Agenda Item 6

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Date	6th February 2020
Ward(s) affected	The Treasury Management Strategy Report covers the whole District
Subject	Treasury Management Strategy 2020/21 to 2022/23

Recommendations

The Audit Committee is asked to recommend to Council:

(i) To approve the Capital Prudential Indicators for 2020/21 to 2022/23 contained within Appendix 2 and Appendix 3 to the main report.

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

(iii) The Treasury Management Strategy 2020/21 to 2022/23 and the Treasury Prudential Indicators contained within Appendix 3.

(iv) To approve the 2020/21 Investment Policy contained in the Treasury Management Strategy Appendix 3 and the detailed criteria included in Appendix 4.

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

(vi) 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.

Executive Summary

This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017). The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management function.

- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by Council of an annual Treasury Management Strategy Statement – including the Annual Investment Strategy and Minimum Revenue Provision Policy – for the year ahead, a Mid-year Review Report and an Annual Report covering activities during the previous year.
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Audit Committee.

This report meets those requirements. It also incorporates the needs of the Prudential Code to ensure adequate monitoring of the capital expenditure plans and the Council's Prudential Indicators (PIs). A definition of these is included at Appendix A.

The Government issued new guidance, wef April 2019, 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' were:

- An increase in the number of 'Prudential Indicators' to cover non-financial as well as financial investments (See Appendix 1);
- A requirement to produce a Capital Strategy, setting out how the Council evaluates, decides upon and manages capital spending (including borrowing for investment purposes) (See Annexe A);
- 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') (See Annexe B).

The Audit Committee has the authority to determine the Recommendations.

1. Background/Introduction

1.1 The contribution the treasury management function makes to the Council 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 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.

1.4 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.

1.5 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.

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

(i) <u>Prudential Indicators</u> – 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 (see Appendix 1).

(ii) <u>Minimum Revenue Provision</u>

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

(iii) <u>Treasury Management Strategy Statement</u>

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) <u>Financial Investment Strategy</u>

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

<u>Investment in non-financial investments</u>

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

1.8 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.

1.9 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.

1.11 **Financial Implications**

Are covered in the body of this report.

1.12 **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, 2020.

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 2020/21.

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 2020/21 – 2022/23 Capital Prudential and Treasury Indicators
Appendix 2	The Capital Prudential Indicators 2020/21 – 2022/23 and the Minimum Revenue Provision (MRP) Statement
Appendix 3	Treasury Management Strategy 2020/21 – 2022/23 (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	Treasury Management Clauses to form part of Standing Orders / Financial Regulations / Constitution

List of Annexes

Annexe A	Capital Strategy
Annexe B	Asset Investment Strategy

Appendix 1

2020/21 – 2022/23 CAPITAL PRUDENTIAL AND TREASURY INDICATORS

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans. The Indicators are required to help Members understand and evaluate the prudence and affordability of the authority's capital expenditure plans and the borrowing and investment activities undertaken in support of this. 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. Capital Expenditure Programme – 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. The maturity structure of fixed and variable interest rate borrowing, to regulate the Council's exposure to large repayment requirements.

Appendix 2

The Capital Prudential Indicators 2019/20-2021/22

Overview

The Council has proposed a Capital Expenditure Programme totaling £11.85m for the three years 2020/21 – 2022/23, which will be financed from existing Council reserves and Government grant funding.

Any new proposals for Capital Expenditure will have to be funded from additional borrowing or the sale of any surplus assets. As part of the Asset Management Plan 2020/24, a review of the existing property portfolio will be carried out over the next five years, to identify any surplus assets for disposal.

From 1 April 2020, International Financial Reporting Standard 16 – Leases impacts on our financial statements and Officers are currently collating all the relevant information in order to assess the impact on our borrowings, prudential indicators and reserves. Early indications are that this will not be material and once the review has been completed.

