DECISION-MAKER:	GOVERNANCE COMMITTEE COUNCIL			
SUBJECT:	TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL LIMITS 2019/20 TO 2022/23			
DATE OF DECISION:	11 FEBRUARY 2019 20 FEBRUARY 2019			
REPORT OF:	SERVICE DIRECTOR FINANCE AND COMMERCIALISATION (S151)			

CONTACT DETAILS				
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STATEMENT OF CONFIDENTIALITY

NOT APPLICABLE

BRIEF SUMMARY

With overall annual expenditure in excess of £600M and an extensive capital programme, the Council is required to actively manage its cash-flows on a daily basis. The requirement to invest or to borrow monies to finance capital programmes, and to cover daily operational needs is an integral part of daily cash and investment portfolio management.

This report explains the context within which the Council's treasury management activity operates and sets out a proposed strategy for the coming year in relation to the Council's cash flow, investment and borrowing, and the management of the associated risks, including the loss of invested funds and the revenue effect of changing interest rates.

The core elements of the current 2019/20 Treasury strategy are :

- To extend the use of short term variable rate debt for a further year to take advantage of the current market conditions of low interest rates.
- To constantly review longer term forecasts and to lock into longer term rates through a variety of instruments as appropriate during the year, in order to provide a balanced portfolio against interest rate risk.
- To secure the best short term rates for borrowing and investments consistent with maintaining flexibility and liquidity within the portfolio.
- To invest surplus funds prudently, the Council's priorities being:
    - Security of invested capital
    - Liquidity of invested capital
    - An optimum yield which is commensurate with security and liquidity.
- To approve borrowing limits that provide for debt restructuring opportunities and to pursue debt restructuring where appropriate and within the Council's risk boundaries.
- To approve the 2019 Minimum Revenue Provision (MRP) Statement

Since 2012, the Council has pursued a strategy of internal borrowing – minimising external borrowing by running down its own investment balances and only borrowing short term to cover cash flow requirements. This has both reduced the credit risk to which the Council is exposed and, due to the differential between long-term borrowing and short-term investment rates, has saved the Council money in terms of net interest costs. This is now being reviewed to see if an alternative Treasury Strategy could generate income that can support local services.

One option being considered is further investment in external pooled funds which would require the Council to externalise some or all of debt long term. To assist with the appraisal the Council has engaged the council's financial advisers, Arlingclose, to analyse the scope within the Council's current and projected balance sheet for longer-term investment, and analyse suitable longer-term asset classes and investment options available to the Council.

Any change to the strategy would require approval by full council and additional Treasury Training would be provided to assist members in understanding the risks and implications of any change to the current strategy.

Investment limits within this report have been increased to allow for a possible change in strategy.

RECOMMENDATIONS:

GOVERNANCE COMMITTEE

It is recommended that Governance Committee:

	(i)	Endorse the Treasury Strategy (TS) for 2019/20 as outlined in the report.
	(ii)	Endorse the 2019 Minimum Revenue Provision (MRP) Statement as detailed in paragraphs 106 to 115.
	(iii)	Endorse the Investment Strategy (IS) as detailed in paragraphs 87 to 105.
	(iv)	Note that the indicators as reported have been set on the assumption that the recommendations in the Capital update report will be approved by Council on 20 February 2019. Should the recommendations change, the Prudential Indicators may have to be recalculated.
	(v)	Note that due to the timing of this report, changes may still be required following the finalisation of capital and revenue budgets and therefore any significant changes to this report will be highlighted in the final version that is presented to Full Council.
	(vi)	Endorse the proposal within the Capital Strategy report, that Governance Committee have delegated authority to approve future Treasury Strategy Reports and associated Prudential Indicators.
	(vii)	Endorse the proposal to explore an alternative Treasury Strategy to generate additional income that can support local services, whilst maintaining a prudent approach.

COUNCIL

It is recommended that Council:

	(i)	Approve the Council's Treasury Strategy (TS) and Prudential Indicators for 2019/20 to 2022/23, as detailed within the report.

	(ii)	Approve the 2019 Minimum Revenue Provision (MRP) Statement as detailed in paragraphs 106 to 115 and to delegate authority to the Chief Financial Officer (CFO) to approve any changes necessary that aid good financial management whilst maintaining a prudent approach.
	(iii)	Approve the Investment Strategy as detailed in paragraphs 87 to 105.
	(iv)	Note that at the time of writing this report the recommendations in the Capital update report, submitted to Council on the 20 February 2019, have not yet been approved. The indicators in the report are based on the assumption that they will be approved, but should the recommendations change, the Prudential Indicators may have to be recalculated.
	(v)	Continue to delegate authority to the Chief Financial Officer (CFO) to approve any changes to the Prudential Indicators, Minimum Revenue Provision or borrowing limits that will aid good treasury management. For example, agreeing an increase in the percentage for variable rate borrowing to take advantage of the depressed market for short term rates. Any amendments will be reported as part of quarterly financial and performance monitoring and in revisions to the TM Strategy.
	(vi)	Approve the proposal within the Capital Strategy report, that Governance Committee have delegated authority to approve future Treasury Strategy Reports and associated Prudential Indicators.
	(vii)	Endorse the proposal to explore an alternative Treasury Strategy to generate additional income that can support local services, whilst maintaining a prudent approach.

