CABINET – 15TH OCTOBER 2020

Report of the Head of Financial Services

Lead Member: Councillor Tom Barkley

Part A

ITEM 7 CAPITAL STRATEGY (INCLUDING THE TREASURY MANAGEMENT STRATEGY) FOR 2020/21

Purpose of Report

This report introduces the Capital Strategy, which is required under the terms of the 'Prudential Code', a statutory code of practice. The report also sets out the Treasury Management Strategy Statement together with the Annual Investment Strategy and Minimum Revenue Provision (MRP) Policy. These latter strategies and the MRP policy are integral to the overarching Capital Finance Strategy and are therefore presented within a single report for context.

This Cabinet report recommends the approval of the above strategies to Council.

Recommendations

1. That the Capital Strategy, as set out at Appendix A of this report be approved and recommended to Council.

2. That the Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Policy as shown at Appendix B of this report be approved and recommended to Council.

3. That the Prudential and Treasury Indicators, also set out in within Appendix B of this report be approved and recommended to Council.

Reasons

1. To enable the Council to comply with the statutory code of practice issued by CIPFA: 'The Prudential Code for Capital Finance in Local Authorities, 2017 Edition'.

2. To ensure that the Council's governance and management procedures for Treasury Management reflect best practice and comply with the CIPFA Treasury Management in the Public Services Code of Practice, Guidance Notes and Treasury Management Policy Statement.

3. To ensure that funding of capital expenditure is taken within the totality of the Council's financial position and that borrowing and investment is

only carried out with proper regard to the Prudential Code for Capital Finance in Local Authorities.

Policy Justification and Previous Decisions

The Capital Strategy must be approved by Council on an annual basis.

The Treasury Management Strategy Statement, Prudential and Treasury Indicators and Annual Investment Strategy must be approved by Council each year and reviewed half yearly.

The original version of the Medium Term Financial Strategy (covering financial years 2020 - 2023) outlined the prospective financial challenges facing the Council and the contribution expected of the Investment Strategy in mitigating these challenges. Whilst the COVID-19 has exacerbated these challenges as reflected in the updated Medium Term Financial Strategy for 2020 – 2023, the Investment Strategy remains a key part of the Council's response.

Implementation Timetable including Future Decisions and Scrutiny

The implementation of this Strategy was previously scheduled for April 2020 but has been delayed due to cancellation of Council meetings due to the COVID-19 outbreak. If approved by Council the Capital Strategy (including its component strategies) will come into effect from 9 November 2020.

In line with the Financial Regulations the Audit Committee had the opportunity to review the draft Financial Strategy at its meeting of 22 September 2020. The Committee resolved not to refer any comments to Cabinet or Council.

This report is also available for the consideration of the Scrutiny Commission on 12 October 2020.

Report Implications

The following implications have been identified for this report.

Financial Implications

There are no direct financial implications arising from this report.

Financial issues arising from the implementation of the strategies are covered within the report.

Risk Management

Risk Identified	*Likelihood*	*Impact*	*Overall Risk*	*Risk Management Actions Planned*
Poor treasury investment decisions due to inadequate treasury management strategies in place	Unlikely 2	Serious 3	Moderate 6	Strategy developed in accordance with CIPFA guidelines and best practice. Adherence to clearly defined treasury management policies and practices
Loss of council funds through failure of borrowers	Remote 1	Major 4	Low 4	Credit ratings and other information sources used to minimise risk Adherence to clearly defined treasury management policies and practices
Volatile market changes (such as interest rates or sector ratings) occur during year	Likely 3	Significant 2	Moderate 6	Approved strategy in place, regular monitoring of position and use of Treasury Consultants and other sources to provide the latest advice.
Significant losses arising from investments in non-financial instruments (such as loans to third parties or property investments)	Unlikely 2	Major 4	Moderate 8	Professional advice will be sought in advance of non-standard or new investment activity. Adherence to strategy which set out limits to investment in individual asset classes.

Key Decision: Yes

Background Papers:

Investment Strategy 2019 - 20, Cabinet Report 19 September 2019

Treasury Management mid-year update – Cabinet Report 14 Nov 2019

Revised Capital Plan 2020 – 2023 – Cabinet Report 15 October 2020

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Part B

Background

1. The implementation of this version of the Capital Strategy has been delayed. Initially scheduled for approval at the Council meeting of 24 February 2020, it was necessary to reschedule the Strategy for approval at the Council meeting of 27 April 2020. This meeting was subsequently cancelled due to the COVID-19 outbreak and hence the Strategy as originally drafted in respect of 2020/21 was not approved by Council.

2. Due to the impact of COVID-19 it has been considered appropriate to modify the original draft Strategy for 2020/21 and hence a second Cabinet report is necessary to recommend the modified version to Council.

3. The Capital Strategy is a requirement arising from the extant version of the 'Prudential Code'. This code is a statutory code of practice and was published by the Chartered Institute of Public Financial Accountants (CIPFA) taking effect from 1 April 2019. It was issued by the Secretary of State under section 15(1)(a) of the Local Government Act 2003. Under that section local authorities are required to 'have regard' to 'such guidance as the Secretary of State may issue'.

4. The Council's treasury management activities also fall within the scope of the Prudential Code.

5. The Capital Strategy forms part of the Council's integrated revenue, capital and balance sheet planning. It sets out the long-term context in which capital expenditure and investment decisions are made, considers risks and rewards and the potential impacts on Council objectives

6. The Capital Strategy is an overarching strategy that encompasses the following aspects:

    - Capital expenditure and governance
    - Capital financing and the borrowing
    - Treasury management investments (essentially financial assets) set out within the Annual Investment Strategy
    - Commercial strategy – investment in non-financial assets (including commercial properties and prospective housing development)
    - Access to knowledge and skills (enabling the strategy to be delivered)
    - Treasury Management policy statement and practices (presented as a separate appendix)

7. The Treasury Management Strategy Statement, incorporating the Annual Investment Strategy, have been prepared in accordance with the revised code and accordingly include:

   - the treasury limits in force which will limit the treasury risk and activities of the council,
   - the Prudential and Treasury Indicators
   - the current treasury position
   - the borrowing requirement
   - prospects for interest rates
   - the borrowing strategy
   - policy on borrowing in advance of need
   - debt rescheduling
   - the investment strategy
   - creditworthiness policy
   - the use of external fund managers and treasury advisers
   - Minimum Revenue Provision (MRP) Policy

Salient features of the proposed Capital Strategy for 2020/21

8. The principal changes and matters of note proposed within the Strategies and other Appendices to this report are:

   - An amendment to the Annual Investment Strategy to increase counterparty limits on deposits with HSBC (the Council's bankers) to take advantage of an easily accessible term deposit at favourable interest rates (see Appendix B – B3)
   - An amendment to the Annual Investment Strategy to increase the maximum maturity period for local authority investments from 24 to 60 months (see Appendix B – B3)
   - An amendment to the Annual Investment Strategy to add Housing Associations (with adequate credit references) to the list of allowed non-specified investments, again to offer the potential of achieving greater investment returns (see Appendix B – B3)
   - Other amendments to the Strategies to allow:

    - The development of a commercial property portfolio enabled by total borrowings of up to £25m

    - Creation of a fund to take opportunities arising from the Town Deal, or other regeneration opportunities enabled by total borrowings of up to £15m

    - Creation of a fund to to allow ‘forward funding’ of buildings or infrastructure within the Enterprise Zone enabled by total borrowings of up to £15m

- It should be stressed that inclusion of the above within the Capital Plan does not imply that all (or any) of the above amounts would be expended. Further discussion of the above is set out later in this document.

- It should also be noted that projects under the three separate themes will be required to follow the necessary due diligence and governenace processes. A key part of the required business case seeking expenditure will be an assessment of cost benefit and return on investment.

- Implementing the above requires:

    - Uplift to the estimates of the Capital Financing Requirement (see Appendix B, section 2.2)

    - Increasing the allowed limits to borrowing and investment activity (see Appendix B, sections 3.2 and 4.4)

- Implementing a policy on MRP which specifically addresses prospective acquisitions of commercial property (see Appendix B, sections 2.4 and Appendix B (2))

9. For the purposes of the Capital Strategy and other documents associated with this report it is assumed that the Council will also approve the Revised Capital Plan 2020 – 2023 which is scheduled for the same Cabinet and council date as this report.

10. As stated in Part A, this report also requests that the Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Policy together with the Prudential and Treasury Indicators, be approved and recommended to Council.

<u>Appendices</u>

Appendix A: Capital Finance Strategy

Appendix B: Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Policy for 2019-20

Sub appendices contained within this document:

B (1) Economic background

B (2) Minimum Revenue Provision

B (3) Treasury Management Practice

B (4) Approved countries for investment

B (5) List of approved brokers for investment

B (6) Current investments (illustrative snapshot)

B (7) Treasury management scheme of delegation

B (8) Treasury management role of the Section 151 Officer

APPENDIX A

Charnwood Borough Council

Capital Strategy

2020 – 2021

Foreword

The requirement for the Capital Strategy arises from the terms of the 'Prudential Code', a statutory code of practice. The implementation of the second iteration of our Capital Strategy has been somewhat delayed due to COVID-19 but this does at least allow us to consider the financial impact of the outbreak (to the extent we understand it at present) and also to reflect emerging opportunities such as those arising from the Town Deal and the Enterprise Zone.