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 2020/21 - 2022/232. 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 2020/21–2022/23 is included in Appendix 3 to complement these indicators. Some of the prudential indicators are shown in the Treasury Management Strategy to aid understanding.

The Capital Expenditure Programme (CEP)

3. The Council's CEP plans are the key driver of treasury management activity and are reflected in the prudential indicators.
4. The Council's forecast CEP plans for the three years to 2022/23 are summarised below and this forms the first of the prudential indicators. 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.
8. The Council is asked to approve the summary CEP projections below.

Prudential Indicator 1 – Capital Expenditure Programme

Capital	2018/19 Actual £m	2019/20 Forecast Outturn £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
Capital Expenditure	61.30	5.08	2.32	2.37	2.07
Financed by:					
Capital reserves	-2.67	-2.62	-0.23	-0.28	0.00
Government grants	-0.82	-0.67	-0.67	-0.67	-0.67
Other grants and contributions	-0.22	-0.93	-0.93	-0.93	-0.93
Revenue	0.00	-0.87	-0.50	-0.50	-0.48
Net financing need for the year	57.59	0.00	0.00	0.00	0.00

The Council's Borrowing Need - Capital Financing Requirement (CFR)

9. The second prudential indicator is the Council's 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

	2018/19 Actual £m	2019/20 Forecast Outturn £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
Capital Financing Requirement (CFR)	115.22	113.15	111.07	109.00	106.92
Net financing need for the year (above)	57.59	0.00	0.00	0.00	0.00
Less MRP and other financing movements	-1.05	-2.08	-2.08	-2.08	-2.08
Movement in CFR	**56.54**	**-2.08**	**-2.08**	**-2.08**	**-2.08**

12. Please note that International Financial Reporting Standard (IFRS 16) becomes effective from 1st January, 2020. An initial review carried out by the Finance Team indicates that the impact of this new standard will not be material and will be reflected in the 2020/21 Treasury Management Outturn report scheduled to be presented to the Audit Committee in 2021.

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

14. 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.

Loans Made to Companies Wholly Owned By the Council

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 2020/21, given the strength of the company's finances and the value of the assets, 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.

<u>Finance leases</u>

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.

16. 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.

	2018/19 Actual £m	**2019/20 Forecast Outturn £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**	**2022/23 Estimate £m**
Fund Balances/Reserves	2.31	2.31	2.31	2.31	2.31
Capital Reserves	8.66	7.33	8.20	9.01	10.11
Earmarked Reserves	8.15	7.40	7.32	7.35	7.49
Total Core Funds	19.12	17.04	17.83	18.67	19.91
Working Capital *	2.00	2.00	2.00	2.00	2.00
Expected Investments	21.12	19.04	19.83	20.67	21.91
Investments Change	-3.60	-2.08	0.79	0.84	1.24

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

Affordability Prudential Indicators

17. 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:

18. **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

	2018/19 Actual £m	2019/20 Forecast Outturn £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
Net Financing Cost (Borrowing)	1.96	1.66	1.66	1.66	1.66
Net Financings (TM Investments)	-0.33	-0.33	-0.33	-0.33	-0.33
Revenue Budget	9.53	9.13	10.53	9.52	9.69
Ratio	**16.14%**	**14.62%**	**12.68%**	**14.03%**	**13.77%**

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

Appendix 3

Treasury Management Strategy 2020/21 – 2022/23

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

   This Council defines its treasury management activities as:

   - The management of the Council'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 Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Council.
   - This Council 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 6.
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);
- Borrowing strategy;
- Investment strategy;
- Sensitivity to interest rate movements;
- Treasury management limits on activity;
- Additional treasury issues.

Debt and Investment Projections 2020/21 – 2022/23

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 (i.e. the underlying capital borrowing need).

