management strategy through the counterparty selection criteria and some of the prudential indicators. Benchmarks for cash type investments are shown below and these form the basis of reporting in this area. In the other investment categories, appropriate benchmarks will be used where available.

Liquidity – This is defined as 'having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives' (CIPFA Treasury Management Code of Practice). In respect of this area the Council seeks to maintain:

- Bank overdraft - £100,000
- Liquid short-term deposits of at least £1m available with a week's notice.

The Authority, with the help of its treasury advisor, has developed further benchmarking analysis by the monitoring of the Weighted Average Life (WAL) of the portfolio. This is done by analysing the availability of liquidity and term risk in the portfolio. A shorter WAL would embody less risk. The investment policy that is proposed for internally managed funds is shown in Appendix 4.

Security of the investments – In the context of benchmarking security is a much more subjective area to assess. Security is currently evidenced by the application of minimum credit quality criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody's and Standard and Poor's). Whilst this approach embodies security considerations, benchmarking levels of risk is more problematic. One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy. The table beneath shows average defaults for differing periods of investment grade products for each of the three main credit rating agencies long term rating categories over the period 1990 to 2017.

Long term rating	1 year	2 years	3 years	4 years	5 years
AAA	0.04%	0.10%	0.18%	0.27%	0.36%
AA	0.02%	0.04%	0.10%	0.17%	0.24%
A	0.05%	0.15%	0.28%	0.42%	0.59%

BBB	0.16%	0.44%	0.77%	1.15%	1.55%
BB	0.71%	2.00%	3.47%	4.92%	6.22%
B	2.90%	7.00%	10.67%	13.74%	16.12%
CCC	18.74%	26.47%	31.60%	35.37%	38.17%

The Council's minimum long term rating criteria is currently A, meaning the average expectation of default for a one year investment in a counterparty with a long term rating would be 0.05% of the total investment (eg for a £1m investment the average loss would be £500). This is only an average, any specific counterparty loss is likely to be higher, but these figures do act as a proxy benchmark for risk across the portfolio.

The Council's maximum security risk benchmark for the whole portfolio, when compared to these historic default tables is:

- **0.05% historic risk of default when compared to the whole portfolio.**

These benchmarks are embodied in the criteria for selecting cash investment counterparties and these will be monitored and reported to Members in the Treasury Management Annual Report. As this data is collated, trends and analysis will be collected and reported. Where a counterparty is not credit rated a proxy rating will be applied.

Appendix 6

Approved countries for investments
(as at 8th January 2019)

This list is based on those countries which have a sovereign ratings of AA- or higher (information supplied by Fitch, Moody's and Standard and Poors).

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- USA

AA

- Abu Dhabi (UAE)
- France
- Hong Kong
- **UK**

AA-

- Belgium
- Qatar

Appendix 7

Treasury Management Clauses to form part of Standing Orders/Financial Regulations/Constitution

1. The Council adopts the key recommendations of the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services; Code of Practice.

2. The Section 151 Officer will ensure that treasury management activities are administered within the parameters defined and agreed by Council and those defined by statutory requirements and professional best practice.

3. The Section 151 Officer will define and propose for agreement by Council, a treasury management policy statement, stating the policies, objectives and approach to risk management in keeping within the above Code's recommendations and will monitor these throughout the year.

4. The Audit Committee is responsible for ensuring effective scrutiny of the treasury management strategy and activity. The Section 151 Officer will submit reports on its treasury management policies, practices and activities including an annual Treasury Management Strategy, a mid-year review and an annual report after the end of the financial year, in the form prescribed in its Treasury Management Practices (TMPs).

Interest Rate Forecasts 2019 - 2022 **Appendix 8**

PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of 01/11/12.

Link Asset Services Interest Rate View	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%
Bank Rate													
Link Asset Services	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
Capital Economics	0.75%	1.00%	1.25%	1.50%	1.70%	1.75%	2.00%	2.00%	-	-	-	-	-
5yr PWLB Rate													
Link Asset Services	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
Capital Economics	2.03%	2.15%	2.40%	2.65%	2.70%	2.75%	2.80%	2.85%	-	-	-	-	-
10yr PWLB Rate													
Link Asset Services	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
Capital Economics	2.43%	2.55%	2.80%	3.05%	3.05%	3.05%	3.05%	3.05%	-	-	-	-	-
25yr PWLB Rate													
Link Asset Services	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
Capital Economics	2.96%	3.08%	3.33%	3.58%	3.53%	3.48%	3.43%	3.38%	-	-	-	-	-
50yr PWLB Rate													
Link Asset Services	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%
Capital Economics	2.78%	2.90%	3.15%	3.40%	3.40%	3.40%	3.40%	3.40%	-	-	-	-	-

ECONOMIC BACKGROUND

GLOBAL OUTLOOK. World growth has been doing reasonably well, aided by strong growth in the US. However, US growth is likely to fall back in 2019 and, together with weakening economic activity in China and the eurozone, overall world growth is likely to weaken.

Inflation has been weak during 2018 but, at long last, unemployment falling to remarkably low levels in the US and UK has led to a marked acceleration of wage inflation. The US Federal Reserve (Fed) has therefore increased rates nine times and the Bank of England twice. However, the European Central Bank (ECB) is unlikely to start raising rates until late in 2019 at the earliest.

KEY RISKS - central bank monetary policy measures
Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as quantitative easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

The key issue now is that that period of stimulating economic recovery and warding off the threat of deflation, is coming towards its close. A new period is well advanced in the US, and started more recently in the UK, of reversing those measures i.e. by raising central rates and, (for the US), reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of a reduction in spare capacity in the economy and of unemployment falling to such low levels, that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this also encouraged investors into a search for yield and into investing in riskier assets such as equities. Consequently, prices in both bond and equity markets rose to historically high valuation levels simultaneously. This meant that both asset categories were exposed to the risk of a sharp downward correction and there has been a sharp fall in equity values in the last quarter of 2018. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. There will need to be a balance in the timing to neither squash economic recovery, by taking too rapid and too strong action, or, conversely, let inflation run away by taking action that was too slow and/or too weak. **The potential for central banks to get this timing and strength of action wrong are now key risks.** At the time of writing, (early January 2019), financial markets are very concerned that the Fed is being too aggressive with its policy for raising interest rates and was likely to cause a recession in the US economy.

The world economy also needs to adjust to a sharp change in **liquidity creation** over the last five years where the US has moved from boosting liquidity by QE purchases, to reducing its holdings of debt, currently about $50bn per month. In addition, the European Central Bank ended its QE purchases in December 2018.

UK. The flow of positive economic statistics since the end of the first quarter of 2018 has shown that pessimism was overdone about the poor growth in quarter 1 when adverse weather caused a temporary downward blip. Quarter 1 at 0.1% growth in Gross Domestic Product (GDP) was followed by a return to 0.4% in quarter 2 and by a strong performance in quarter 3 of +0.6%. However, growth in quarter 4 is expected to weaken significantly.

At their November quarterly Inflation Report meeting, the Monetary Policy Committee (MPC) repeated their well-worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, where monetary policy is neither expansionary of contractionary, than before the crash. Indeed the MPC gave a figure for this of around 2.5% in ten years time, but declined to give a medium term forecast. However, with so much uncertainty around Brexit, the MPC warned that the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth. They warned they could also *raise* Bank Rate in the same scenario if there was a boost to inflation from a devaluation of sterling, increases in import prices and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor could potentially provide fiscal stimulus to support economic growth, though at the cost of increasing the budget deficit above currently projected levels.

It is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Getting parliamentary approval for a Brexit agreement on both sides of the Channel will take well into spring 2019. However, in view of the hawkish stance of the MPC at their November meeting, the next increase in Bank Rate is now forecast to be in May 2019. On the assumption that a Brexit deal is agreed by both the UK and the EU. The following increases are then forecast to be in February and November 2020 before ending up at 2.0% in February 2022.

Inflation. The Consumer Price Index (CPI) measure of inflation has been falling from a peak of 3.1% in November 2017 to 2.1% in December 2018. In the November Bank of England quarterly Inflation Report, inflation was forecast to still be marginally above its 2% inflation target two years ahead, at about 2.1%, given a scenario of minimal increases in Bank Rate.

As for the **labour market** figures in October**,** unemployment at 4.1% was marginally above a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 3.3%, 3 month average regular pay, excluding bonuses. This meant that in real terms, i.e. wage rates less CPI inflation, earnings are currently growing by about 1.2%, the highest level since 2009. This increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC was right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy.