REASONS FOR REPORT RECOMMENDATIONS

1. In order to comply with Part 1 of the Local Government Act 2003, and the established TM procedures that have been adopted by the Council, each year the Council must set certain borrowing limits and approve the various strategies which includes:
   - Treasury Strategy for 2019/20:
     - Borrowing – Paragraphs 34 to 44,
     - Debt Rescheduling – Paragraph 45
     - Investments – Paragraphs 46 to 69
   - Treasury Management Indicators – Paragraphs 70 to 79
   - Investment Strategy – Paragraphs 87 to 105
   - MRP Statement – Paragraphs 106 to 115

ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

2. Alternative options for borrowing would depend on decisions taken on the review of the capital update report being taken at Full Council on 20 February 2019.

DETAIL (Including consultation carried out)

CONSULTATION

3. The proposed Capital Update report on which this report is based has been subject to separate consultation processes.

BACKGROUND

4.	Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code)* which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.
5.	Investments held for service purposes or for commercial profit though not part of Treasury are also considered in this report for completeness.
6.	Overall responsibility for treasury management remains with the Council. No TM activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. Our current policy is shown in appendix 1. This report covers treasury activity and the associated monitoring and control of risk.
7.	The purpose of this report is to allow Council to approve: • Treasury Strategy and Prudential Indicators for 2019/20 to 2022/23 • Investment Strategy and associated indicators for 2019/20 to 2022/23 • 2019 MRP Statement
8.	The strategy takes into account the impact of the Council's Revenue Budget and Capital Programme on the Balance Sheet position, the Prudential Indicators and the current and projected Treasury position. There is no longer a requirement to include indicators relating to Prudence, Affordability & Sustainability in the Treasury Strategy as they are now required to be reported as part of the Capital Strategy, but these have been included for information as Appendix 2 as they provide the framework around which the Treasury Indicators have been set. The outlook for interest rates (Appendix 3) has also been taken into account in developing this strategy
9.	The Council acknowledges that effective TM will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in TM, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management. To aid the Council in carrying out its TM function, it has appointed TM Advisors (Arlingclose), who advise the Council on strategy and provide market information to aid decision making. However it should be noted that the decisions are taken independently by the CFO taking into account this advice and other internal and external factors.
10.	In accordance with the CLG Guidance, the Council will be asked to approve a *revised Treasury Management Strategy Statement* should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates; material change to the Council's capital programme or in the level of its borrowing or investment balances.
11.	The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer, having consulted with relevant officers and members believes that the above strategy represents an appropriate balance between risk management

and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Options	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses will be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs will be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs will be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs will be less certain

<u>Economic Background</u>

12. The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Council's treasury management strategy for 2019/20.

13. Following a weak reading in the first quarter of 2018 attributed to weather-related factors, UK GDP growth rebounded in the second quarter to 0.4%, but at an annual rate of only 1.2% this remains below trend. As economic growth had evolved broadly in line with its May Inflation Report forecast, the Bank of England's Monetary Policy Committee (MPC) voted unanimously for a rate rise of 0.25% in August, taking Bank Rate to 0.75%.

14. The headline rate of UK Consumer Price Inflation rose to 2.7% year on year in August 2018, higher than both the consensus forecast and the Bank's August Inflation Report. Labour market data is positive. The ILO unemployment rate fell to 4%, its lowest level since 1975. The 3-month average annual growth rate for pay excluding bonuses rose to 3.1% in August providing some evidence that a shortage of labour is supporting wages. However, adjusting for inflation this means real wages were only up by 0.4% and only likely to have a moderate impact on household spending.