External debt	2018/19 Actual £m	2019/20 Forecast Outturn £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
Debt at 1st April	50.00	102.85	102.85	102.85	102.85
Expected change in debt	52.85	0.00	0.00	0.00	0.00
Other long-term liabilities (OLTL) at 1st April	1.75	1.73	1.72	1.70	1.68
Expected change in OLTL	-0.02	-0.02	-0.02	-0.02	-0.02
Actual gross debt at 31st March	**104.58**	**104.57**	**104.55**	**104.53**	**104.51**
Capital Financing Requirement	115.22	111.33	109.25	107.18	105.10
Under/(over) borrowing	10.64	6.76	4.70	2.65	0.59
Gross Debt Exceeds CFR	**No**	**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 2020/21 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 2019/20 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.

    Prudential Indicator 5 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.

12. 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

	2020/21 Estimate £m	**2021/22 Estimate £m**	**2022/23 Estimate £m**
Debt	102.85	102.85	102.85
Other long-term liabilities	1.716	1.698	1.680
Total	**104.55**	**104.53**	**104.51**

14. **Prudential Indicator 6: 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

	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
Debt	107.0	107.0	107.0
Other long term liabilities	4.0	4.0	4.0
Total	**111.0**	**111.0**	**111.0**

17. 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.

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

	2018/19 Actual	2019/20 Forecast Outturn	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Gross debt to net service expenditure	**10.97:1**	**11.45:1**	[illegible]	[illegible]	[illegible]

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

	2018/19 Actual	2019/20 Forecast Outturn	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Dependence on non-fee and charges income to deliver core services	**16.18**	[illegible]	[illegible]	[illegible]	[illegible]

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

	2018/19 Actual	2019/20 Forecast Outturn	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Investment Cover Ratio	**2.44**	[illegible]	[illegible]	[illegible]	[illegible]

21. **<u>Prudential Indicator 10 - Loan to value ratio</u>**

	2018/19 Actual	2019/20 Forecast Outturn	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Total debt compared to total asset value	**30.31%**	**[illegible]**	**[illegible]**	**[illegible]**	**[illegible]**

Borrowing Strategy 2020/21 – 2022/23

22. 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.

23. **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.

24. **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.

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

26. **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

27. 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

28. 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.

29. **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.

30. **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.

31. 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

32. 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').

33. 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.

34. 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.

35. 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.

36. 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.

37. 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.

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 requirements to 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.

  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 Limit category - 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.

<u>Prudential Indicator 11 – Principal Sums Invested > 365 days</u>

56. 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			
	2020/21	**2021/22**	**2022/23**
Principal sums invested > 365 days	£10m	£10m	£10m

Sensitivity to Interest Rate Movements

57. 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	**2020/21 Estimated + 1%**	**2020/21 Estimated - 1%**
Interest on borrowing	£1,030,000	£1,030,000
Investment income	£270,000	£270,000

Treasury Management Boundaries on Activity

58. There is one further treasury activity boundary. Maturity structures of borrowing (fixed and variable rate) – 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.

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

Prudential Indicator 13 – Fixed and Variable Interest Rate Borrowing

Maturity Structure of fixed interest rate borrowing 2020/21		
	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 2020/21		
	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

60. 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

61. 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.

62. 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.

63. This service is subject to regular review.

Member and Officer Training

64. 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

65. **PWLB increase in margins of 100 bps (1%)**

    On 9th October 2019 HM Treasury and PWLB announced that it was restoring interest rates to levels available in 2018, by increasing the margin that applies to new by 1% on top of usual lending terms. Many local authorities will now be viewing the PWLB as a lender of last resort. It is very likely that alternative providers of finance will step into the market for lending to local authorities.

66. **Ethical investing**

    This is a topic of increasing interest to members, and one that is also being raised through officers. However, investment guidance, both statutory and from CIPFA, makes clear that all investing must adopt SLY principles – security, liquidity and yield: ethical issues must play a subordinate role to those priorities.

    Link Asset Services is looking at ways in which we can incorporate these factors into our creditworthiness assessment service, but with a lack of consistency, as well as coverage, they continue to review the options and will update clients as progress is made. As such, it is not practicable to include Environmental, Social and Governance issues into this template at the current time.