In the **political arena**, the Brexit deal put forward by the Conservative minority government was defeated on 15th January. It is unclear at the time of writing, how this situation will move forward. However, our treasury advisors central position is that Prime Minister May's government will endure, despite various setbacks, along the route to reaching an orderly Brexit though the risks are increasing that it may not be possible to get full agreement by the UK and EU before 29th March 2019. In which case this withdrawal date is likely to be pushed back to a new date. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary and fiscal policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

USA. President Trump's massive easing of fiscal policy is fuelling a, temporary, boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2% (annualised rate) in quarter 1 to 4.2% in quarter 2 and 3.5%, (3.0% y/y), in quarter 3, but also an upturn in inflationary pressures. The strong growth in employment numbers and the reduction in the unemployment rate to 3.9%, near to a recent 49 year low, has fed through to an upturn in wage inflation which hit 3.2% in November. However, CPI inflation overall fell to 2.2% in November and looks to be on a falling trend to drop below the Fed's target of 2% during 2019. The Fed has continued on its series of increases in interest rates with another 0.25% increase in December to between 2.25% and 2.50%, this being the fifth increase in 2018 and the ninth in this cycle. However, they did also reduce their forecast for further increases from three to two. This latest increase compounded investor fears that the Fed is over doing the speed and level of increases in rates and that it is going to cause a US recession as a result. There is also much evidence in previous monetary policy cycles of the Fed's series of increases doing exactly that. Consequently, we have seen stock markets around the world falling under the weight of fears around the Fed's actions, the trade war between the US and China and an expectation that world growth will slow.

The tariff war between the US and China has been generating a lot of heat during 2018, but it is not expected that the current level of actual action would have much in the way of a significant effect on US or world growth. However, there is a risk of escalation if an agreement is not reached soon between the US and China.

Eurozone. Growth was 0.4% in quarters 1 and 2 but fell back to 0.2% in quarter 3, though this was probably just a temporary dip. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of nearly 2% for 2018, the horizon is less clear than it seemed just a short while ago. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank ended all further purchases in December 2018. The ECB is forecasting inflation to be a little below its 2% top limit through the next three years so it may find it difficult to warrant a start on raising rates by the end of 2019 if the growth rate of the EU economy is on a weakening trend.

China. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus, medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems. Progress has been made in reducing the rate of credit creation, particularly from the shadow banking sector, which is feeding through into lower economic growth. There are concerns that official economic statistics are inflating the published rate of growth.

Japan - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It is likely that loose monetary policy will endure for some years yet to try to stimulate growth and modest inflation.

Emerging countries. Argentina and Turkey are currently experiencing major headwinds and are facing challenges in external financing requirements well in excess of their reserves of foreign exchange. However, these countries are small in terms of the overall world economy, around 1% each, so the fallout from the expected recessions in these countries will be minimal.

INTEREST RATE FORECASTS

The interest rate forecasts provided by Link Asset Services in Appendix 8 are predicated on an assumption of an agreement being reached on Brexit between the UK and the EU. On this basis, while GDP growth is likely to be subdued in 2019 due to all the uncertainties around Brexit depressing consumer and business confidence, an agreement is likely to lead to a boost to the rate of growth in 2020 which could, in turn, increase inflationary pressures in the economy and so cause the Bank of England to resume a series of gentle increases in Bank Rate. Just how fast, and how far, those increases will occur and rise to, will be data dependent. The forecasts in this report assume a modest recovery in the rate and timing of stronger growth and in the corresponding response by the Bank in raising rates.

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

However, there would appear to be a majority consensus in the Commons against any form of non-agreement exit so the chance of this occurring has now substantially diminished.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

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

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

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England monetary policy** 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**, possibly in **Italy**, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has made a lot of anti-austerity noise. The EU rejected the initial proposed Italian budget and demanded cuts in government spending which the Italian government initially refused. However, a fudge was subsequently agreed, but only by *delaying* the planned increases in expenditure to a later year. This can has therefore only been kicked down the road to a later time.

The rating agencies have started on downgrading Italian debt to one notch above junk level. If Italian debt were to fall below investment grade, many investors would be unable to hold it. Unsurprisingly, investors are becoming increasingly concerned by the words and actions of the Italian government and consequently, Italian bond yields have risen, at a time when the government faces having to refinance large amounts of debt maturing in 2019.

- Weak capitalisation of some **European banks**. Italian banks are particularly vulnerable. One factor is that they hold a high level of Italian government debt, debt which is falling in value. This is therefore undermining their capital ratios and raises the question of whether they will need to raise fresh capital to plug the gap.
- **German minority government.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD is reviewing whether it can continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018. A new party leader has now been elected. However, this makes little practical difference as she is still expected to aim to continue for now as the Chancellor. However, there are five more state elections coming up in 2019 and EU parliamentary elections in May/June. These could result in a further loss of electoral support for both the CDU and SPD which could also undermine her leadership.
- **Other minority eurozone governments.** Spain, Portugal, Ireland, the Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile. Sweden is also struggling to form a government due to the anti-immigration party holding the balance of power, and which no other party is willing to form a coalition with. The Belgian coalition collapsed in December 2018 but a minority caretaker government has been appointed until the May EU wide general elections.
- **Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU while **Italy,** in 2018, also elected a strongly anti-immigration government. Elections to the EU parliament are due in May/June 2019.
- Further increases in interest rates in the US could spark a **sudden flight of investment funds** from more risky assets e.g. shares, into bonds yielding a much improved yield. Throughout the last quarter of 2018, we saw sharp falls in equity markets interspersed with occasional partial rallies. Emerging countries which have borrowed heavily in dollar denominated debt, could be particularly exposed to this risk of an investor flight to safe havens e.g. UK gilts.
- There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is now rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.
- **Geopolitical risks,** especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

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

- **Brexit** – if both sides were to agree by 29 March a compromise that quickly removed all threats of economic and political disruption and so led to an early boost to UK economic growth.
- **The Fed causing a sudden shock in financial markets** through misjudging the pace and strength of increases in its Fed Funds Rate and in the pace and strength of reversal of QE. Which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- **UK inflation,** whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

Annexe A

Mole Valley District Council
Capital Strategy

1. **Purpose of the Capital Strategy**

Our Capital Strategy sets out how the Mole Valley District Council (MVDC) will manage the future investment and financing of capital resources to contribute towards the achievement of its key objectives and priorities.

The Capital Strategy is a framework by which capital expenditure decisions are made. It is required under the Prudential Code for Capital Finance in Local Authorities as good governance.

The objectives of MVDC Capital Strategy are to:

- Prioritise and deploy capital resources in advancement of the Corporate Objectives
- Support service plans
- Look for opportunities for crosscutting and joined up investment
- Invest in assets that reflect the visions and aspirations of local people in service delivery
- Manage investment and the Council's property and other assets effectively and efficiently

2. **Overview**

The Capital Strategy considers all aspects of the Council's capital expenditure and extends to areas where the Council is able to influence others through the use of its capital resources. It forms part of the Council's integrated revenue, capital and balance sheet planning.

The strategy covers capital expenditure, capital financing and asset management and is one of the key strategies alongside the more operational strategies for these and other areas including Treasury Management, Tax, Property Investment and service areas.

It also gives an overview of how associated risk is managed and the implications for future financial sustainability.

It ensures that all new capital projects are evaluated and investment decisions made whilst ensuring funding is targeted towards meeting priorities.

The Capital Strategy:

- States the council's processes for:
  - Project initiation
  - Deciding on the prioritisation of capital projects
  - Monitoring and evaluating schemes
- Takes account of significant revenue implications

- Provides a framework for the management and monitoring of the capital programme
- Identifies funding and provides a basis to inform bidding for additional capital resources (e.g. from the Heritage Lottery, government initiatives)
- Apprises the corporate review of existing properties

2.1 **Scope**

The Capital Strategy includes all capital expenditure and capital investment decisions not only as an individual local authority but also those entered into under group arrangements or other partnership arrangements.

2.2 **Project Initiation**

Capital projects are subject to robust justification process, bringing together a clear business case with sufficient detailed costings to ensure transparent decisions can be taken.

Proposals are given independent oversight and review of the project in terms of validation arrangements, estimated figures and project milestones.

Business cases are prepared in accordance with the Council's Project Management process.

A formal process on a rolling basis for supervision and review of projects is drawn up to ensure they are subject to thorough oversight for the duration of the project. To ensure project delivery is achievable robust project management arrangements are undertaken with ownership of projects siting in the initiating department and clearly defined areas of responsibility for each task in the project.

For larger projects where feasibility is less certain viability assessments and robust business cases are prepared before bids are made for funds. This includes undertaking all preparatory work to fully understand the requirements of a project before budget is sought. Officer resource is assessed when considering projects to ensure both delivery of projects and day-to-day work is covered.

A time based resource plan is used to flag significant pressure on resources.

A clear link between budgets and service plans must be presented to Members of the Council.

2.3 **Deciding on the prioritisation of capital projects**

Capital projects will be assessed for:

- Strategic fit – corporate objectives are being met by the expenditure
- Identified need – e.g. vital repairs and maintenance of existing assets
- Achievability – this may include alternatives to direct expenditure by the Council such as partnerships with others, rent or buy options, alternative delivery vehicles
- Affordability and resource use – to ensure total capital investment remains within sustainable limits
- Practicality and deliverability

- Revenue generation is achieved from the Investments
- Non-monetary impacts such as future economic growth, social well-being or environmental

2.4 **Monitoring and evaluating schemes**

In assessing potential capital schemes the Council will have regard to:

- Governance arrangements
- How each scheme will be reviewed
- The formal approval process

2.4.1 **Governance process for approval and monitoring of capital spend**

For all capital investment the appropriate level of due diligence will be undertaken with the extent and depth reflecting the level of risk being considered in accordance with the Council Risk Appetite Statement.