Generally, this version of the Capital Strategy builds on our initial thinking and develops in more detail some of our plans and aspirations in the areas of capital planning, treasury management, and new borrowing to assist the economic development of our communities as they recover from the COVID-19 outbreak. At this point in time we still have the intention of developing a portfolio of commercial property to help us mitigate the financial challenges outlined in the latest version of our Medium Term Financial Strategy. This is something that is more important than ever given the additional financial pressures arising from COVID-19 but we are aware that the rules around borrowing to finance commercial property are likely to change, and clearly any investment decisions made will need to be in compliance with extant regulation.

Alongside this Capital Strategy, we are also bringing forward mid-year revisions of the Medium Term Financial Strategy 2020 - 23, Budget 2020/21, and Capital Plan 2020 – 23, which aim to provide a 'reset' in the light of the COVID-19 outbreak, and be helpfully read in conjunction with each other.

Our plans include a more proactive approach to treasury management, investment in regeneration and economic development, prospective investments in commercial property and the wider development of commercial opportunities. We also still have aspirations to deliver housing through the mechanism of a Housing Development Company in order to meet the ongoing demand for new homes within our Borough. Enabling these initiatives require additional flexibility in the Council's treasury management and borrowing policies which are introduced within the Capital Strategy and associated Treasury Management Strategy which outlines important changes in this regard, in particular the anticipated use of prudential borrowing to support investment and a more financially advantageous approach to refreshing the environmental services fleet. Security and liquidity will remain as key elements of the Council's approach to financial management but the anticipated challenges ahead point us towards a more proactive approach in the use of our financial assets.

Councillor Tom Barkley

Cabinet Lead Member for Finance & Property Services

September 2020

CAPITAL STRATEGY (INCLUDING TREASURY MANAGEMENT)

The purpose of the Capital Strategy is to demonstrate that the Council takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability. It sets out the long term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes. The Capital Strategy comprises a number of distinct, but inter-related, elements as follows:

1. **Capital expenditure**; which includes an overview of the governance process for approval and monitoring of capital expenditure, including the Council's policies on capitalisation, and an overview of its capital expenditure and financing plans.

2. **Capital financing and borrowing**; provides a projection of the Council's capital financing requirement, how this will be funded and repaid. It therefore sets out the Council's borrowing strategy and explains how it will make prudent revenue provision for the repayment of debt should any borrowing be required.

3. **Treasury management investments**; explains the Council's approach to treasury management investment activities, including the criteria for determining how and where funds will be invested to ensure that the principal sums are safeguarded from loss and that sufficient liquidity is maintained to ensure that funds are available when needed.

4. **Commercial investments**; provides an overview of those of the Council's current and any potential commercial investment activities that count as capital expenditure, including processes, due diligence and defining the Council's risk appetite in respect of these, including proportionality in respect of overall resources.

5. **Knowledge and skills**; summarises the knowledge and skills available to the Council and provides confirmation that these are commensurate with the Council's risk appetite. Further details are provided in the following sections.

6. (Appendix B). **Treasury management policy statement and practices**; this is presented separately; it updates to the Council's Treasury Management Policy Statement and to its Treasury Management Practices. These set out the Council's policies, objectives and approach to risk management of its treasury management activities, and the manner in which it seeks to achieve its policies and objectives for treasury management.

1. Capital expenditure

1.1. Capitalisation policies

1.1.1. Capital expenditure involves acquiring or enhancing non-current assets with a long-term value to the Council, such as land, buildings, and major items of plant and equipment or vehicles, as well as the contribution or payments of grants to others to be used to fund capital expenditure. Capital assets shape the way services are delivered for the long term and may create financial commitments for the future in the form of financing costs and revenue running costs. Subsequent expenditure on existing assets is also classified as capital expenditure if these two criteria below are met.

1.1.2. Expenditure is classified as capital expenditure when the resulting asset:

- Will be held for use in the delivery of services, for rental to others, or for administrative purposes; and
- Is of continuing benefit to the Council for a period extending beyond one financial year.

1.1.3. There may be instances where expenditure does not meet this definition, but would nevertheless be treated as capital expenditure. This is known as 'Capitalisation' and it is the means by which the Government, exceptionally, permits local authorities to treat revenue costs as capital costs. It allows exceptional revenue costs, that should be met from revenue resources to be treated as capital expenditure. Permission is given through capitalisation directions, which the Secretary of State can issue under section 16(2)(b) of the Local Government Act 2003.

1.1.4. The Council operates a de-minimis limit of £10,000 for capital expenditure. This means that items below this limit are charged to revenue rather than capital.

1.2. Governance

1.2.1. A three year Capital Plan is prepared by officers and approved by Council. Potential schemes are identified by Officers, in conjunction with Cabinet members, and supported by a Capital Application form. Following a process of review by senior officers a report is prepared for Cabinet with recommendations as to which schemes to include in the Plan, how the Plan would be funded and other elements such as risk and compliance with the Prudential Code.

1.2.2. Once adopted the three year Capital Plan is formally reviewed by Cabinet at the end of year two when Heads of Service are asked to submit proposals for the following three years. 'Year three' of the current plan would then become 'year one' of the new plan.

1.2.3. New schemes can only be added outside of this procedure where they are in substitution of existing schemes or have a separate source of funding so that the actual total level of the Plan would not increase.

1.2.4. All schemes of £50,000 in value or greater require Capital Appraisal and all procurement and contracting must adhere to the Contract Procedure Rules. The s151 Officer makes recommendations to Cabinet as to whether funding should be released to allow new schemes to be included in the Capital Plan.

1.2.5. After the end of the financial year an outturn report detailing the total amount of capital expenditure incurred during the year is submitted to Cabinet by the Section 151 Officer.

1.2.6. Prior to the closure of the Council's accounts a report detailing the proposed method of funding the capital expenditure incurred is submitted to Cabinet by the Section 151 Officer as required by the Local Government & Housing Act 1989.

1.3. Current Capital Plan

1.3.1. The Council has a policy of preparing a three year Capital Plan, and then refreshing this every other year. Due to timings, there are at the time of drafting this Strategy essentially two Capital Plans in existence. The first covering the financial years 2018/19 - 2020/21, was originally approved by Council on 26 February 2018 with the latest amendments approved by Cabinet at its meeting of 16 December 2019. The second is the 'new' capital plan covering financial years 2020/21 – 2022/23 which was approved by Council on 24 February 2020.

1.3.2. It was always envisaged that the Capital Plans would be merged to create to single Plan from 1 April 2020. Additionally, following the COVID-19 outbreak this merged Capital Plan will be subect to a mid-year revision to reflect additional financial pressures and emerging new priorities. This amended, merged, Capital Plan is scheduled for consideration at the Council meeting of 9 November 2020, alongside this Capital Strategy.

1.3.3. In totality, to 31 March 2023, capital expenditure (including externally funding) is planned as follows:

General Fund	£78m
HRA	£24m

The capital expenditure for the General Fund shows a very significant increase over previous years. This includes £4.8m required for the purchase of the Environmental Services Fleet and other amounts which are designed to allow the Council to invest in the event that opportunities present themselves. The key elements here are:

- £15m - Regeneration funding to support Town Deal and other initiatives
- £15m – Forward funding of schemes enabling the development of the Enterprise Zone financed by future business rate receipts
- £25m – Creation of a commercial property portfolio

1.3.4. It should be stressed that inclusion of the above within the Capital Plan does not imply that all (or any) of the above amounts would be expended. Further discussion of the above is set out later in this document.

1.3.5. The Capital Plan is funded by a combination of the following sources:

- Capital grants and contributions - amounts awarded to the Council in return for past or future compliance with certain stipulations.
- Capital receipts – amounts generated from the sale of assets and from the repayment of capital loans, grants or other financial assistance.
- Revenue contributions – amounts set aside from the revenue budget.

1.3.6. Prudential borrowing - In addition to the above the Council also has the option to borrow to fund capital expenditure. At this point in time the Council has not taken any borrowing to fund General Fund capital expenditure but some level of borrowing will now be required if the Council is to deliver its Capital Plan within the projected timescales.

1.3.7. The Council has taken out borrowing to fund the purchase of its housing stock (held within the Housing Revenue Account) from the Government under the 2012 Self-Financing Regime. This totals £79m.

1.3.8. Borrowing allows the Council to defer the funding of its capital expenditure so that it does not need to fund immediately from existing reserves, but instead charges to the revenue budget over a number of years into the future.