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 3.

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.	£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.	£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 £5 million	£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 investment category subject to guarantee from the parent company.	£5m

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 3.

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 and Organisation, 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 Council, 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 2018.

Long term rating	1 year	2 years	3 years	4 years	5 years
AAA	0.04%	0.10%	0.17%	0.26%	0.36%
AA	0.02%	0.04%	0.09%	0.17%	0.24%
A	0.05%	0.14%	0.26%	0.40%	0.56%

BBB	0.15%	0.42%	0.73%	1.10%	1.47%
BB	0.68%	1.92%	3.34%	4.73%	5.95%
B	2.80%	6.78%	10.40%	13.48%	15.85%
CCC	18.82%	26.40%	31.62%	35.13%	38.19%

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

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).

Annexe A

Capital Strategy

The Capital Strategy considers the funding implication s of the CEP (PI 1 above) and where borrowing is required, the Treasury Management Strategy sets out the Council's borrowing strategy for the 2020/21 and forecasts for 2021/22 and 2022/23 along with its policy for managing investments.

The Treasury Management Strategy incorporates the statutory prudential indicators along with the Minimum Revenue Provision Policy to be adopted for 2019/20.

The Capital Strategy also provides an overview of the governance arrangements for capital investment decisions and outlines the Council's arrangements for managing risk.

Background

The Capital Strategy is a requirement for authorities following the publication of the revised Prudential Code for Capital Finance in Local Authorities in 2017.

The Capital Strategy provides:

- A high level overview of how capital expenditure, capital financing and treasury management activity supports the provision of services.
- An overview of how associated risk is managed.
- The implications for future years budgets and financial sustainability.

Consequently, the Capital Strategy maintains a strong link to the aims in the Council's 2019/24 Strategy which are:

- Community Wellbeing
- Environment
- Prosperity

The Capital Strategy covers the following key topics:

- Governance, reporting and scrutiny arrangements
- The Capital Programme
- Asset Management
- The extent of commercial activity
- The approach to borrowing and investments as set out in the Treasury Management Strategy
- The policy for setting aside amounts to repay debt as set out in
- the Minimum Revenue Provision Policy
- The financial indicators required by the Prudential Code
- The approach to risk
- The extent of other long-term liabilities
- Current knowledge and skills to deliver the Capital Strategy

Governance Framework

The Council's CEP involves the expenditure and financing of a modest £11.85m of capital schemes over the period 2020/21 to 2022/23. It is important therefore given the risks surrounding capital projects that appropriate governance arrangements are in place. For the Council these governance arrangements encompass:

- The Capital Strategy Statement itself which is approved annually at Full Council.
- The Cabinet which approves all capital schemes.
- The Audit Committee which is responsible for approving the PI's.
- The Senior Leadership Team (SLT) which has overall responsibility for the management and monitoring of the Capital Expenditure Programme.
- The Capital Board which oversee and agree business cases for capital schemes prior to submission to SLT and Cabinet.
- The Constitution (including Financial Regulations, the Scheme of Delegation and Contract Standing Orders) which sets out the powers of the Executive and senior officers with regard to capital expenditure.

Each month the Cabinet receives and approves a capital monitoring report which identifies any variation to the approved programme arising either from the re-phasing of schemes, changes in resource availability and requirements and new capital schemes.

All capital expenditure is guided by the Council's financial accounting framework which ensures that only expenditure that properly falls as capital expenditure in accordance with accounting convention and / or statutory guidance is capitalised.

The CEP is s subject to both internal and external audit scrutiny.

Capital Expenditure Programme 2020/21 to 2022/23

In summary, the Council is proposing to spend £11.85m over the next 3 years, which will be funded from existing reserves and Government grants.

The majority of the CEP incorporates previous investment decisions made by Cabinet and the Council. New projects will be incorporated within the Programme based on the core principles outlined in the Capital Strategy.