Due diligence process and procedures will include:

- Scrutiny of the capital programme by Value for Money Overview and Scrutiny Committee
- Identification of the risk to both the capital sums invested and the returns
- Understanding the potential impact on the financial sustainability of the Council if the risks come to fruition
- Identifying assets being held for security against any potential debt or charges on assets
- Seeking independent and expert advice where necessary The Chief Finance Officer (Section 151 Officer) will ensure that Members are adequately informed and understand the risks of capital investment decisions.

2.4.2 **How each scheme will be reviewed.**

The business case put forward for a capital project will be reviewed to ensure it takes account of stewardship, value for money, prudence, sustainability and affordability.

Investment decisions will consider risk and reward and how the project contributes to the achievement of corporate objectives. The phasing of projects over more than one financial year will be assessed to ensure timetabling of plans and budgeting is realistic and funding is available over the life of the project.

Contingency budgets will be considered as part of the review process to increase transparency of budgeting and to avoid over-budgeting of funds.

2.4.3 **The formal approval process**

Project proposals will be put to Council for formal approval together with funding requirements and, if successful, will form the Council's capital programme which is the Council's plan of capital investment for future years. This ensures the Council's overall capital strategy, governance procedures and risk appetite are fully understood by all members.

2.5 **Revenue Implications**

The revenue implications of capital investment must always be considered in investment decisions and prioritisation of projects. These include costs and savings implications.

Costs to consider include:

- Cost of borrowing (including Minimum Revenue Provision)
- Loss of investment income if reserves or useable capital receipts are used
- Running costs associated with the asset:
    - Salaries of employees or the appropriate management fee of outsourcing
    - Heat and light etc.
    - Administrative support costs
    - Future maintenance
- Savings, including benefits, to identify in the proposal include:
    - Any positive impact of investment and economic growth on the Council's council tax base and business rates income
    - Capital projects that generate income, revenue savings or efficiencies

2.6 **Framework for the management and monitoring of the Capital Programme**

A standard approach to project management is used across the Council.

A standardised set of project documentation allows a thorough overview of projects and makes the assessment of project progress against initial plans and milestones transparent.

These documents include risk registers and project baselines.

The finance system is used as a tool for budget management and is accessed by both finance staff and project managers to give up to date information on project spend. Close monitoring and reporting of slippage is undertaken to give timelier reporting which then allows for greater flexibility with capital spend allowing opportunities for alternative projects to be introduced.

Full requirements in regard to management of financial information can be found in the Council's Financial Regulations.

The Council will assign a Project Manager to each project to oversee planning, delivery, management, skills assessment and governance of capital projects. Project management must be used on every project irrespective of funding source.

2.7 **Funding the Strategy**

Proposals for capital projects must identify the funding requirements for the timescale of the project including any revenue implications.

Funding must be appropriate for the project and will come from:

- Reserves
- Capital receipts – from the sale of assets or finance lease receipts
- Government grants – such as disabled facilities grant funding
- Third party grants and contributions

- Community infrastructure Levy
- Revenue contributions
- Other developer contributions
- External (prudential) borrowing

Any restrictions on borrowing or funding of ongoing capital finance e.g. S106 requirements will be assessed.

Project appraisal will consider additional or alternative funding sources, match funding opportunities, bidding timeframes and the likely success of being awarded a grant. Other funding sources may include national lottery, government grant, heritage lottery fund etc.

2.7.1 **Flexible use of capital receipts**

The Secretary of State believes that individual local authorities are best placed to decide which projects will be most effective for their area. The key criteria to use when deciding whether expenditure can be funded by the capital receipts flexibility is that it is forecast to generate ongoing savings.

If the Council plans to use this funding option a strategy will be prepared setting out the planned use of this flexibility, listing the projects and the expected savings or service transformation outcome for each project, and the impact on the Council's prudential indicators.

2.7.2 **Borrowing**

The Council's approach to borrowing is set out in the Treasury Management Statement. The Council may consider internal or external borrowing.

The following issues will be considered prior to undertaking any external borrowing:

- Affordability
- Maturity profile of existing debt
- Interest rate and refinancing risk
- Borrowing source

Minimum revenue provision (MRP) – local authorities are required to set aside some of their revenues as provision for debt each year of an amount considered to be 'prudent'. Prudent provision should ensure that debt is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefit.

The Executive has authority to bid, negotiate and complete on property acquisitions and investments with a total individual cost of up to £10million, within a total aggregate sum of £30million over the period 2018/2019 to 2020/2021, subject to the decision fully satisfying all the criteria and process requirements set out in the Property Investment Strategy.

2.8 **The corporate review of existing assets – Asset Management**

The Council's arrangements for the corporate review of existing assets is contained in the Asset Management Strategy. This provides the framework for the operational work of asset management and the aims and objectives and the current property portfolio and the plan of asset management including acquisitions, maintenance requirements and planned disposals.

These assets, together with the Council's other assets, are held in the Council's Asset Register which is maintained and updated on a regular basis.

2.8.1 **Commercial Investment**

These are investments made outside the normal treasury management activity and are taken with the aim of making a financial surplus for the Council.

The detail is contained in the Council's Asset Investment Strategy which documents the Council's requirements for:

- Ensuring effective due diligence
- Risk appetite
- Proportionality in respect of overall resources.
- Independent and expert advice and scrutiny arrangements Performance is monitored by the Value for Money Overview and Scrutiny Committee.

2.9 **Service reviews**

As part of service planning asset reviews will be undertaken to consider the use of existing property and whether it can be better used in achieving the Council's objectives. The use of assets needs to be considered as customers' needs and expectations change. Examples include:

- Consideration of sales of assets not being used to deliver operational services or those not delivering best value, e.g. ransom strips
- A lease on a council owned property may be up for renewal which could create opportunities for change
- The local plan could redesignate a particular area which would allow for the potential redevelopment of council owned land or property.

2.10 **Other Considerations**

All capital schemes must comply with legislation and Council policies such as the Financial Regulations and Contract Procurement Rules. Reference should also be made to other strategies and plans of the Council. Documents for reference are:

- Corporate Plan
- Asset Investment Strategy
- Treasury Management Strategy
- Asset Management Strategy
- Financial Regulations
- Contract Procurement Rules
- Medium Term Financial Plan

2.11 Glossary

- CIPFA – Chartered Institute of Public Finance and Accountancy

- MRP - Minimum Revenue Provision

Annexe B

Mole Valley District Council Asset Investment Strategy Annual Report to Council for 2018/2019

Issued in accordance with the statutory guidance on Local Authority Investments (3rd edition)

January 2019

Version	Date	
1.0	29 January 2019	Issued for Audit Committee 07.02.19

Mole Valley District Council

1. INTRODUCTION

1.1 Mole Valley District Council's (**MVDC**) Medium Term Financial Strategy (**MTFS**), approved in 2013, set out MVDC's approach to managing its financial position over the period 2014/2015 – 2020/2021. The themes of the MTFS included:

- Make best use of assets: through projects that use MVDC land and property to improve services and generate income;
- Improve returns on investment: without unduly compromising on security and liquidity, seek to diversify investments to obtain a better yield, with particular consideration of property and property related funds;
- Capital spend to generate income: opportunities to invest MVDC capital in a way that generates benefits for MVDC's revenue budget.

1.2 In order to keep pace with increasing demands for services in the face of ongoing reductions in the Government Revenue Support Grant (**RSG**), MVDC identified the acquisition of property assets as a means of meeting MVDC's budget pressures and the Asset Investment Strategy (**AIS**) was approved at a meeting of Full Council on 11 October 2016.

2. THE ASSET INVESTMENT STRATEGY

2.1 MVDC, like many other authorities, is an experienced property manager. Prior to the approval of the AIS in October 2016, MVDC already owned a variety of investment property in Leatherhead and Dorking. These properties had been acquired over a number of years to facilitate the economic development of the district and to also generate a rental income stream which supported the wider financial position of MVDC.

2.2 The AIS set out a comprehensive framework for the acquisition of additional property investments, covering the acquisition criteria, the governance and decision making processes, and the legal framework, including the incorporation of one or more property investment company or companies. The total funds allocated to the AIS in October 2016 were £48.5 million, with a target rental contribution to MVDC's revenue budget of £0.75 million per annum by 2019/2020. This target rental contribution was based on a 5.75% yield, capital financing costs of 4% and portfolio administration costs of 0.15%.

2.3 In February 2018, the addition of a further £51.5 million to the Capital was approved at a meeting of Full Council. This increased the funds allocated to the Asset Investment Strategy (**AIS**) to £100 million. In addition, the scope of the AIS was extended to include property funds as a possible investment class. A number of amendments to the evaluation criteria were also approved to enable a more diverse portfolio to be acquired. These amendments were:

- the Internal Rate of Return was amended from a hurdle rate of 7% to a target of 6%;
- a revised Investment Evaluation Matrix as set out in Appendix B1.