1.3.9. The implications of financing capital expenditure from ‘borrowing’ are explained later on in Treasury Management Investments.

2. Capital Financing Requirement and borrowing

2.1. The Council is required by regulation to comply with the CIPFA Prudential Code for Capital Finance in Local Authorities (referred to as the 'Prudential Code') when assessing the affordability, prudence and sustainability of its capital investment plans. Fundamental to the prudential framework is a requirement to set a series of prudential indicators. These indicators are intended to collectively build a picture that demonstrates the impact over time of the Council's capital expenditure plans upon the revenue budget and upon borrowing and investment levels, and explain the overall controls that will ensure that the activity remains affordable, prudent and sustainable.

2.2. At the time of drafting the Government, in conjunction with CIPFA, is consulting on a revised set of rules and associated Prudential Code, which will significantly restrict the ability of local authorities to borrow for the acquisition of commercial properties. The final detail of any changes, and effective date of implementation of the new Code will obviously be addressed as part of any investment decisions.

2.3. As referenced in the previous section, the Council's capital expenditure plans mean that it is highly likely that the Council will need to finance this expenditure using prudential borrowing. This is an important departure from historical practice and the implications of this approach are set out within Appendix B of this document set which details (potential) prudential borrowing within the overall context of the Council's Capital Financing Requirement.

2.4. The full details of the Council's Capital Financing Requirement (CFR) position and the limits that have been set for borrowing and all the associated prudential indicators are provided In the Treasury Management Strategy Statement (Appendix B).

3. Treasury management investment

3.1. The Treasury Management Code and statutory regulations require the Council to prepare an annual strategy that explains how the Council will invest its funds, giving priority to security and liquidity, and then to yield. This Annual Investment Strategy is set out in full in the Treasury Management Strategy Statement (Appendix B).

3.2. The Council's Treasury Management Strategy Statement (TMSS) covers 'specified investments' and loans to other local authorities. The policies are designed to comply with the Statutory Guidance on Local Government Investments ('the Guidance'), effective from 1 April 2018. The Council manages treasury operations in line with its TMSS, which in turn is in accordance with the guidance. The Council is required to review the TMSS on an annual basis.

3.3. The Guidance defines in detail what criteria an investment would meet to be categorised as 'specified' One of the criteria of specified investments is that the local authority has a contractual right to repayment within 12 months. Certain loans to other local authorities made by the Council have a term of up to two years (with an intention to increase the allowed maimum to five years), so do not fall strictly within the definition. However, the Council considers that management of this type of financial instrument should fall within the ambit of the TMSS.

CHANGES TO THE TREASURY MANAGEMENT STRATEGY FOR 2020/21

3.4. Interest rates are at historically low levels and are expected to remain so for several months ahead. In a continuation of the current direction, in which the Council has sought to increase returns from its treasury management activities.

3.5. Assuming an average fund under management of £50m, an increase in return by an average of 0.1%, this would generate additional income of £50,000 per annum.

3.6. Given the above the following amendments have been made to the TMSS:

- An amendment to increase counterparty limits on deposits with HSBC (the Council's bankers) to take advantage of an easily accessible term deposit at favourable interest rates (see Appendix B – B3)

- An amendment to increase the maximum maturity period for local authority investments from 24 to 60 months (see Appendix B – B3)

- An amendment to add Housing Associations (with adequate credit references) to the list of allowed non-specified investments, again to offer the potential of achieving greater investment returns (see Appendix B – B3)

4. Commercial investments

4.1. The prolonged low interest rate environment has meant that treasury management investments have not generated significant returns. However, the introduction of the general power of competence has given local authorities far more flexibility in the types of activity they can engage in. These changes in the economic and regulatory landscape, combined with significant financial challenges, have led many authorities to consider different and more innovative types of investment.

4.2. CIPFA has issued an update to its Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes (the Treasury Management Code). One of the main changes introduced by the new Code is to require authorities to incorporate all of the financial and non-financial assets held for financial return in authorities' annual capital strategies.

4.3. Separately, the Ministry of Housing, Communities and Local Government has issued Statutory Guidance on Local Government Investments under section 15(1)(a) of the Local Government Act 2003 and effective for financial years commencing on or after 1 April 2018.

4.4. As is the case for treasury activities, commercial investment should balance:

- Security – to protect the capital sums invested from loss
- Liquidity – ensuring the funds invested are available for expenditure when needed
- Returns – ensuring that the Council's investment ability is used effectively

4.5. Commercial investments of are primarily undertaken by the Council in order to generate income to support the delivery of a balanced budget. Such investments are only entered following a full assessment of the risks and having secured expert external advice (i.e. where it is relevant to do so).

4.6. Commercial investment may be defined quite widely and could include, for example:

- Commercial property investment held solely for the purposes of generating a financial return
- Investments in wholly owned companies and joint ventures (which maybe in the form of equity or loans)
- Wider scale and more ambitious regeneration projects
- Ad-hoc complex investments

4.7. The Statutory Guidance describes non-financial investment as being in non-financial assets held primarily or partially to generate a profit. Usually it will be expected that the underlying asset could be 'realised' to recoup the capital invested.

4.8. There are important aspects of financial reporting that Council's must be aware of. In terms of reporting it is necessary to state whether:

- The fair value of non-financial investments is sufficient to provide security against losses, and that the underlying assets provide adequate security for the originating capital investment

- Where the fair value is insufficient detail of mitigating actions should be provided to protect the capital invested

- Additionally, where the fair value assessment recognises a loss in the non-financial investment the subsequent Capital Strategy will need to reflect the impact of loss of security and the associated revenue consequences

- Fair value accounting in this context is covered by International Financial Reporting Standard 9, as modified by a five-year statutory override applicable to local authorities (covering financial years from 2018/19). The implication of the override is that if a local authority recognises a loss on investment then this will not impact on the general fund, or, therefore, on an authority's ability to set its budget. However, the override is (currently) time limited and a major downturn in the value of specific assets, or the property market generally, represents a clear risk in future financial periods.

4.9. The following paragraphs outline options open to the Council and sets out the strategic approach the Council intends to adopt in this area.

<u>Commercial Investment properties</u>

4.10. The Council already owns land and buildings that have been acquired for capital appreciation and/or solely to earn rentals, rather than for the supply of goods or services or for administrative purposes. Such assets are classified as investment properties (unless they are acquired as the outcome of a regeneration priority).

4.11. In considering its approach to investment properties the Council has to consider the application of parameters including:

- Prospective cost of potential acquisitions

- The maximum proportion of the Council's investment assets that should be held in the form of investment properties

- The balance of property assets held with different sectors of the market

- Possible geographical limits on prospective acquisitions

- Whether properties are acquired purely on commercial grounds or whether other policy objectives, such as regeneration, should also be taken into account

- The required or target rental yield from properties held for investment

4.12. The strategy for 2020/21 is set out below.

STRATEGY FOR 2020/21 - INVESTMENT IN COMMERCIAL PROPERTY

An total of £25m to expand the Council's commercial property portfolio has been created within the updated 2020 - 23 Capital Plan. This amount represents the total value of the commercial property portfolio considered appropriate for the Council at this time.

This investment will be purely to generate investment returns to address the financial challenges outlined in the extant MTFS.

No specific minimum or maximum will be applied to any single property investment, to avoid restricting the Council's actions should financially advantageous opportiunities present themselves. However, it is envisaged that acquistions, at least initially, will normally be in the range of £1m - £10m. It should also be noted that availability of funds set aside in the capital plan provide a natural limit on the cost of acquisitions.

The target minimum acceptable net yield, after allowing for interest payments and MRP charge will be 3.5%. This minimum net yield may be varied, e.g. it may be appropriate to accept a lower yield to balance risk within the overall property portfolio. In cases where the 3.5% minimum net yield will not be met, this will be understood and recorded in any delegated decision to purchase, providing a clear rationale and justification.

Property acquisitions may often be located outside of the Borough - this assists the Council to act in the same way as a commercial landlord and not allow returns to be compromised by local considerations – but this will not preclude good investment opportunities within the Borough being taken up.

Reserves will be created out of rental income to allow for the impact of:

- MRP requirements
- Allowance for void rental periods and landlord repair obligations

Appropriate independent professional advice will be sought for each property acquisition.

Timing of any transaction may not allow for presentation of the item at a full meeting of the Scurtiny Comission. Therefore, prior to finalising any transaction, reports will be presented to the Chair of Scrutiny Comission at a mimum, outlining the business case and rationale as well as any case for urgency in decision making.

Pro tem it will be assumed that all funding will be allocated to the 2020/21 financial year.