The CEP is subject to regular review with monitoring reports submitted to Cabinet monthly. Estimates of capital grant allocations are known to be subject to future variations. This includes the confirmed or indicative capital grant allocations for 2020/21 and future years. Any changes to capital grant allocations will be reflected in the grant income budgets.

Capital Appraisal Process

All new capital schemes are subject to a rigorous approval process. A strategic business case is required for all capital projects which:

- Sets out the schemes contribution to delivering the aims of the 2019/24 Strategic Plan
- Identifies the amount and source of any required funding.
- Is based on full lifetime costing including capital financing costs where relevant.
- Sets out the planned outcomes to be delivered.
- Includes a risk assessment.
- Incorporates appropriate due diligence in the form of financial and legal scrutiny (including external support when appropriate).
- Considers the revenue impact and financial affordability of schemes.

Subject to delegated limits, all new capital schemes will require Cabinet approval before they can progress. When the Cabinet approves a new scheme it will be added to the approved CEP.

The approved programme is monitored on a continuous basis and performance reported at regularly to Cabinet and the Audit and Governance Committee.

Investments and Loans

The Council may acquire assets in the form of freehold and leasehold properties or make loans where the primary purpose is the pursuit of regeneration or place-shaping priorities and not necessarily to generate a return over debt costs.

Loans

The Council may provide short-term cash flow support or longer term assistance to third parties via loans, with interest rates being determined through independent appraisal and having regard to state aid legislation.

To manage risk the Council will seek to ensure security through the application of charges on assets or appropriate director guarantees. The credit risk of the loan portfolio will be measured using the "expected credit loss" model as required under accounting standards introduced for local authorities in 2018/19.

Loans provided for a capital purpose are classed as capital expenditure under statutory regulations. Therefore, all such loans (including those to Council companies) will require Cabinet approval and the type and value of loasn will form a part of the CEP to be approved as part of the budget setting process. Subsequent variation to the approved amounts will require approval by Cabinet.

Regeneration

Where the Council acquires assets or uses its own assets as part of its wider regeneration priorities then it will seek to ensure that projects deliver longer term economic and financial benefits and where possible cover the capital financing costs. With regard to the acquisition of tenanted property the Council will seek to ensure that:

- Assets are of suitable specification and will not incur excessive repairs and maintenance charges (which in some instances may not be able to be passed on to tenants).
- Tenants are of sound covenant and are able to pay rent on time and in full.
- That the remaining lease period or the time to any break period is of sufficient length to ensure that the revenue stream from rentals is protected.
- That the rate of return is at least equal to or better than the cost of financing the asset.
- That the lease terms include full repairing and insuring provision and that rent review clauses are upward only.
- That properties include opportunities for future growth or regeneration.

Capital Financing

Wherever possible the CEP will utilise and maximise external funding provided either by central Government capital grant or other third party contributors (e.g. developers or other public sector agencies such as the Combined Authority). Whilst grants and other contributions will reflect Government and partner-led priorities they will nevertheless be deployed to address priority needs in the District.

The CEP is also reliant on internal or locally generated funding in the form of capital receipts from asset sales, direct revenue funding and prudential borrowing. In more recent years and as a result of central Government cuts to grant funding, capital investment plans have become increasingly reliant on capital receipts and prudential borrowing.

The Council has a substantial land and property estate. Where assets are identified as surplus to operational requirements they may be disposed of, resulting in a capital receipt. Capital receipts are generally not ring-fenced and will be used in such ways as to maximise the achievement of corporate priorities (including revenue efficiencies arising from capital receipts flexibilities) or to finance capital schemes. Capital receipts may also be used to repay amounts borrowed when there are clear benefits from doing so and this is set out further in the Minimum Revenue Provision Policy.

Based on the CEP no further borrowing is anticipated between 200/21 and 2022/23.