2.4 The report to Full Council in February 2018 adjusted the target contribution to MVDC's revenue budget from the AIS to reflect the changes identified to the assumptions underpinning the October 2016 forecast. Based on a £100 million total investment allocation, the forecast contribution was £1.35 million per annum by 2019/2020. The adjusted forecast took account of the impact of a higher rate of borrowing in the first year of the AIS, of 2.36%, rather than 2%. The revised AIS model assumed that for the second tranche of investment, it would be at a Public Works Loan Board (**PWLB**) rate of 2.58% and assumed that of the total £100 million, £26.8 million would not be invested until 2019/2020 and the final tranche of £17.1 million would not be invested until 2020/2021.

IMPLEMENTATION OF THE AIS

3. SOURCING INVESTMENT OPPORTUNITIES

3.1 Officers established relationships with a variety of agents supplemented by a dedicated Property Investment page on the molevalley.gov.uk website. This contained a landing page for agents to better inform introducing agents as to the AIS criteria and the service that agents are required to provide.

3.2 In-house qualified[1] and experienced chartered surveyors in the Investment and Regeneration team who have between them 76 years professional post-qualification experience, review and analyse proposed investment opportunities against the AIS criteria. This enables MVDC to act as an intelligent client and to robustly review and interrogate the reports and opinions of its professional advisers. A property summary with the marketing brochure (if available) is submitted to the Asset Investment Working Group (**AIWG**) together with supporting commentary and an analysis setting out how the asset scores against each of the AIS criteria based on a recommended maximum purchase price. The AIWG comprises officers and members from each political group. The membership and terms of reference of the AIWG is set out in the MVDC constitution[2].

3.3 If, following consultation with the AIWG, the Deputy Chief Executive decides that a bid is to be submitted (up to the agreed maximum), the relevant chartered surveyor in consultation with the Deputy Chief Executive will lead negotiations via the introducing agent with the objective of obtaining best value. If a bid is accepted and heads of terms agreed, MVDC will instruct full due diligence. The technical due diligence is undertaken by external professional advisers in accordance with the relevant RICS professional standards, including a purchase report undertaken in accordance with the RICS Valuation – Professional Standards January 2014 (revised April 2015) (the 'Red Book') supported by building surveys and a Dun & Bradstreet (D&B) analysis of covenant strength (the ability of the tenant(s) to pay the rent).

3.4 The legal due diligence is outsourced to a panel firm on the Surrey Legal Services Framework who offers commercial property, planning, construction, environmental, corporate, commercial and tax law services. The in-house Legal Services team are

[1] MRICS: Member of the Royal Institute of Chartered Surveyors

[2] Part 3 – Responsibility for Functions: page 59 "Terms Of Reference Of The Asset Investment Working Group"

appraised of the transaction but do not have the capacity to undertake the due diligence in the very tight timescales required to secure the asset.

3.5 On completion of the due diligence, the chartered surveyor updates the initial analysis of the investment opportunity to take account of the due diligence and this is then provided to the AIWG together with confirmation of the final purchase price and gross investment level. Following consultation with the AIWG, the Deputy Chief Executive makes the final decision to:

3.5.1 acquire the investment asset in the name of Mole Valley District Council using its powers to acquire land under section 120(1) of the Local Government Act 1972;

3.5.2 in reliance on its section 1 Localism Act 2011 powers, to fund Mova Property Limited for the purposes of acquiring the investment asset, with the directors of Mova Property Limited (which include the Deputy Chief Executive, the Chief Executive and the Corporate Head with responsibility for Planning) making the decision to proceed to exchange and completion of the investment asset.

3.6 The decisions are taken by the Deputy Chief Executive under special urgency powers as set out in MVDC's constitution. The special urgency powers are used by the Deputy Chief Executive as transaction timescales mean it is not practicable to defer such decisions for meetings of Cabinet. Details of the decisions are published on MVDC's website as soon as practicable after the decision has been taken and these are subsequently reported to the next Council meeting.

4. PORTFOLIO

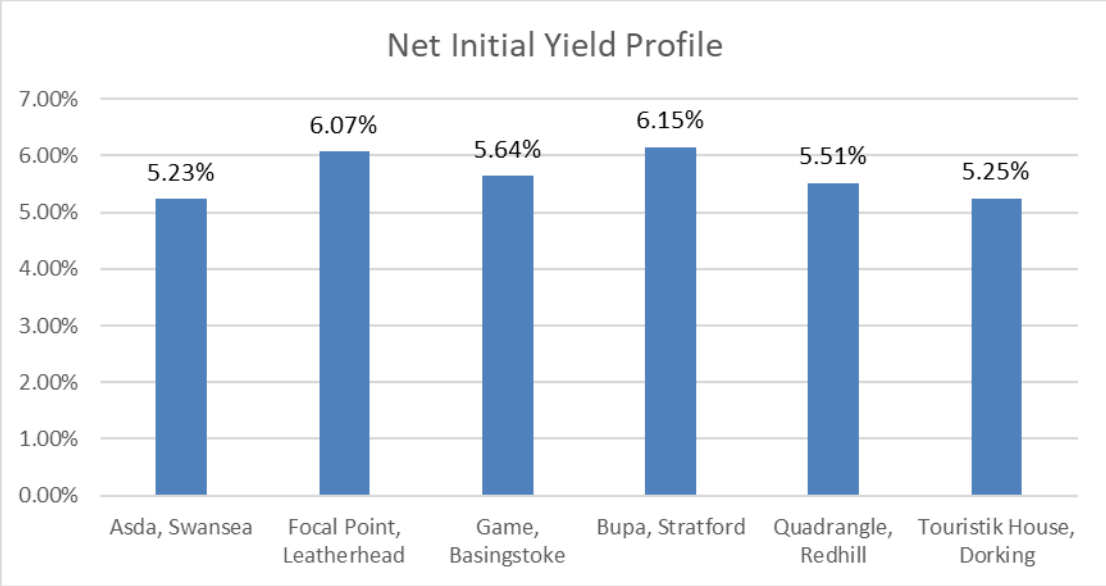
4.1 Since the commencement of the AIS in October 2016, six freehold properties have been acquired. Three freehold properties were acquired in the period April 2017 to January 2018, and a further three freehold properties were acquired in the period July 2018 to October 2018.

4.2 There have been no abortive bids in the period since the February 2018 report to Full Council. The combination of the following factors:

- clear criteria, reflecting MVDC's risk appetite, against which opportunities could be objectively assessed;
- a governance structure which enabled MVDC to work to exacting transaction timetables,
- an in-house qualified and experienced team of chartered surveyors,
- appropriate external legal advisors and other professional advisors such as building surveyors who were able to resource the due diligence to an exacting timetable, and
- access to finance,

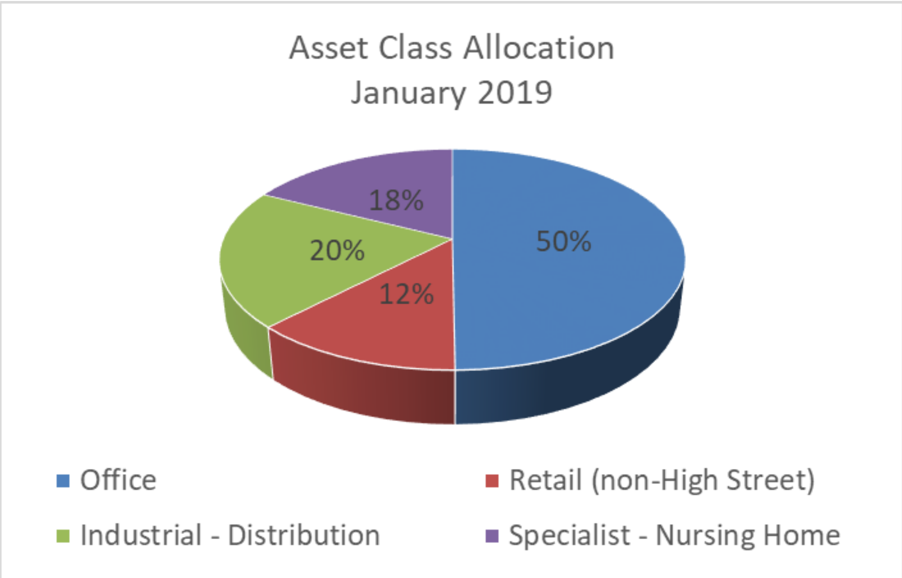
meant that MVDC was viewed as a credible buyer. This in turn meant that MVDC's bid, whilst it was often not the highest, was preferred, as the seller drew reassurance that MVDC would be in a position to proceed without delay, subject to the requirements of our due diligence process and external valuation report.

4.3 Further details of the assets are set out in Appendix B1, however, the table below demonstrates how each of the acquisitions to date exceed the 5% Net Initial Yield[3] requirement.