<u>Loans to local enterprises and third parties</u>

Loans to local enterprises or partner public sector bodies could be considered, as part of a wider strategy for local economic growth, even though they may not all be seen as prudent if adopting a narrow definition of prioritising security and liquidity. Such loans could be considered as an option to generate a yield. There would need to be a set of criteria drawn up which would need to be met before any loan was given. These might include:

- Whether or not the loan has security
- The term of the loan
- The profile of capital repayments
- The credit rating of the counterparty
- That total financial exposure to this type of loan is proportionate
- An allowed 'expected credit loss' model for assessing credit risk is adopted[1]
- Appropriate credit control arrangements to cover overdue payments are in place
- The local authority has formally agreed the total level of loans by type that it is willing to make, and the total loan book is within that self-assessed limit

The Council will not proactively seek to market loans to third parties but will consider offering loans to local enterprises, local charities, on a case by case basis, as and when approached.

The Council will also consider offering a loan, on a case by case basis, to any subsidiaries that may exist at a point time; in particular, this would apply should the Council have a subsidiary Housing Development Company.

The strategy in this area is set out below.

STRATEGY FOR 2020/21 – LOANS TO THIRD PARTIES AND SUBSIDIARIES

No money will be set aside within the Capital Plan unless and until a specific proposal is available for consideration.

Should an opportunity to offer a loan to a third party arise reports will be taken to Cabinet, and Council if required, to seek specific approval for that transaction.

All prospective debtor organisations will be either be located, or will have substantial operations, within the Borough.

Any asset created through the loan will be located within the Borough.

The purpose of the loan will support local economic growth as defined within the extant Corporate Plan.

The maximum total loan book the Council would manage will be £10m.

The maximum single loan to an individual organisation will be:

- Secured loan £5m
- Unsecured loan £2m

The maximum total value of unsecured loans will be £4m.

Loans will be offered on a commercial basis with rates offered dependent on risk; unsecured loans will attract higher interest rates. Rates offered will be in accordance with independent professional advice

[1] As defined within International Financial Reporting Standard 9 – in broad terms the likelihood of a creditor defaulting in future must be considered in accounting for impairment (compared to previous Standards in which accounting was based on actually incurred losses)

Due diligence will be carried out on prospective debtor organisations. Generally, independent professional advice will be taken to ensure that the structure of loan finance offered, and the risk and return associated with that structure is appropriate.

Support for Subsidiaries

The Council does not currently have any wholly owned local trading or property (housing) companies. Should the Council decide to form a subsidiary then Council could decide to provide the funding required to support these organisations. As with providing loans to local enterprises and third parties there would need to be a set of criteria drawn up which would need to be met before any loan was given. This would mitigate the risk of loss to the Council.

However, the Council is actively considering the creation of a Property Development Company (probably with a housing focus). It may be appropriate to invest directly in the equity of a Property Development Company, rather than in the form of a loan, as described above. The basis of investment will be equivalent, as described below.

STRATEGY FOR 2020/21 - INVESTMENT IN A PROPERTY DEVELOPMENT COMPANY

No money has been allocated within the capital plan at present. This funding *may* be in the form of an equity investment in the PDC, upon which dividends or and / or management fees will be due to the Council. It is assumed that this funding be financed through Council borrowing, as and when investment is required. *At minimum*, dividends and management fees will cover all of the Council's borrowing costs, in cases where the subsidiary company is wholly owned by the Council. At minimum dividends and management fees will cover all of the Council's borrowing costs, plus a margin of in cases where a subsidiary company or joint venture is only partially owned by the Council. Professional advice will be taken to ensure: • Any loans are structured in the most advantageous way, having regard to risk, prospective returns, and tax implications • MRP can be avoided or mitigated through the loan structure Appropriate due diligence will be carried out on prospective partner organisations. In total, the maximum investment in a PDC, whether by loan or equity investment, will be an amount of £10m.

Economic development and regeneration

COVID-19 has, as might be expected, had a significantly negative impact on businesses, which is reflected in both the physical environment and employment rates. In general, the Council would want to consider investment projects that benefit its communities, but it also has the opportunity to invest using the following specific arrangements:

- Town Deal: The Government has provided funding of up to £25m to support improvements to Loughborough town centre; release of some of this funding may be facilitated by providing 'match' funding from the Council[2]

- Enterprise Zone: The Council can support the development of infrastructure on its Enterprise Zone sites by taking out a loan to fund projects, repayable fro future business rates generated

The strategy as related to the these opportunities is set out below:

STRATEGY FOR 2020/21 - INVESTMENT IN THE TOWN DEAL AND REGENERATION PROJECTS

An amount of £15m to fund material investment in the Town Deal and regeneration projects will be included in the revised Capital Plan 2020-23 (subject to approval by Council).

Pro tem it will be assumed that this funding is phased £5m in 2021/22 and £10m in 2022/23.

It is assumed that this funding be financed through Council borrowing, as and when investment is required.

For Town Deal investment:

- Investment for projects will be allocated based on approvals through the Town Deal governance processes and subject to overarching central government approval (based on the Town Investment Plan).

Investment in other regeneration projects (ie. where funding is to come from this £15m allocation) will be approved by Cabinet on a case by case basis. In general, it is antipated that such projects will provide a positive financial return to the Council, but that a lower return than may be achievable with pure commercial investment will be acceptable.

STRATEGY FOR 2020/21 - INVESTMENT IN THE ENTERPRISE ZONE

An amount of £15m to forward fund investment in the Enterprise Zone (EZ) will be included in the revised Capital Plan 2020-23 (subject to approval by Council).

This total amount will be profiled for the 2020/21 financial year to ensure there is no impediment to investment opportunities (although in practice much of this allocation may be carried forward into future years).

The mechanism by which the investment will work is as follows:

1. The Council will take out a loan for the amount required to fund the project
2. Funds will be passed to the LLEP, who will then make a grant to the site sponsor[3] who will undertake the project delivery
3. The Council will cover the loan costs by retaining business rates generated by the project that would otherwise have been due to the LLEP (the LLEPP share of business rates generated is 85% as set out in the EZ agreement)

MRP treatment – generally, MRP will be calculated using the annuity method reflecting the life of underlying assets being long term and assumed at 40 years. However, where the loan is taken out on a repayment basis (as may be the case) then no MRP charge will be deemed necessary.

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[2] Although it should be noted that the Town Deal also strongly encourages participation and investment from the private sector

[3] The site sponsors would be either Charnwood Campus (Jayplas) or Loughbourough University

Forward funding agreements will be:

- Based on business cases supported by the Council and subject to approval by the LLEP Board (where the Council has representation at present)
- Subject to Cabinet approval on a case by case basis

A condition of any forward funding agreement is that the loan will have to be underwritten by the site sponsor.

It is assumed that this forward funding be financed through Council borrowing, as and when investment is required. It is also expected that repayment of the loan via future business rates will create a small 'margin' versus the terms of the loan that will provide a positive contribution to the Council's finances.

Other commercial investments

Investment in other types of asset, or in larger and more complex arrangements, is not considered within this iteration of the Commercial Investment strategy. In practice, should opportunities arise, the Commercial Investment and Capital Strategies could be amended, subject to the approval of full Council, to allow emerging opportunities to be exploited. It can also be assumed that any significant investment would be subject to the specific approval by Cabinet.

5. Knowledge and Skills

5.1. The Council recognises the importance of ensuring that all officers involved in the treasury management function (including commercial investment activities) are fully equipped to undertake the duties and responsibilities allocated to them. The Strategic Director for Corporate Services is responsible for recommending and implementing the necessary arrangements and does this by:

- Appointing individuals who are capable and experienced.

- Providing training and technical guidance to all individuals involved in the delivery of the treasury management function to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills to undertake the duties and responsibilities allocated to them.

- Appointing a treasury management advisor and other professional advisors when required. This ensures that the individuals involved in delivery of the Council's treasury management activities have access to specialist skills and resources. In addition, professional advisors are employed as required to ensure that the Council has access to the specialist skills and resources necessary to undertake commercial investment activities.

5.2. Treasury management advisors - The Council employs Link Asset Services (Treasury Solutions) to provide it with treasury management advice. The services provided by Link Asset Services (Treasury Solutions) include advice on treasury matters and capital finance issues, economic and interest rate analysis and creditworthiness information. Notwithstanding this, the final decision on all treasury matters remains vested with the Council. The services received from Link Asset Services (Treasury Solutions) are subject to regular review, including through periodic re-tendering.

6. Treasury management Policy Statement and Treasury Management Practices

6.1 The Council's Treasury Management Policy Statement and its Treasury Management Practices have been updated to reflect the requirements of the updated Treasury Management Code. They are presented for approval in the Treasury Management Strategy (Appendix B)

APPENDIX B

Charnwood Borough Council

Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

2020/21

Including Commercial activities/non treasury activities

INDEX

1. INTRODUCTION

1.1 Background

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 the cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in generally low risk counterparties or instruments commensurate with the Council's risk appetite, ensuring the provision of adequate liquidity (cash balances) initially before considering investment return.

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 longer term cash management may involve arranging long or short term loans, or using longer term cash flow surpluses. When prudent and econcomic any debt previously drawn may be restructured to meet Council risk or cost objectives.

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.

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.