All previous borrowing was undertaken in full compliance with the CIPFA's Prudential Code which requires authorities to approve their own borrowing limits for the year with indicators to measure the affordability and sustainability of the Capital Programme.

Whenever possible, capital schemes financed from prudential borrowing will be along invest to save or invest to earn principles – that is, the scheme is required to make a return or generate revenue savings sufficient to cover its capital financing costs.

However not all capital schemes funded through prudential borrowing will generate such a return and in such cases, the resulting capital financing implications are a cost to the revenue budget. The revenue implications of capital financing decisions are monitored and reported as part of the budget monitoring framework.

Asset Management Plan (AMP) 2020/2024

The Council owns a property portfolio estimated to be worth approximately £186 million (as at June 2019), which will produce an annual income of £8.341m in 2019/20. Its properties fulfil a number of purposes for the benefit of our communities, they are pivotal to the delivery of services and provision of infrastructure for the residents.

Rental income from property assets is also a feature of the Council's Medium Term Financial Strategy, contributing towards the cost of operating council services and other forms of capital expenditure.

The AMP is based around three key areas:

- Proactive Approach to Asset Management
- Identification and Management of Surplus Property
- Use of Assets to support the delivery of organisational objectives

The Asset Management Plan, provides a framework through which these assets can be managed. It identifies the maintenance requirements of assets and also those assets which may be surplus and which can either be sold and used to fund new capital schemes or used as contributions to wider regeneration initiatives.

The Asset Management Strategy plays a key role in shaping the CEP (and also in funding the programme via capital receipts) in terms of the investment required to ensure that assets contribute to efficient service delivery.

Decisions to dispose of assets (subject to delegated limits) are taken by the Cabinet.

Annexe B

Asset Investment Strategy Annual Report 2019/2020

Introduction

The statutory guidance on Local Authority Investments (3rd edition) states that, in line with the key principles of transparency and democratic accountability, a number of specific disclosures and statements should be reported to Full Council each year.

The first report prepared in accordance with the statutory guidance was submitted for approval by Full Council at its meeting in February 2019 and sought to provide a full overview of the implementation of the Asset Investment Strategy (AIS) since its initial approval in October 2016.

As no acquisitions or disposals have been made since the last report, this report for 2019/2020 only provides an update on the portfolio's performance against the same set of key indicators used in 2018/2019, together with those statements and disclosures recommended by the statutory guidance.

Portfolio risk indicators

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, or both.	No fall in rating assigned to tangible net worth AND risk	There has been no fall in the rating assigned to tangible net worth for any of the tenant D&B ratings. Four of the tenants' D&B risk rating has deteriorated from 1 (minimum risk) to 2 (lower than average risk) and one tenant's risk rating has deteriorated from a 1 (minimum risk) to a 3 (higher than average).
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	100%	100%

	reconcile the service charge account may reflect poor performance by the managing agent.		
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. One rent review has been completed since the last Annual Report.
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

Statutory Guidance recommended Statements and Disclosures

Four of the recommended quantitative indicators are Prudential Indicators 7-10 inclusive reported in the Treasury Management Strategy in Appendix 3 to the main report.

The remaining five recommended quantitative indicators 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 5.7% per annum across the AIS assets.
Benchmarking of returns	A measure against other investments and against other council's property portfolios	Other investments: CCLA: 4.3% per annum (on average) Other investments: 0.4% 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: £5.263 million Total contribution £1.050 million projected for 2020/2021
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: for those properties held by Mova Property Limited, these are included in the statutory accounts. In relation to properties held by MVDC, these are managed in-house and

		reported as part of the MVDC budget monitoring process and in the statutory accounts. External managing agents for those assets outside the South-East and investment advisory services will be tendered in 2020.
Vacancy levels and tenant exposures for non-financial investments	Monitoring vacancy levels (voids) ensure the property portfolio is being managed (including marketing and tenant relations) to ensure the portfolio is as productive as possible,	None.