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15. In contrast, the US economy has continued to perform well, the US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the 2.25%-2.50% range in November while lowering its forecast of rate rises in 2019 to two from the three previously projected. A temporary truce in the ongoing

	trade war between the US and China was announced as the leaders of both countries agreed to halt new trade tariffs for 90 days to allow talks to continue. Tariffs already imposed will remain in place. The fallout continues to impact on economic growth and stock market volatility. Despite slower growth in the region, the European Central Bank has started conditioning markets for the end of quantitative easing as well as the timing of the first interest rate hike, currently expected in 2019, and the timing and magnitude of increases thereafter.
	Credit Outlook
16.	The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ringfencing legislation. Bank of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank are the ringfenced banks that now only conduct lower risk retail banking activities. Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and NatWest Markets are the investment banks. Credit rating agencies have adjusted the ratings of some of these banks with the ringfenced banks generally being better rated than their non-ringfenced counterparts
17.	European banks are considering their approach to the UK's exit from the European Union, with some looking to create new UK subsidiaries to ensure they can continue trading here. The credit strength of these new banks remains unknown, although the chance of parental support is assumed to be very high if ever needed. The uncertainty caused by protracted negotiations between the UK and EU is weighing on the creditworthiness of both UK and European banks with substantial operations in both jurisdictions.
	Interest Rate Forecast
18.	Following the increase in Bank Rate to 0.75% in August 2018, the Council's treasury management adviser Arlingclose is forecasting two more 0.25% hikes during 2019 to take official UK interest rates to 1.25%. The Bank of England's MPC has maintained expectations for slow and steady rate rises over the forecast horizon. The MPC continues to have a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose believes that MPC members consider both that ultra-low interest rates result in other economic problems, and that higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise when rate cuts will be required.
19.	The UK economic environment remains relatively soft, despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. Whilst assumptions are that a deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" still hangs over economic activity. As such, the risks to the interest rate forecast are considered firmly to the downside.
20.	Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected based on Arlingclose's interest rate projections, due to the strength of the US economy and the ECB's forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.5% and 2% respectively over the interest rate forecast horizon, however volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.

21. A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix 3

22. For the purpose of setting the budget, it has been assumed that new investments for 2019/20 will be made at an average rate of 1.12% for short term and 4.25% for long term, and that new long-term loans taken over the period of the strategy will be borrowed at an average rate of 3.25%.

BALANCE SHEET SUMMARY AND FORECAST

23. At 31 December 2018 the Council held £307M of debt (£235M borrowing plus £72M other long term liabilities) and £54M investments which is set out in further detail in Appendix 2.

24. Forecast changes in these sums are shown in the balance sheet analysis shown below.

25. **Table 1: Balance Sheet Summary and Forecast**

	31-Mar-18 Actual £M	31-Mar-19 Forecast £M	31-Mar-20 Forecast £M	31-Mar-21 Forecast £M	31-Mar-22 Forecast £M	31-Mar-23 Forecast £M
General Fund CFR	322.03	338.93	345.79	347.27	348.58	356.23
Housing CFR	157.92	171.67	182.00	190.54	192.84	199.75
Total CFR	**479.95**	**510.60**	**527.79**	**537.81**	**541.42**	**555.98**
Less Other Debt Liabilities*	(73.39)	(70.93)	(67.55)	(64.02)	(60.08)	(43.41)
Loans CFR	**406.56**	**439.67**	**460.24**	**473.79**	**481.34**	**512.57**
Less External Borrowing**	(251.16)	(231.70)	(169.87)	(150.59)	(147.84)	(147.84)
Internal (over) Borrowing	**155.40**	**207.97**	**290.36**	**323.20**	**333.50**	**364.73**
Less Usable Reserves	(146.28)	(136.00)	(136.00)	(136.00)	(136.00)	(136.00)
Less Working Capital Surplus	(84.82)	(84.82)	(84.82)	(84.82)	(84.82)	(84.82)
New Borrowing or (Investments)	**(75.70)**	**(12.85)**	**69.54**	**102.38**	**112.68**	**143.91**

** finance leases, PFI liabilities and transferred debt which form part of the Council's total debt*

*** shows only loans to which the Council is committed and excludes optional refinancing*

26. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), which is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. Any capital expenditure which has not immediately been paid for, will increase the CFR. The CFR is reduced by the application of resources such as capital receipts, grants or charges to revenue.

27. While usable reserves and working capital are the underlying resources available for investment.

28. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. **Table 1** shows that the Council has an increasing CFR due to the impact of the capital programme and a decreasing working balance surplus and will therefore need to borrow up to £145M over the forecast period.

29. CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. **Table 1** shows that the Council expects to comply with this recommendation during 2019/20, using £208M of internal resources.