CIPFA defines treasury management as:

> *"The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."*

1.2 Reporting requirements

1.2.1 Capital Strategy

The CIPFA 2017 Prudential and Treasury Management Codes requires as from 2020/21 all local authorities to prepare a capital strategy report, which provides the following:

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

The aim of this capital strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

This capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset. The capital strategy will show:

- The corporate governance arrangements for these types of activities;
- Any service objectives relating to the investments;
- The expected income, costs and resulting contribution;
- The debt related to the activity and the associated interest costs;
- The payback period (MRP policy);
- For non-loan type investments, the cost against the current market value;
- The risks associated with each activity.

Where a physical asset is being bought, details of market research, advisers used, (and their monitoring), ongoing costs and investment requirements and any credit information will be disclosed, including the ability to sell the asset and realise the investment cash.

Where the Council has borrowed to fund any non-financial investment, there should also be an explanation of why borrowing was required and why the borrowing is justified in the light of MHCLG Investment Guidance and the CIPFA Prudential Code.

If any non-financial investment sustains a loss during in a financial year, the strategy and revenue implications will be reported through the same procedure as the capital strategy.

To demonstrate the proportionality between the treasury operations and the non-treasury operation, high-level comparators are shown throughout this report.

1.2.2 Treasury Management reporting

The Council is required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals.

a) **Prudential and treasury indicators and treasury strategy** (this report) - The first and most important report covers:
- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

b) **A mid-year treasury management report** – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

c) **An annual treasury report** – This provides details of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit Committee and the reports are also available for consideration by the Scrutiny Commission.

1.3 Treasury Management Strategy for 2020/21

The strategy for 2020/21 covers two main areas:

Capital issues
- Capital plans and prudential indicators;
- Minimum revenue provision (MRP) policy.

Treasury management issues
- current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, MHCLG MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny (which largely falls under the ambit of the Audit Committee). Suitable training is provided for members on a periodic basis as part of the wider Member training programme. Officers are also available to train and advise members on an ad hoc basis outside of this programme if required. The training needs of treasury management officers are reviewed annually as part of the Personal Review process

1.5 Treasury management consultants

The Council uses Link Asset Services Treasury Solutions as its external treasury management advisors. 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 the service of our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, that from our treasury advisers.

It also recognises that there is value in employing external providers of treasury management services in order to access specialist skills and resources. Officers will ensure that the terms of appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

The scope of investments within the Council's operations may include both conventional treasury investments, (the placing of residual cash from the Council's functions), and more commercial type investments, such as investment properties in the future. The commercial type investments require specialist advisers, and the Council would appoint suitably qualified specialist advisers in relation to this activity when required.

2. THE CAPITAL PRUDENTIAL INDICATORS 2020/21-2022/23

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

2.1 Capital expenditure

The Council's capital expenditure plans are the key driver of Treasury Management activity. This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

Capital expenditure	*2019/20 Actual £'000*	*2020/21 Revised Estimate £'000*	*2021/22 Revised Estimate £'000*	*2022/23 Revised Estimate £'000*
General Fund - general	2,236	11,789	3,208	2,444
Commercial Investments	0	25,000	0	0
Enterprise Zone	0	15,000	0	0
Regeneration	0	5,000	10,000	0
HRA	8,208	8,941	7,381	7,724
Total	**10,444**	**65,730**	**20,589**	**10,168**

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Financing of capital expenditure	***2019/20 Actual £'000***	***2020/21 Revised Estimate £'000***	***2021/22 Revised Estimate £'000***	***2022/23 Revised Estimate £'000***
Total Capital Expenditure as per above table	**10,444**	**65,730**	**20,589**	**10,168**
Financed by:				
Capital receipts	1,120	6,817	2,384	1,751
Capital grants	857	2,676	1,274	1,143
Capital reserves	4,595	630	0	0
Revenue Contributions	3,872	8,207	6,931	7,274
Internal borrowing	0	2,400	0	0
External borrowing	0	45,000	10,000	0
Total Funding	**10,444**	**65,730**	**20,589**	**10,168**

2.2 The Council's borrowing need (the Capital Financing Requirement)

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

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

The resultant CFR projections are set out in the table below. These reflect the Revised Capital Plan (which is subject to approval by Council 9 November 2020) and the main body of the Capital Strategy report, and comprise:

- Part funding of the Environmental Services fleet in 2020/21 through Internal borrowing (£2.4m)
- Creation of a fund to purchase Commercial Property (£25m), all profiled for 2020/21
- Creation of a Regeneration fund to take advantage of opportunities arising from the Town Deal, and others that may arise; £15m split £5m in 2020/21 and £10m in 2021/22

- Creation of a £15m fund – all profiled in 2020/21 – to enable forward funding within the Enterprise Zone (to be repaid through business rates generated)

Capital Financing Requirement	***2019/20 Actual £'000***	***2020/21 Revised Estimate £'000***	***2021/22 Revised Estimate £'000***	***2022/23 Revised Estimate £'000***
CFR - Fleet	0	2,400	2,400	2,400
CFR – Commercial Activites ActivitiesActivities	0	25,000	25,000	25,000
CFR – Regeneration	0	5,000	15,000	15,000
CFR – Enterprise Zone	0	15,000	15,000	15,000
CFR – HRA	81,820	81,820	81,820	81,820
Total CFR	**81,820**	**129,220**	**139,220**	**139,220**
Movement in CFR represented by:				
Net financing need as per 2.1 for the year (above)	0	47,400	10,000	0
Less MRP/VRP and other financing movements	0	0	(968)	(1,133)
Movement in CFR	**0**	**47,400**	**9,032**	**(1,133)**

2.3 Core Funds and Expected investment balances

The application of resources (capital receipts, Capital Reserves, Revenue Contributions to Capital, Capital Grants) to finance Capital expenditure will have an ongoing impact on investments unless resources are supplemented each year by new resources (assets sales, grants etc). Detailed below are estimates of the year end balances held for each resource.

The Revised Capital Plan (subject to approval of Council on 9 November 2020) runs through to 31 March 2023. Funding for this capital expenditure is as per table above in 2.1. Any additional proposals for capital expenditure will require a capital appraisal and business plan to be considered by Senior Leadership Team and Cabinet approval. The funding position is regularly reviewed and if there is a need to borrow, this will require a further appraisal and a revision to the Capital programme and the Treasury Management Strategy and will therefore require additional Council approval.

2.4 Minimum revenue provision (MRP) policy statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (Voluntary Revenue Provision - VRP).

MHCLG regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision.

There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place).

MRP Overpayments - A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), VRP or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2020 the total VRP and overpayments were £0m.

The Council has for the General Fund a CFR requirement and therefore will need to make a MRP provision. As the Council is likely to fund capital expenditure from borrowing in the near future and as there is a statutory requirement to have an approved MRP Statement in place in advance for each year, an MRP policy has been included in this Treasury Management Strategy as Appendix B(2). Council is asked to adopt and approve the MRP policy statement.

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the capital expenditure of the Council over the next 3 years. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes so that sufficient cash is available to meet this service activity. This will involve both the management of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

One of the key indicators is that the Council's gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2020/21 and the following two financial years. This is to ensure that the Council conducts its activities within well-defined limits. Also the indicator allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes or speculative purpose.

The table below shows the forward projections for external debt against the underlying need to finance capital expenditure through borrowing or other long term liabilities, i.e. the CFR, highlighting any over or under borrowing.

	2019/20 Actual £'000	***2020/21 Estimate £'000***	***2021/22 Estimate £'000***	***2022/23 Estimate £'000***
External Debt at 1 April	81,190	81,190	128,590	138,590
Expected change in Debt	0	47,400	10,000	0
Actual debt at 31 March	**81,190**	**128,590**	**138,590**	**138,590**
Capital Financing Requirement	81,820	129,220	139,220	139,220
Under/(over) borrowing	**630**	**630**	**630**	**630**

The table shows that the Council has complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments and existing plans. Within the above figures there is some £57m debt that relates to the finance of the Environmental Services fleet, new commercial activities and non-financial investment.

It is worth reiterating that whilst the above projections are consistent with the Revised Capital Plan, as the covering Cabinet report notes, if investment opportunities of sufficient quality do not arise in line with the above projections then the required borrowing associated with these investments would not take place.

Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 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 or speculative purposes.

The Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this report.

3.2 Treasury Indicators: limits to borrowing activity

The operational boundary.

This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Operational boundary	*2019/20 Actual £'000*	*2020/21 Estimate £'000*	*2021/22 Estimate £'000*	*2022/23 Estimate £'000*
Debt	81,190	81,190	81,190	81,190
Commercial Activities/Non-financial investments	0	47,400	57,400	57,400
Other long term liabilities	0	0	0	0
Total	**81,190**	**128,590**	**138,590**	**138,590**

The authorised limit for external debt.