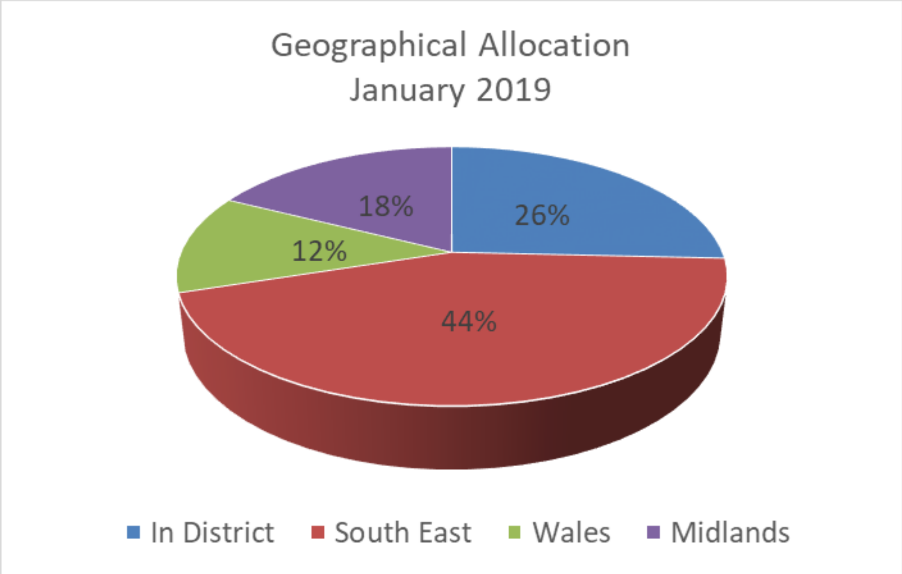
4.4 A diversified portfolio has been established. The diversification is geographical, asset class, tenant sector and tenant contribution.

4.5 The pie chart 'Asset Class Allocation' sets out the amount invested in each asset class as a percentage of the total amount invested. The Office asset class consists of Focal Point, Leatherhead (with two tenants), Quadrangle, Redhill and Touristik House, Dorking.

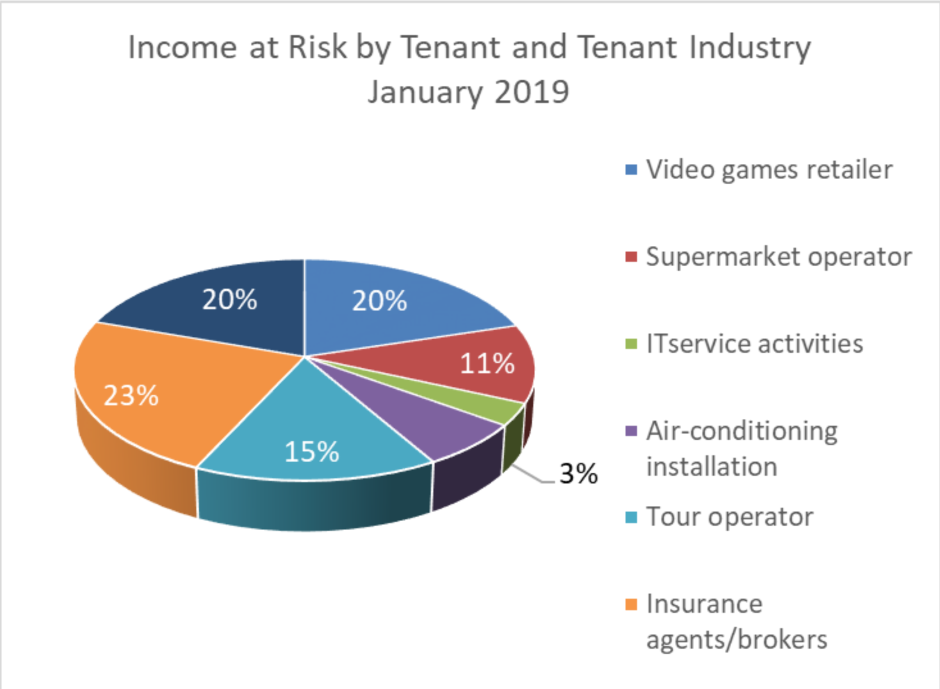


[3] Net Initial Yield is calculated by dividing the rent payable by the tenant by the total acquisition cost of the asset (being purchase price, stamp duty land tax, agent's fee, legal and technical due diligence fees).

4.6 The pie chart 'Geographical Allocation' sets out the amount invested by region as a percentage of the total amount invested. The properties classified as within the South East (but not in district) are Quadrangle, Redhill and Game, Basingstoke.

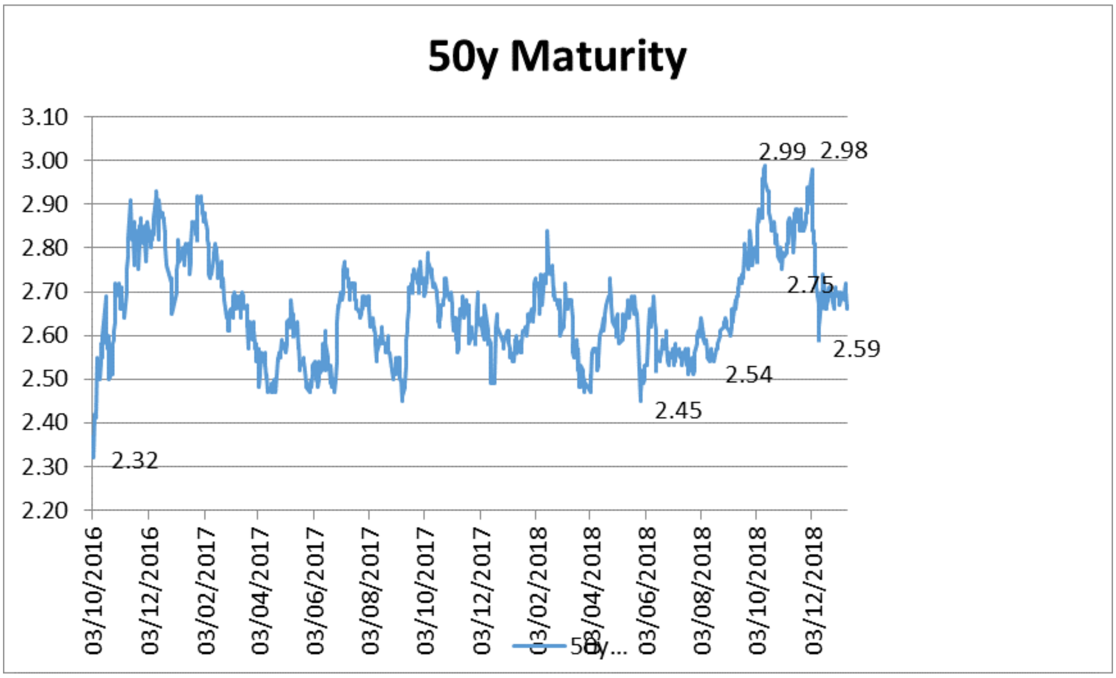


4.7 The pie chart 'Income at Risk by Tenant and by Tenant Industry' shows the industry in which tenant operates (and we have seven tenants across six properties, as Focal Point is occupied by two tenants), and the amount of rent receivable by MVDC as a percentage of the total rent receivable.



5. PORTFOLIO FINANCIAL PERFORMANCE

5.1 The Bank of England increased the base rate from 0.5% to 0.75% in August 2018; and the Public Works Loan Board (PWLB) lending rates, which are tied to Gilts rather than the base rate, also increased. Gilts yields reflect the relative attractiveness of investing in the UK, compared to other countries, and are sensitive to global political and economic factors. The graph below shows the volatility in PWLB rates for a fixed interest 50 year interest-only loan during the period October 2016 to January 2019.



5.2 No asset disposals are planned during the financial year 2019/2020. Political and economic uncertainty leading to volatility of cost of capital means that no further investments will be pursued under the AIS. MVDC may however continue to acquire property in accordance with its other priorities, such as Transform Leatherhead or to further its service delivery objectives.

5.3 The table at Appendix B2 of this report sets out the modelled target contribution in the Council report of 11 October 2016 against the projected contribution from the AIS assets as at the date of this report and assumes that no further investments will be acquired in 2019/2020.

5.4 The revenue generated to MVDC's general fund by the AIS portfolio is monitored as part of the monthly budget monitoring process and formally reported to meetings of the Cabinet as part of the business and budget reporting.

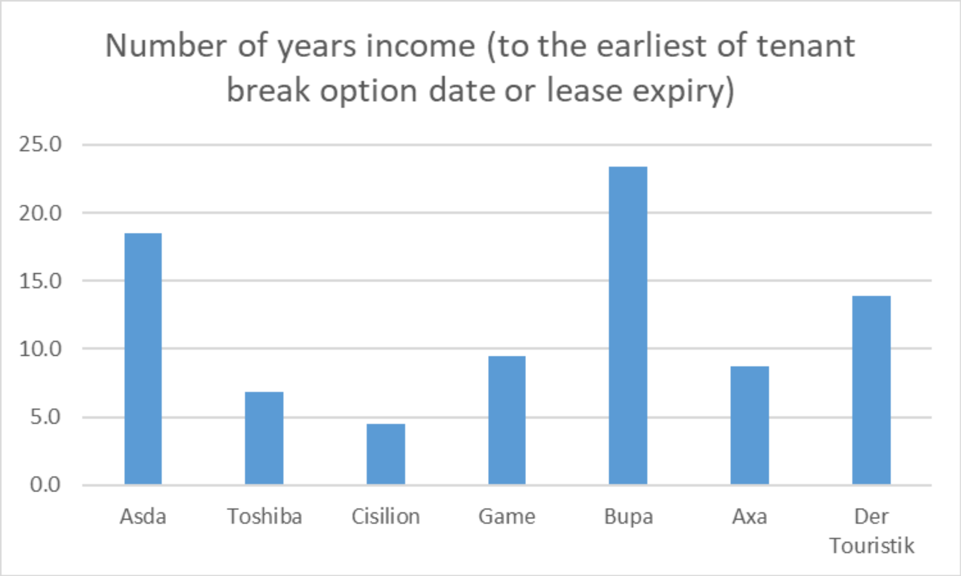
5.5 From a property and tenant risk management perspective, performance against the following basket of indicators illustrate the status of the AIS portfolio. All the AIS properties are tenanted; there are no vacant assets or unlet floor space.

Indicator	**Purpose**	**Target**	**Actual**
Fall in tenant D&B rating from date of acquisition	A fall in the D&B score indicates either a fall in tangible net worth or an increased risk of failure, or both.	No fall in rating assigned to tangible net worth AND risk of failure	One tenant's risk of failure has fallen from a 1 (minimum risk of failure) to a 2 (lower than average risk). There is no deterioration in tangible net worth.

			The position will be monitored.
Rent collection rates	Rent arrears indicate that the tenant may be in financial difficulty.	100% collection rate	100%
Late payments	Late payment indicate that the tenant may be experiencing cash flow difficulty.	0%	0%
Bad debts	Rent or other payments owed to MVDC that are classified as non-recoverable indicate that the tenant is in financial difficulty	£nil	£nil
Service charge reconciliation	No receipt of service charge from the tenant indicates that the tenant is in financial difficulty. A failure to reconcile the service charge account may reflect poor performance by the managing agent.	100%	100%
Outstanding rent reviews in excess of 12 months	Rent reviews which are calculated by reference to a pre-determined rate should be agreed and documented in a timely manner by landlord and tenant – subject to the publication date of the relevant information Where they are calculated by reference to Open Market Value (OMV), the process is more protracted. If the asset is over rented (the tenant's rent is more than the market rent) or the tenant had a poor covenant, this could protract agreement.	Nil	Nil. Two rent reviews agreed and documented since acquisition of the relevant asset. Next rent reviews fall in 2021/2022.
Health & Safety Incidents or Insurance Claims	Incidents or claims reported to the landlord may indicate a want of repair by the tenant with repairing obligations.	Nil	Nil

5.6 As can be seen from Appendix B1, there are no break options or lease expiries falling in 2019/2020, with the first tenant only break falling in 2023 and the first lease expiry not falling until 2026. As a result, there have been no dilapidation claims (which may arise on lease expiry if a tenant has not kept the asset in the required standard of repair under the lease) or capital expenditure incurred by MVDC (where necessary to secure a new occupier) across the AIS portfolio to date.

5.7 The number of years income by tenant is profiled in the chart below:



5.8 There are a number of risks arising from the AIS portfolio. These are set out at Appendix B3 together with the risk mitigation measures. For example, in relation to dilapidation claims, regular inspections of the asset and monitoring compliance with the tenant's repairing obligations should minimise the risk of an unplanned dilapidations claims or unplanned capital expenditure to put the asset back in lettable condition arising on lease expiry. Where the hold strategy for a specific asset anticipates that the asset will be held beyond expiry of the current lease, conservative assumptions relating to void periods and to capital expenditure have been factored into the IRR calculations. MVDC also operates revenue reserves.

5.9 Given that the income from the AIS portfolio is used to service the interest payments on the PWLB borrowing and funds service delivery, the greatest risks to MVDC from the AIS portfolio are from a reduction in the rental stream through the following events:

- a tenant seeking to reduce by negotiation the rent payable under the lease;
- a tenant seeking to negotiate a surrender of the lease due to a change in business circumstances;
- a tenant being unable to pay the rent in accordance with their lease obligations due to cash flow difficulties and/or entering into some form of insolvency proceedings.
- a tenant not complying with their repairing and insuring obligations;
- a tenant electing to exercise a break option and there being a delay in MVDC/Mova Property Limited finding a replacement occupier, and/or only being able to secure a replacement occupier through accepting a lower rent.

6. INVESTMENT MARKET

6.1. The table below sets out the Prime Yields (the yield on fully rented property of the best physical quality, the best location and with the best tenant covenant) for a range of different asset classes. As can be seen, they are generally below MVDC's NIY 5.0% threshold, which has meant that MVDC has focused on acquiring investment assets in regional locations.

Asset class	Prime Yield (Q2 2017)	Prime Yield (Q3 2018)
Shops	4.00%	4.25%
Shopping Centres	6.00%	6.25% (Sub regional)
Retail Warehouses	4.50%	4.75%
Central London Offices	3.50%	3.50%
Rest of South East Offices	5.00%	5.00%
Rest of UK Offices	4.75%	4.75%
Office Parks	5.25%	5.25%
South East Industrial	4.00%	3.75%
Rest of UK Industrial	5.00%	4.75%
Distribution Warehouses	4.00%	3.75%
Hotels & Leisure	4.75%	4.25%

(Source LSH UK Investment Transactions Bulletin – Q22017 and Q32018)

6.2. The table above illustrates that prime yields have increased (in other works, purchase prices have fallen) across the retail asset classes by on average 0.25% between Q2 2017 and Q3 2018. Prime yields on other asset classes have remained stable or fallen (in other words, purchase prices have stayed flat or increased). Full year data for 2018 is not available as at the date of this report.

6.3. According to the LSH UK Investment Transactions Bulletin – Q32018, UK commercial property remains attractive for overseas investors, and notwithstanding the risks around Brexit, the UK continues to offer relative value and a safe haven for international capital. Property compared to other investment classes has continued to provide good value, with the All Property total return forecast at around 6.5% for 2018 with income providing the main component of return.

6.4. Diversification of the portfolio across asset classes provides some protection from MVDC from fluctuations in the relative value of different asset classes. Through having secured long term funding from PWLB, MVDC is in a position of being a long-term investor which enables MVDC to withstand cyclical fluctuations in asset classes or across the commercial property market as a whole.

7. PORTFOLIO MANAGEMENT

7.1. At the time of purchase, officers worked with the acquiring agent to model a number of scenarios to identify when the asset should be sold (the optimum hold period). To assist in the risk management of the portfolio, MVDC commissioned Ernst & Young LLP (**E&Y**) to create a financial model.

7.2. The E&Y model enables officers to model purchases, to assess the impact of a property on both Mova companies from a profit and loss, balance sheet and cash flow basis, as well as the impact on MVDC General Fund (prior to MRP). It also enables officers to undertake sensitivity testing of the portfolio. There are currently ten different scenarios which can be evaluated, including inflation rates (CPI and RPI), void costs, staff costs, running costs, capex, hold period, exit proceeds, service charges, and interest rate changes. It enables officers to update the purchase assumptions and assess lease events to determine the implications on the asset management strategy of an individual asset and the optimum hold period. Monitoring in the initial post-acquisition period has focused on financial performance and tenant relations and monitoring; the resource allocated to this monitoring will extend and intensify over the term of the holding, as hold strategies and valuations are revisited and refreshed.

7.3. The Investment and Regeneration team receive regular market updates on investment trends, activity forecasts, investor sentiment and the state of occupational markets from the RICS as well as various member firms.

7.4. Tenant covenant strength is monitored quarterly, using the tenant risk indicators set out at section 5.5, including Dun and Bradstreet reports supplemented by company reports and accounts, and alerts. Tenant default is a significant risk to the success of the AIS, with the implications of void periods, and associated costs and corresponding loss of rent.

7.5. Lease event dates (such as break options, rent reviews lease expiries) are tracked and have been or will be managed by the Investment and Regeneration team at the appropriate time.

7.6. The actual decision to sell a property may be triggered by a variety of factors, including the state of the property market and the economic cycle, lease events, market forces, portfolio mix, tenant financial standing or changes in the AIS objectives. The portfolio is actively managed with a view to minimising risk and maximising returns. To take account of the costs of acquisition, it is not envisaged that any properties would be divested in the first three years post-acquisition, and the minimum optimum hold period modelled on acquisition is generally not less than five years.

7.7. The properties purchased under the AIS are subject to an annual revaluation using the fair value model in International Accounting Standard 40: Investment Property as adapted. The annual revaluation is undertaken by Wilks Head & Eve LLP, London based firm of RICS registered valuers who value all of MVDC's property portfolio. Any change in fair value valuations of the AIS assets will be recorded in the balance sheet of both MVDC and Mova Property Limited; however there will be no impact on MVDC's income and expenditure statement and so this would have no impact on council tax. In order to ensure that MVDC has sufficient funds to repay the loans from PWLB at the end of the term, MVDC will transfer funds each year to a ring-fenced reserve account; this is known The annual revaluation of the three assets held under the AIS as at 31 March 2018 all recorded an appreciation in capital value and provide security for capital loss.