A further key prudential indicator represents a control on the maximum 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 which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

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

It should be noted that the authorised limit (as shown in the table below) has been set based on the current capital expenditure and funding plans. The Council has decided to take forward commercial investment plans as part of the investment Strategy report to Cabinet on 19th September and following this the authorisaton limits have increased by £15m, these were recommended to Council as part of the 14th November Treasury Management Mid year cabinet report, and it is also recommended that the limits increase further to cover projected additional borrowing in 2021/22 of £10m and £5m in 2022/23.

The authorised limit will be amended as follows (assuming the Capital Strategy is approved by Council) :

Authorised limit	*2019/20 Actual £'000*	*2020/21 Estimate £'000*	*2021/22 Estimate £'000*	*2022/23 Estimate £'000*
Debt	96,000	96,000	96,000	96,000
Commercial Activities/Non-financial investments	0	47,400	57,400	57,400

Authorised limit	*2019/20 Actual £'000*	*2020/21 Estimate £'000*	*2021/22 Estimate £'000*	*2022/23 Estimate £'000*
Other long term liabilities	0	0	0	0
Total	**96,000**	**143,400**	**153,400**	**153,400**

In October 2018 the Government published the "Limit of Indebtedness (Revocation) Determination 2018". This removed the HRA debt cap which was £88,770kand therefore the HRA is able to determine its own level of borrowing in alignment with prudential guidelines. This means that it can borrow providing it can demonstrate that the interest and loan repayments are affordable, within the overall HRA.

3.3 Prospects for interest rates

There are limited changes to Treasury Advisor Bank Rate forecasts over recent months.

Similarly, there is very little change to forecasts for PWLB rates and only by a few changes of 10 bps.

We have updated our previous forecasts for LIBID rates as financial markets have moved lower since our previous newsflash. However, as LIBOR rates will cease from the end of

2021, there are no forecasts for 2022 and 2023. We will be continuing to look at market developments in this area and will monitor these with a view to communicating with you when agreement is reached on how to replace LIBOR.

There is a slight change to interest rate forecasts table below traditionally, Treasury Advisors have used 3m LIBID forecasts, with the rate calculated using market convention of 1/8th (0.125%) taken off the LIBOR figure. Given that 3m LIBOR is currently running below 10bps, that would give a figure of around 0% to somewhere modestly into negative territory. However, the liquidity premium that is still in evidence at the short end of the curve means that 3m rates actually being achieved by investors is still modestly in positive territory. While there are differences between counterparty offer rates, our analysis would suggest that an average rate of around 10bps should be achievable.

PWLB rate forecasts are based on the Certainty Rate (minus 20 bps) which has been accessible to most authorities since 1st November 2012. The table below is for PWLB Certainty Rates for non- HRA borrowing (currently gilts plus 180 basis points). The Treasury consultation on reviewing PWLB margins and lending ended on 31st July. We expect that the Non-HRA Certainty Rate will be subject to revision downwards post the PWLB Consultation Paper conclusion but we don't know the precise timing of that i.e. would expect it to be somewhere between this August and March next year.

The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the central view.

Link Group Interest Rate View 11.8.20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 Month average earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	-	-	-	-
6 Month LIBID	0.10	0.10	0.10	0.10	0.10	0.10	0.10	-	-	-	-
12 Month LIBID	0.20	0.20	0.20	0.20	0.20	0.20	0.20	-	-	-	-
5yr PWLB Rate	1.90	1.90	2.00	2.00	2.00	2.00	2.00	2.10	2.10	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50

The coronavirus outbreak has done huge economic damage to the UK and around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its last meeting on 6th August, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected within the forecast horizon ending on 31st March 2023 as economic recovery is expected to be only gradual and, therefore, prolonged.

GILT YIELDS / PWLB RATES. There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectations that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets over the last 30 years. Over the year prior to the coronavirus crisis, this has seen many bond yields up to 10 years turn negative in the Eurozone. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

Gilt yields had therefore already been on a falling trend during the year up until the coronavirus crisis hit western economies. Since then, we have seen these yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies and moved cash into safe haven assets i.e. government bonds. However, major western central banks started massive quantitative easing purchases of government bonds and this has acted to maintain downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance, in "normal" times would have caused bond yields to rise sharply. At the close of the day on 28th August, all gilt yields from 1 to 4 years were in negative territory, while even 25-year yields were at only 0.97% and 50 year at 0.82%. Meanwhile, equity markets have enjoyed a rebound since the lows of March as confidence has started to return among investors that the worst is over and recovery is now on the way.

From the local authority borrowing perspective, HM Treasury imposed **two changes of margins over gilt yields for PWLB rates** in 2019-20 without any prior warning. The first took place on 9th October 2019, adding an additional 1% margin over gilts to all PWLB period rates. That increase was then at least partially reversed for some forms of borrowing on 11th March 2020, but not for mainstream General Fund capital schemes, at the same time as the Government announced in the Budget a programme of increased infrastructure expenditure. It also announced that there would be a consultation with local authorities on possibly further amending these margins; this was to end on 4th June, but that date was subsequently put back to 31st July. It is clear that the Treasury will no longer allow local authorities to borrow money from the PWLB to purchase commercial property if the aim is solely to generate an income stream (assets for yield).

It is possible that the non-HRA Certainty Rate will be subject to revision downwards after the conclusion of the PWLB consultation; however, the timing of such a change is currently an unknown, although it would be likely to be within the current financial year

3.4 Investment and borrowing rates

- Investment returns have been low in during 2020/21 with little prospect of increase in the following two years. However, if major progress was made with an agreed Brexit, then there is upside potential for earnings.

- It is likely there will remain a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

3.5 Borrowing strategy

The Council is currently maintaining an under-borrowed position overall. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt. Instead cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

Against this background and the risks within the economic forecast, caution will be adopted with the 2020/21 treasury operations. The Council will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances both internally and externally.

When the Council invests in commercial property it is likely that this will be funded by external borrowing in the long term. In the short to medium term however, the Council is able to temporarily utilise its cash balances as an alternative to external borrowing i.e. internally borrow. This is considered to be an effective strategy at present as:

- It enables the Council to avoid significant external borrowing costs in the short to medium term (i.e. making it possible to avoid net interest payments); and
- It mitigates the risks associated with investing cash.

3.6 Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

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

3.7 Debt rescheduling

At a point in time, short term borrowing rates may be considerably cheaper than longer term fixed interest rates. In this event there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify whether there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

However, rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100 bps increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates.

The Council currently has one long term market debt which matures in 2024 and it carries a current interest rate of 11.625%. The cost of replacing this debt is prohibitive and this position is unlikely to change in the next three years.

The £79.19m of HRA debt is at fixed interest rates and the twenty four loans are repayable from 2024 to 2061. Their maturity dates are set to match income and expenditure levels in the HRA Business Plan and they will be reviewed in line with that plan. However, the primary objective of the plan over the next few years is to invest in the Council's housing stock and this position is not expected to change in the near future. Therefore these debts are unlikely to be rescheduled over the next three years. All rescheduling will be reported to the Cabinet at either the half year or full year report stage.

3.8 Municipal Bond Agency

It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. The Agency hopes that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority may make use of this new source of borrowing as and when appropriate.

4. ANNUAL INVESTMENT STRATEGY

4.1 Investment policy – management of risk

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 assets, are covered in the Capital Strategy, (a separate report).

The Council's investment policy has regard to the following: -

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018
- The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return).

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

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

2. **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as **"credit default swaps"** and overlay that information on top of the credit ratings.

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

4. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in appendix 12B (3) under the categories of 'specified' and 'non-specified' investments.

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

5. **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments are revised from £25m to a total of £30m, (see paragraph 4.3).

6. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 4.2.

7. **Transaction limits** are set for each type of investment in 4.2.

8. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see paragraph 4.4).

9. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 4.3).

10. This authority has engaged **external consultants**, (see paragraph 1.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

11. All investments will be denominated in **sterling**.

12. As a result of the change in accounting standards for 2018/19 under IFRS 9, 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. (In November 2018, the MHCLG concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1 April 2018)

However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year.
The above criteria has changed from last year due to a new investment Strategy.

Investment instruments identified for use in the financial year are listed in appendix B (3) under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices.

4.2 Creditworthiness policy

This Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

Dark pink	Up to 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
Light pink	Up to 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5
Purple	Up to 2 years
Blue	Up to 1 year (only applies to nationalised or semi nationalised UK Banks)
Orange	Up to 1 year
Red	Up to 6 months

Green	Up to 100 days
No colour	not to be used

The Link Asset Services' creditworthiness service uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances, consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on any external support for banks to help support its decision making process.

UK banks – ring fencing

The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

4.3 Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch, other than the UK where the Council has set no limit. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 12B (4). This list will be added to, or deducted from by officers should ratings change in accordance with this policy.

4.4 Investment strategy

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 (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow (amend as appropriate), where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Investment returns expectations.

The suggested budgeted investment earnings rates for investments up to about three months duration in each financial year for the next five years are as follows: -

Average earnings in each year	Now	Previously
2020/21	0.10%	1.0%
2021/22	0.10%	1.0%
2022/23	0.10%	1.50%
2023/24	0.25%	1.50%
2024/25	0.75%	1.75%
Long term later years	2.00%	2.25%

As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts. The general expectation for an eventual trend of gently rising gilt yields is unchanged. Negative, (or positive), developments could significantly impact safe haven flows of investor money into UK, US and German bonds and produce shorter term movements away from our central forecasts.

Our interest rate forecast for Bank Rate is in steps of 25 bps whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps.

On the assumption that the UK and EU agree a Brexit deal by the end of 2019 or soon after, then Bank Rate is forecast to increase only slowly over the next few years to reach 1.25% by quarter 1 2022. Bank Rate forecasts for financial year ends (March) are:

- Q1 2021 0.75%
- Q1 2022 1.00%
- Q1 2023 1.25%

Additionally the Council currently has loans to other Local Authorities and has invested in two property funds in 2018/19 following a selection process assisted by our Treasury Advisors Link. Both of these investment types are for periods of greater than 365 days and it is anticipated that returns on investments will be above the rates shown for the proportion of funding invested for these longer periods. Potential sums to be invested in this way are given below and the current snapshot of investments held for over 365 days is shown in Appendix 12B (6).

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.

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

Maximum principal sums invested > 365 days			
£m	**2019/20**	**2020/21**	**2021/22**
Principal sums invested > 365 days	£25m	£30m	£30m

4.5. Investment risk benchmarking

This Council will use an investment benchmark to assess the investment performance of its investment portfolio. For cash investments this will be the 3 month London Interbank Bid Rate (LIBID) which matches the weighted average time period of our current cash investments. Should the Council invest in Property Funds an appropriate additional benchmark will be added to measure the performance of these investments. This will be reported in the next available treasury report to Members.

4.6 End of year investment report

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

APPENDICES FOR APPENDIX 12B

B (1). Economic Background

B (2). Minimum Revenue Provision Policy

B (3). Treasury management practice 1 – credit and counterparty risk management

B (4). Approved Countries for Investment

B (5). Approved Brokers for investments

B (6). Current Investments as at 10th September 2020

B (7). Treasury management scheme of delegation

B (8). The treasury management role of the section 151 officer

APPENDIX B(1)

ECONOMIC BACKGROUND

As expected, the Bank of England's Monetary Policy Committee kept Bank Rate unchanged on6th August. It also kept unchanged the level of quantitative easing at £745bn. Its forecasts were optimistic in terms of three areas:

- The fall in **GDP** in the first half of 2020 of 28% was revised upwards to 23%. This is still one of the largest falls in output of any developed nation but is only to be expected as the UK economy is heavily skewed towards consumer facing services – an area which was particularly vulnerable to being damaged by lockdown.
- The peak in the **unemployment rate** was revised down from 9% in Q2 to 7½% by Q4 2020.
- It forecast that there would be excess demand in the economy by Q3 2022 causing CPI **inflation** to rise above the 2% target in Q3 2022, (based on market interest rate expectations for a further loosening in policy). But even if the Bank were to leave policy unchanged, inflation was still projected to be above 2% in 2023.

It also squashed any idea of using **negative interest rates**, at least in the next six months or so. It suggested that while negative rates can work in some circumstances, it would be "less effective as a tool to stimulate the economy" at this time when banks are worried about future loan losses. It also has "other instruments available", including QE and forward guidance.

The MPC still expects the £300bn of **quantitative easing** purchases announced between the March and June meetings to continue until the "turn of the year". This implies that the pace of purchases will slow further to about £4bn a week, down from £14bn a week at the height of the crisis and £7bn more recently.

In conclusion, this would indicate that the Bank can now just sit on its hands as the economy is recovering better than expected. However, the MPC acknowledged that the "medium-term projections were a less informative guide than usual" and the minutes had multiple references to **downside risks,** which were judged to persist both in the short and medium term. One has only to look at the potential for a second wave of the virus to see the dangers. However, rather than a national lockdown, as in March, any spikes in virus infections are now likely to be dealt with by localised measures and this will limit the amount of economic damage caused. In addition, Brexit uncertainties ahead of the year-end deadline are likely to be a drag on recovery. The wind down in the furlough scheme through to the end of October is another development that could cause the Bank to review the need for more support for the economy later in the year. If the Bank felt it did need to provide further support to recovery, then it is likely that the weapon of choice would be more QE. Overall, the pace of recovery is not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. There will also be some painful longer term adjustments as e.g. office space and travel by planes, trains and buses may not recover their previous level of use for several years or possibly ever. There is also likely to be a reversal of globalisation as this crisis has shown up how vulnerable long distance supply chains are. On the other hand, digital services is one area that has already seen huge growth.

One new key addition to **forward guidance** was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistent if it takes no action to raise Bank Rate. In this connection, there has been much discussion by forecasters of the main central banks moving to an average inflation rate target i.e. periods above the target are acceptable.

The **Financial Policy Committee** (FPC) report on 6th August revised down their expected credit losses for the banking sector to "somewhat less than £80bn". They state that in their assessment "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%

EU. The economy was recovering well towards the end of Q2 after a sharp drop in GDP. However, there are growing fears of a second wave of the virus that could cause a renewed collapse in activity.

US. The incoming sets of data during the first week of August were almost universally stronger than expected. With the number of new daily coronavirus infections beginning to abate, recovery should continue over the coming months and employment growth should pick up again too. The increase in tension between the US and China is likely to lead to a lack of momentum in developing on the initial positive moves to agree a phase one trade deal.

China. After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2. However, this was boosted by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to poor economic returns and so lead to a further misallocation of resources which will weigh on growth in future years.

Japan. It looks as if a second wave of the virus is gaining momentum and could damage economic growth further.

World growth. Latin America and India are currently hotspots for virus infections. World growth will be in recession this year.

The balance of risks to the UK

The overall balance of risks to economic growth in the UK is probably relatively even but is subject to major uncertainty due to the virus.

There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates while the Bank of England has ruled out the use of negative interest rates and increases in Bank Rate are likely to be some years away. However, it is always possible that safe haven flows, due to unexpected developments in other major economies, could impact gilt yields, (and so PWLB rates), in the UK.

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

UK / EU trade negotiations – if it were to cause significant economic disruption and a major downturn in the rate of growth.

Bank of England takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

A resurgence of the **Eurozone sovereign debt crisis.** The ECB has taken monetary policy action to support the bonds of weaker EU states, especially Italy. In addition, the EU recently agreed a €750bn support package for weaker states. These actions will shield Italy for the next year or so. However, the cost of the virus crisis has added to Italy's already huge debt mountain and its slow economic growth will leave it vulnerable to markets returning to taking the view that its level of debt is unsupportable.

Weak capitalisation of some **European banks**, particularly Italian banks.

German minority government. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The CDU has done badly in recent state elections but the SPD has done particularly badly and this has raised a major question mark over continuing to support the CDU. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until the general election in 2021.

- **Other minority EU governments.** Austria, Sweden, Spain, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU. There has also been rising anti-immigration sentiment in Germany and France.
- **Geopolitical risks,** for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe haven flows.

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

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

TreasuryAdvisor's ForecasForecast

We do not think that the MPC will increase Bank Rate during the current and next two financial years as we expect the economy to take a prolonged period to recover momentum after the Covid crisis.

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

Gilt yields and PWLB rates

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

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

Our target borrowing rates and the current PWLB (certainty) borrowing rates are set out below.

PWLB debt	Current borrowing rate as at 10.8.20	Target borrowing rate now (end of Q3 2020)	Target borrowing rate previous (end of Q3 2020)
5 year	1.74%	1.90%	1.90%
10 year	1.96%	2.10%	2.10%
25 year	2.50%	2.50%	2.50%
50 year	2.30%	2.30%	2.30%

Borrowing advice: since November 2018, PWLB rates have fallen significantly up until 100 bps were added to all PWLB rates in October 2019. As our long-term forecast for Bank Rate is 2.00%, and PWLB certainty rates are close to or above 2.00%, there is little near-term value in borrowing from the PWLB at present, particularly until it is clear what the new non-HRA borrowing rate will look like after HM Treasury concludes its review of the PWLB Consultation Paper responses. Accordingly, clients will need to reassess their risk appetite in terms of either seeking cheaper alternative sources of long-term borrowing or switching to short term borrowing in the money markets until such time as the Government might possibly reconsider the margins charged over gilt yields. Please speak to your CRM to discuss alternative borrowing sources available.

As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts. The general expectation for an eventual trend of gently rising gilt yields is unchanged. Negative, (or positive), developments could significantly impact safe haven flows of investor money into UK, US and German bonds and produce shorter term movements away from our central forecasts.

Our interest rate forecast for Bank Rate is in steps of 25 bps whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps.