7.8. Officers are seeking to appoint an investment advisor in 2019 to assist the Investment and Regeneration team in keeping the portfolio, and in particular the optimum hold periods, under regular review. This appointment will follow a competitive procurement process undertaken in accordance with MVDC's contract standing orders.

7.9. As no further capital is to be invested on AIS acquisitions, the current managing agent arrangements for the AIS assets are going to be aggregated and a competitive tender process undertaken in 2019. The role of the managing agent will be to support the Investment and Regeneration team in monitoring and ensuring tenant compliance with tenant repairing obligations and in the case of Focal Point, to manage rent and service charge collection as well. For the other assets, rent invoicing and rent collection is managed by the Investment and Regeneration team with support from the Finance team.

8. INVESTMENT IN PROPERTY FUNDS

8.1. As highlighted in the February 2018 report to Council, officers received advice from Ernst & Young on the accounting and regulatory issues of investment in property funds. As any additional investment in property funds will be funded by MVDC's capital programme, which in turn is supported by borrowing, such investments will need to be classified as capital expenditure in accordance with the requirements of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003.

8.2. The purchase of units in property funds such as the CCLA (a UK charity fund manager who manage investments for churches, charities, and local authorities (CCLA)) that are approved by the Treasury under the Trustee Investments Act do not count as capital expenditure, and this means that MVDC will not be able to use the AIS funds, if extension is approved, to increase its holding in the CCLA or similar funds. The work currently being undertaken by Link Treasury Services Limited will determine the availability, suitability and desirability of Funds which meet this capital requirement.

8.3. Link Treasury Services advised officers that there were no suitable funds in which investment would classified as capital expenditure which could deliver an appropriate return to MVDC, after taking account of its cost of funds and the requirement for a minimum revenue provision (**MRP**).

9. LEGAL IMPLICATIONS

9.1. The October 2016 report to Council set out the legal implications of the Asset Investment Strategy. Since that report, MVDC has established its wholly owned company Mova Holdings Limited (company registration number 10510854) and a subsidiary, Mova Property Limited (company registration number 10510956), for the purposes of acquiring and holding properties purchased for the purposes of the Asset Investment Strategy using MVDC's general power of competence (section 1 Localism Act 2011). Mova Property Limited holds the property assets, funded through a mixture of equity and debt facilities from MVDC.

9.2. The articles of association of both companies recognise that as the directors are also officers of MVDC, there may be situations where the companies interests' are not aligned to those of either or both of the companies. An example of this is in relation to the rate at which MVDC is prepared to lend to Mova Property Limited. Advice has been obtained from PriceWaterhouseCoopers as to what constitutes an arms-length interest rate and the appropriate funding structure (debt: equity ratio), taking account of both tax and state aid compliance. Specific advice is provided on a transactional basis by external lawyers, Freeths LLP (appointed under a Legal Services framework) to the directors with the in-house Legal Services team advising MVDC.

9.3. Although the directors are required to manage the companies' activities in accordance with the Asset Investment Strategy approved by the Council, the directors must also ensure that any board decisions to purchase property also promote the success of the companies, taking into account the terms of the loan facilities offered to the company. All the directors have received training on directors' duties under the Companies Act 2006. Refresher training on directors' duties will be offered in 2019 and training on broader corporate governance is being explored for the directors. The Executive Head of Service with responsibility for Legal Services obtained the Institute of Directors' certificate in company direction in 2018 which places significant emphasis on corporate governance for small and large companies and this will be drawn on in order to design and deliver further training to the directors in 2018/2019.

9.4. As described earlier in the report, to support the directors' financial decision making and risk-management of the portfolio, a bespoke tool has been developed by Ernst & Young to enable the financial impact of actual and potential properties on both the company and on MVDC to be modelled. This tool also allows an ongoing review to ensure the company holds properties for the optimum period and disposes of properties at the right time in order to maximise returns. This supplements Sage, which has been purchased as the company's accounting software and which provides management accounts. An auditor has been appointed in respect of the Mova companies.

9.5. MVDC has the power to invest under its investment power contained in section 12 of the Local Government Act 2003. Any investment must be suitable and appropriate as part of a diversified investment strategy and be consistent with the Council's fiduciary duty to act in the best interests of its council tax payers and MVDC's best value duty under the Local Government Act 1999. Where such an investment results directly or indirectly in an increase in MVDC's borrowing requirements then, provided (i) the additional borrowing is prudent and complies with MVDC's Affordable Borrowing Limit determined under section 3 of the Local Government Act 2003 and (ii) MVDC follows proper accounting practices in accordance with section 21 of the Local Government Act 2003, it is considered to be lawful. MVDC is required to have due regard to statutory guidance on Local Government Investments and on Minimum Revenue Provision.

10. REVISED STATUTORY GUIDANCE : STATEMENTS AND DISCLOSURES

10.1. The AIS properties have been acquired by MVDC and by Mova Property Limited, a wholly owned company. In accordance with the statutory guidance issued by MHCLG in February 2018, a number of statements and disclosures are required to be contained in this document or to be clearly signposted, where they are contained in other report or document.

10.2. The revised statutory guidance relates to the implementation of the AIS in the following ways:

- AIS properties acquired directly by MVDC are classified as non-financial investments;
- Loans extended to Mova Property Limited and shares acquired in Mova Holdings Limited for the purposes of funding the acquisition of AIS properties by Mova Property Limited are classified as loans and non-specified investments respectively.

10.3. The AIS properties acquired by Mova Property Limited are financed by MVDC through loans equal to 70% of the purchase price, excluding acquisition costs, with the balance of the total acquisition cost being funded through the purchase of shares. MVDC has the benefit of a legal charge (mortgage) over the AIS asset owned by Mova Property Limited as well as a parent company guarantee from Mova Holdings Limited in favour of MVDC. External advice was sought on structuring the financing of the Mova companies to ensure that it was state aid compliant.

10.4. As well as a maximum Loan to Value (LTV) of 70% of the purchase price, the sustainability of the interest rate payments by Mova Property to MVDC is assessed by reference to an interest rate cover ratio over the life of the loan. The interest rate cover ratio is Earnings before Interest, Tax, Depreciation and Amortisation (EBITDA) divided by the annual rent. A ratio of 1.5 - 2.0 has been considered acceptable to both the directors of Mova Property Limited as borrower and to MVDC as lender.

10.5. The AIS properties acquired in the financial year 2017/2018 were valued by an external valuer, Wilks Head Eve LLP, in accordance with Internal Accounting Standard 40 for the purposes of producing the 2018 accounts and all three recorded an appreciation in capital value and provide security for capital loss. The three AIS properties acquired in the financial year 2018/2019 will be valued by an external valuer for the purposes of producing the 2019 accounts. If a loss is recognised in the fair value of any of the AIS properties as part of the 2019 year end accounts preparation and audit process, a report will be presented to Full Council detailing the impact of the fair value loss on the security of the investments and any revenue consequences arising as a result.

10.6. In relation to liquidity, this is recorded as a risk on the risk register together with the mitigations. For each asset, a business plan coupled with a discounted cashflow, typically modelled using valuation software such as Argus, was developed prior to acquisition, reflecting assumptions around rental growth and capital growth. This modelling established the hold period consistent with the target IRR, and it is this hold period and underlying assumptions that will be monitored.

10.7. In relation to proportionality, should MVDC not achieve the expected net income from the AIS assets (for example due to tenant default) in 2019/2020, MVDC has revenue reserves available for allocation as a sinking fund against void periods incurred.

10.8. Four of the quantitative indicators recommended in the statutory guidance are set out in the Treasury Management Strategy:

- Debt to net service expenditure (NSE) ratio (Gross debt as a percentage of net service expenditure is a proxy for the size and financial strength of a local authority)
- Commercial income to NSE ratio (Dependence on non-fees and charges income to deliver core services)
- Investment cover ratio (The total net income from property investments compared to the interest expense)
- Loan to value ratio (The amount of debt compared to the total asset value).

10.9. The remaining five quantitative indicators recommended in the statutory guidance are set out in the table below:

Quantitative Indicator	Description	
Target Income Returns	Net revenue income compared to equity. This is a measurement of achievement of the portfolio of properties.	The weighted average yield is 5.63% per annum across the AIS assets.
Benchmarking of returns	A measure against other investments and against other council's property portfolios	Other investments: CCLA: 4.5% per annum (on average) Other investments: 1.6% per annum (on average)
Gross and net income	The income received from the investment portfolio at a gross level and net level (less costs) over time	Total rent: £5.234 million Total contribution £1,050 million projected for 2019/2020
Operating costs	The trend in operating costs of the non-financial investment portfolio over time as the portfolio of non-financial investments expands.	Operating costs: these include the costs of administering the companies (statutory filings, accountancy, audit services and tax advisory), company secretarial, as well as managing agents and investment advisors. These are to be tendered in 2019/2020.
Vacancy levels and tenant exposures for non-financial investments	Monitoring vacancy levels (voids) ensure the property portfolio is being managed (including marketing and	None. Further indicators relating to tenant covenant monitoring are set out in this report at section 4 and

	tenant relations) to ensure the portfolio is as productive as possible,	in the risk register at Appendix B3.