APPENDIX B(2)

MINIMUM REVENUE PROVISION (MRP) POLICY STATEMENT

Under Regulation 27 of the 2003 Regulations, local authorities are required to charge MRP to their revenue account in each financial year. It should cover the gap between the Capital Financing Requirement (CFR) and grant income and capital receipts.

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (MRP). It is also allowed to undertake additional voluntary payments if desired (voluntary revenue provision - VRP). Any planned overpayments must be recorded clearly in the MRP statement.

MHCLG regulations have been issued which require the full Council to approve an MRP Statement in advance of each year; hence, the inclusion of this policy within the Capital Strategy.

The Council is required to calculate in each financial year a prudent provision to ensure that debt is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits (asset life). MRP cannot be negative, and can only be zero if the CFR is nil or negative, or if the charge is fully reduced by reversing previous overpayments. A maximum asset life of 40 years can be used, except freehold land which can be 50 years.

In calculating MRP the Council must base its calculation on methods set out within ‘guidance’ issued by the Secretary of State under section 21(1A) of the Local Government Act 2003. Under that section local authorities are required to ‘have regard’ to this guidance. The extant guidance distinguishes between borrowing incurred prior to 2008 and that incurred in subsequent years. The Council did not incur borrowing to finance assets prior to 2008 and hence its options on which its MRP calculation is based are restricted to Options 3. and 4. as set out in guidance, as below:

Option 3: Asset Life Method

Where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, MRP is to be determined by reference to the useful life of the asset.

There are two main methods by which this can be achieved, as described below.

(a) Equal instalment method

MRP is the amount given by the following formula:

$$\frac{A - B}{C}$$

Where:

A is the amount of capital expenditure in respect of the asset financed by borrowing or credit arrangements.

B is the total provision made before the current financial year in respect of that expenditure.

C is the inclusive number of financial years from the current year to that in which the estimated useful life of the asset expires.

(b) Annuity method

MRP is the principal element for the year of the annuity required to repay over the asset’s useful life the amount of capital expenditure financed by borrowing or credit arrangements. The authority should use an appropriate interest rate to calculate the amount. Adjustments to the calculation to take account of repayment by other methods during repayment period (e.g. by the application of capital receipts) should be made as necessary.

Option 4: Depreciation method

MRP is deemed to be equal to the provision required in accordance with deprecation accounting in respect of the asset on which expenditure has been financed by borrowing or credit arrangements. This should include any amount for impairment charged to the income and expenditure accounts.

Selected Charnwood calculation methods

- For assets with a life of 10 years or less, the straight line asset life method (Option 3 (a)) will be used
- For assets with a life in excess of 10 years, the annuity asset life method (Option 3 (b)) will be used

The asset life method calculation requires estimated useful lives of assets to be input in to the calculations. These life periods will be determined by the Council's Chief Financial Officer (this is the Council's designated s151 Officer, a role currently held by the Strategic Director of Corporate Services), with regard to the statutory guidance and advice from professional valuers if required.

The Chief Financial Officer may also determine that if, in their opinion, the straight line method is more prudent for an asset with a life in excess of 10 years then this option may be used.

Generally, the straight line asset life method is considered appropriately prudent for assets with a relatively short term life (such as most types of plant and equipment). Assets purchased with a longer life will usually be land and buildings and hence an annuity asset life method will be used reflecting that such assets will in practice have a value at the end of the designated asset life. One aspect of the annuity asset life method is that it generates MRP payments that are relatively low in early years which then increase over the asset life. This structure of MRP is well-suited to commercial properties as the increase in MRP could be expected (broadly) to mirror increasing rental income created by periodic rent reviews.

The designated asset life of land and buildings, including commercial property for investment purposes, will usually be set at 40 years, in accordance with the guidance and in common with other local authorities.

In line with the extant guidance MRP will be not be charged until the later of the year after capital expenditure is incurred or the year after the asset becomes operational

The calculation of MRP is also subject to the following details:

- An average asset life for each project will normally be used. There will not be separate MRP schedules for the components of a building (e.g. plant, roof etc.). Asset life will be determined by the Chief Finance Officer. A standard schedule of asset lives will generally be used (as stated in the Statement of Accounts accounting policies).
- MRP will commence in the year following the year in which capital expenditure financed from borrowing is incurred, except for single assets when expenditure is being financed from borrowing the MRP will be deferred until the year after the asset becomes operational.

- Other methods to provide for debt repayment may occasionally be used in individual cases where this is consistent with the statutory duty to be prudent, as justified by the circumstances of the case, at the discretion of the Chief Finance Officer; this may includecertain circumstances relating to investment (forward funding) within the Enterprise Zone and where the underlying loan is taken out on a repayment basis. In this case no MRP charge will be deemed necessary assuming the loan term does not exceed the asset life

APPENDIX B(3)

TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to maximum of 1 year** with the exception of other Local Authorities which have a maximum of 2 years and investments in Property Funds which are longer-term investments. All investments will meet the minimum 'high' quality criteria where applicable.

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories. The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

	Minimum credit criteria /	**** Max % of total investments/ £ limit per institution**	**Max. maturity period**
DMADF – UK Government	N/A	Unlimited	6 months
UK Government gilts	UK sovereign rating	Unlimited	12 months
UK Government Treasury bills	UK sovereign rating	Unlimited	12 months
Bonds issued by multilateral development banks	AAA	Unlimited	6 months
Money Market Funds (CNAV, LVAV & VNAV)	AAA	£10m any one institution and £30m in total	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.5	AAA	£7m any one institution and £18m in total	Liquid
Local authorities	N/A	£5m any one institution and £20m in total	5 Years
Property Funds	N/A	£5m in total	20 Years
Term deposits with banks and building societies	Purple	£8m any one institution and £12m in total	Up to 12 months
	Blue	£7m any one institution and £12m in total	Up to 12 months
	Orange	£8m & (£12m for HSBC only) any one institution and £25m in total	Up to 12 months
Term deposits with banks and building societies	Red	£8m any one institution and £40m in total	Up to 6 Months
	Green	£6m any one institution and £20m in total	Up to 100 days
	No Colour	Nil	Not for use

Non Specified Investments: In light of the current and forecast low interest rates on specified investments the Council included the opportunity to invest in established Property Funds run by Fund Managers in a previous Treasury Management Strategy. These funds are longer term investments (typically 2-5 years) and give potentially higher returns than more liquid investment categories. Investments totaling £5m have been made in Property Funds since 2018. These investments will form part of the £30m limit for investments of over 365 days duration.

The Council will also add investments with Housing Associations of up to £5m, for up to a two year period. Prior to this the Council will undertake a separate due diligence exercise to ensure they have the minimum credit rating requirement and generally satisfy the Council’s lending policuies.

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, a review of the accounting implications of new transactions will be carried prior to any investment decision.

APPENDIX B(4)

APPROVED COUNTRIES FOR INVESTMENTS @14/09/2020

This list is based on those countries which have sovereign ratings of AA- or higher (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Hong Kong, Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link Asset Services credit worthiness service.

AAA

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

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France

AA-

- Belgium
- Hong Kong
- Qatar
- U.K.

APPENDIX B(5)

List of Approved Brokers for Investments

The list below represents approved brokers that the Council will use to facilitate its investment strategy when necessary;

King and Shaxson

Tradition (UK) Ltd

RP Martin

Link Asset Services Agency Treasury Service

APPENDIX B (6)

Current Investments as at 10th September 2020 (for information only).

For illustrative purposes only the Council's investments as at 10th September 2020 are set out below. Please note that these investments alter on a daily basis.

Institution	**Colour**	**Amount invested £m**	**Transaction Limit**	**Maturity Date**	**MaxTime Limit**
SloughCouncil	N/A	2,000	5,000	01/04/2021	5 Years
Wyre Forest District Council	N/A	2,000	5,000	09/10/2020	5 Years
Liverpool City Council	N/A	2,000	5,000	14/10/2020	5 Years
Santander	Red	8,000	8,000	180 Day Notice	6 Months
Goldman Sachs international Bank	Red	2,500	2,500	35 Day Notice	6 Months
Goldman Sachs international Bank	Red	2,500	2,500	95 Day Notice	6 Months
Standard Chartered Bank	Red	5,000	8,000	183 Days	6 Months
HSBC Bank	Orange	5,000	12,000	3 Months	12 Months
HSBC Bank	Orange	7,000	12,000	31 day Notice	12 Months
Money Market Funds	AAA Rated	27,840	30,000 in total	1 Day	12 Months
Property Funds	N/A	5,000	5,000 in total	N/A	20 Years
TOTAL		**68,830**			

APPENDIX B(7)

TREASURY MANAGEMENT SCHEME OF DELEGATION

(i) Council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

(ii) Cabinet

- approval of/amendments to the organisation's adopted clauses, treasury management policy
- statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing monitoring reports and acting on recommendations;

(iii) Audit Committee/Overview Scrutiny Board

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

APPENDIX B(8)

THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER

The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensure that the authority has appropriate legal powers to undertake expenditure on non- financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above