Appendices

Appendix B1 Portfolio and AIS criteria

Appendix B2 Contribution

Appendix B3 Risk Register

APPENDIX B1

Asset and Tenant	Date of Acquisition	Purchase Price (excluding acquisition costs)	Gross Cost of Acquisition	Fair Value as at 31 March 2018 (IAS 40)	Net Initial Yield (%)	Current Rent per annum (£)	Unexpired lease term or term certain
Asda Superstore, Ystalyfera, Swansea Wales Tenant: Asda Stores Limited 	24.4.2017	£10,800,000	£11,461,033	£10,945,500	5.23%	£599,450	2037
Focal Point, Leatherhead Tenants: Cisilion Limited and Toshiba Carrier UK Limited 	06.12.2017	£8,030,000	£8,504,657	£8,189,000	6.07%	£519,964	2026 (Toshiba) 2027 (Cisilion with Tenant only break on 15 September 2023
Game Head Office and Distribution	31.01.2018	£17,600,000	£18,664,455	£17,921,500	5.64%	£1,060,000	2033 (Tenant option

Centre, Basingstoke Tenant: Game Retail Limited 							to break with effect on 7 October 2028
Alveston Leys Nursing Home, Stratford-upon-Avon Tenant: ANS Homes Limited Guaranteed by Bupa Care Homes (CFG) PLC 	31.07.2018	£15,300,000	£16,223,346	N/A as acquired during 18/19 Financial Year	6.15%	£1,029,308	2042
Quadrangle, Redhill Tenant: Axa Assistance UK Limited Guaranteed by Inter Partner Assistance SA	29.08.2018	£21,050,000	£22,267,980	N/A as acquired during 18/19 Financial Year	5.51%	£1,226,849	2032 (with Tenant only break clause in 2027)

							
Touristik House, Dorking Tenant: Der Touristik UK Limited (formerly Kuoni Travel Limited) Guaranteed by Rewe-Zentralfinanz E.G 	19.10.2018	£14,350,000	£15,288,624	N/A as acquired during 18/19 Financial Year	5.25%	£802,420 per annum including 01 January 2023	2033

AIS evaluation criteria

	Score	4	3	2	1	0
Investment Evaluation Criteria	**Weighting Factor**	**Excellent**	**Very Good**	**Good**	**Acceptable**	**Marginal**
Occupier Lease Length[4]	**12**	Greater than 20 years	13 -19 years	10-13 years	7-10 years	5-7 years
Tenancy Strength	**10**	Single tenant with strong financial covenant	Single tenant with good financial covenant	2 x tenants with strong financial covenants	Multiple tenants with strong financial covenant	Multiple tenants with good financial covenant / or risky single covenant
Repairing Terms	**8**	FRI[5] - no landlord management	FRI - Landlord to manage estate	IRL[6] - 100% recoverable	IRL partially recoverable	IRL landlord's obligation
Location	**6**	Prime towns, good location	Prime towns, non-prime location	Non-prime towns, good location	Non-prime towns, non-prime location	Tertiary
Tenure	**4**	Freehold / Virtual Freehold	Lease 150 years plus	Lease 135 - 149 years	Lease 110 - 134 years	75 - 109 years
Lot size	**2**	£10-15m	£8-10m or £15-£18m	£5-8m or £18-£20m	£3-5m or £20-£25m	£2-3m or over £25m

Maximum possible score: 168 Minimum score required: 100

NIY – Net Initial Yield – 5% hurdle rate
IRR – target 6%.

[4] Lease Length is the unexpired lease term or where there is a tenant break clause, up to the break date.

[5] FRI – full repairing and insuring lease

[6] IRL – internal repairing lease

APPENDIX B2 FINANCIAL MODEL AND CONTRIBUTION

	AIS Model (Approved by Council on 11 October 2016) £000	Income and Expenditure as at February 2018 £000	Adjusted AIS Model (Approved by Council on 20 February 2018) £000	Projected Income and Expenditure to for 2019/2020 £000
Capital Expenditure	48,530	35,500	100,000	92,410
Gross Rent	(2,790)	(2,176)	(5,749)	(5,234)
Capital Financing Costs (Interest and Provision for Repayment)	2,038	1,709	4,396	3,933
Net Contribution	752 (pre-tax) by 2019/2020;	467 (pre-tax)	1,353 (pre-tax) by 2020/2021	1,305 pre-tax and expenses 1,050 contribution **after tax and expenses** projection for 2019/2020.

Variance:

The Adjusted AIS Model profiled investment over the four financial years 2017/2018 to 2020/2021, and assumed that:

- by 2018/2019 approx. £56 million would have been invested;
- a weighted average rental yield of 5.75%;
- a weighted average cost of capital of 4.40%.
- MRP of 2% applying for the full year with no MRP payment holiday.
- No provision for sinking fund

Implementation of the AIS to date has resulted in:

- Approx. £92.4 million has been invested by 2018/2019;
- A weighted average rental yield of 5.63%
- A weighted average cost of capital of 4.40% (comprising weighted average interest rate from PWLB of 2.40% plus MRP at 2%);
- No Minimum Revenue Provision is required during the financial year in which the borrowing is drawn down.
- Weighted average yield of 1.23% (excluding assumed portfolio management costs and tax).
- The tax treatment of interest deductions changed with effect from 1 April 2017 which limited the tax deductibility of loan interest at £2 million.

The following PWLB borrowing was undertaken to support the AIS element of MVDC's capital programme:

Drawdown Date	Principal	Rate (% per annum)	Repayment date
28-Apr-17	£3,000,000	2.36	28/04/2067
26-May-17	£7,000,000	2.32	26/05/2067
08-Jan-18	£30,000,000	2.37	28/01/2068
30-May-18	£16,500,000	2.39	30/05/2068
20-Aug-18	£22,000,000	2.35	20/08/2068
16-Oct-18	£14,350,000	2.40	18/10/2028

APPENDIX B3 Risk Register

Risk	Risk Description	Likelihood (L)	Impact (I)	Total Score (LxI)	Risk Assessment and Controls	Adjusted Score
Downturn in property market	The capital value of existing assets falls. Open market rent reviews are negatively affected.	3	4	12	MVDC has borrowed £78.5 million over 50 years, and £14.35m over 10 years as a result of the AIS. The long term funding combined with the Minimum revenue provision requirements, means that MVDC is in a position to hold the assets over the long-term and to ride out cyclical downturns in the property market including Brexit-related volatility or depreciation. The market value of the AIS portfolio will be monitored through the appointed investment advisor. The IAS 40: investment accounting value of the AIS portfolio will be obtained annually and reflected in MVDC's/Mova Property Limited's balance sheet. A fall in value does not impact the income and expenditure statement for MVDC or the P&L for	6 Where Impact adjusted = 2

					Mova group companies. The rent review provisions are upwards only so contractually there will be no impact on revenue for MVDC or profit for Mova Property Limited. The portfolio is diversified.	
Tenant Default	Failure to pay rent or to otherwise comply with their lease obligations, resulting in loss of income and/or unplanned capital expenditure on lease expiry/termination, resulting in unplanned voids.	2	4	8	Tenant covenant strength was assessed as part of the initial acquisition process, and the existence of guarantors and/or rent deposits taken into consideration. As well as monitoring tenant covenant strength through credit reference reports, financial accounts and alerts, there is a set of indicators which also serve as indicators of a tenant's financial standing. Standard credit control practices apply. Diversification of tenant's industry/business type. MVDC operates revenue reserves from which a sinking fund against unplanned for void periods can be established. Managing agents are to be re-appointed and will undertake regular inspections to ensure that the tenant is complying with the repairing lease obligations; failure to keep in good repair is also another indication that a tenant is experiencing	6 Where Impact adjusted = 3

					cash flow difficulties. The MVDC in-house team has met at least once the relevant tenant representative.	
Liquidity	The process of buying and selling commercial property is complex and carries risk from market fluctuations, abortive transactional costs and delays in realising capital.	2	4	8	MVDC has borrowed £78.5 million over 50 years, and £14.35m over 10 years as a result of the AIS. The long term funding combined with the Minimum revenue provision requirements, means that MVDC is in a position to hold the assets over the long-term and to ride out cyclical downturns in the property market, including Brexit-related volatility or depreciation. The assets are investment grade, as a result of having acquired assets with on average greater than 10 years unexpired lease terms. Each asset was the subject of a detailed business plan as at acquisition; setting out a preferred hold strategy. Good portfolio management, keeping the market and wider economy under review and re-evaluating hold strategies. Good documentation management and access to agents and legal advisors helps streamline the sale process if disposal decision reached.	6 Where Impact adjusted = 3
Changes in Tenant	Certain types of	3	3	9	A diversified portfolio by asset class.	6

or Investor Demand	property may be less in demand from investors (affecting market valuation) or tenants (affecting rental and market valuations). This may be as a result of other investment opportunities becoming more attractive, an increase in supply or structural changes affecting occupier demand/interest for property.				The average term certain of the portfolio is 12.2 years and the average unexpired lease term is 14.2 years. Having locked in favourable cost of funding rates enables MVDC/Mova Property Limited to take a longer-term view as to when to dispose of the assets, informed by specialist advice.	Where Impact adjusted = 3