<u>Liability Benchmark</u>

30. To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as **Table 1** above, but that cash

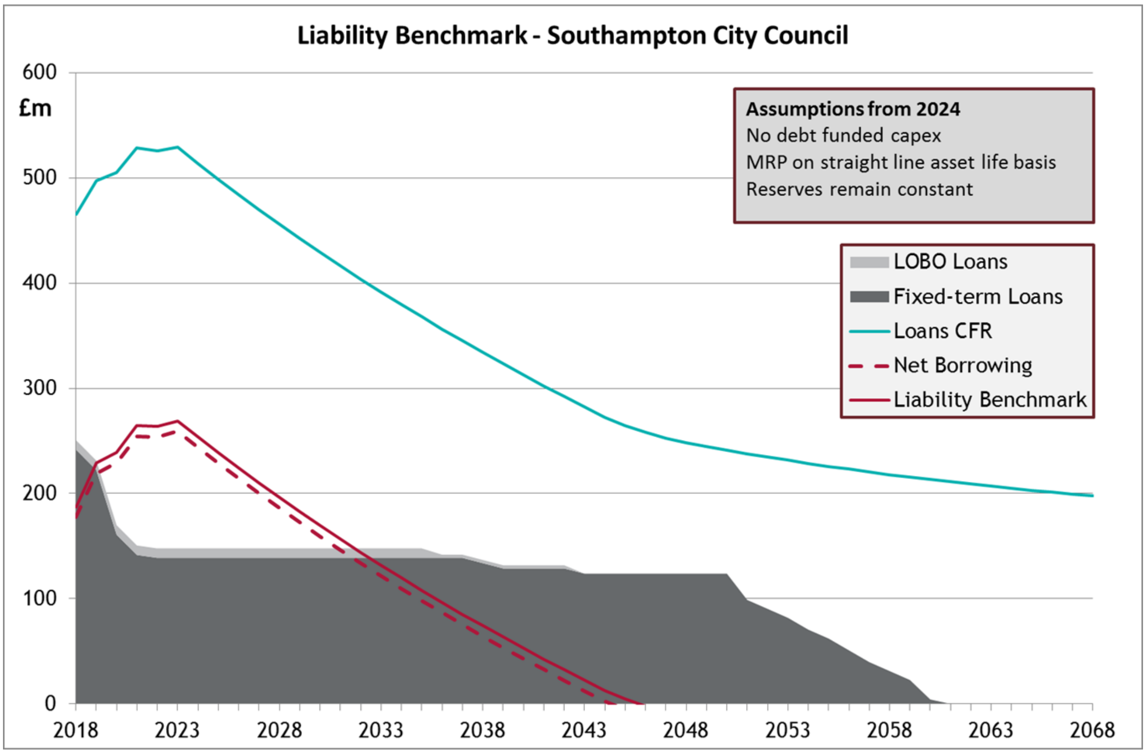
and investment balances are kept to a minimum level of £10M at each year-end to maintain sufficient liquidity but to further minimise credit risk.

Table 2: Liability benchmark

	31-Mar-18 Actual £M	31-Mar-19 Forecast £M	31-Mar-20 Forecast £M	31-Mar-21 Forecast £M	31-Mar-22 Forecast £M	31-Mar-23 Forecast £M
Loans CFR	**406.56**	**439.67**	**460.24**	**473.79**	**481.34**	**512.57**
Less Usable Reserves	(146.28)	(136.00)	(136.00)	(136.00)	(136.00)	(136.00)
Less Working Capital Surplus	(84.82)	(84.82)	(84.82)	(84.82)	(84.82)	(84.82)
Plus Minimum investments	10.00	10.00	10.00	10.00	10.00	10.00
Liability Benchmark	**185.46**	**228.85**	**249.42**	**262.97**	**270.52**	**301.75**

31. The long term liability benchmark assumes capital expenditure is in line with the forecasts shown in **Appendix 4, table 15**, minimum revenue based on the life of the asset and income, expenditure and reserves all increasing by inflation. This is shown in the chart below.

32.



33. This demonstrates that even with lower investment balances that there is still an underlying need for the council to borrow during 2019/20 as our actual committed debt at £170M will be below the benchmark of £249M.

BORROWING STRATEGY

34. The Council currently holds £235M of loans a decrease of £16M since the 31 March 2018 as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in **Table 1** above shows that the Council expects the total loans CFR to increase by £33M in 2018/19 and a further £21M in 2019/20 bringing our estimated loans CFR to £460M. Our committed borrowing at the end of 2020 is £170M, a reduction £81M from the actual position at 31 March 2018. This would be unsustainable without further borrowing as shown in **Table 1,** which shows a borrowing requirement of £70M, by 31 March 2020.

	If it was cost effective the Council could also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing.
	Objectives
35.	The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.
	Strategy
36.	Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.
37.	By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2019/20 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.
38.	Alternatively, the Council may arrange forward starting loans during 2019/20, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period. In addition, the Council may borrow further short-term loans to cover unexpected cash flow shortages.
	Sources
39.	The approved sources of long-term and short-term borrowing are: • Public Works Loan Board (PWLB) and any successor body • any institution approved for investments (see below) • any other bank or building society authorised to operate in the UK • UK public and private sector pension funds (except HCC Pension Fund) • capital market bond investors • UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues
40.	In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities: • leasing • hire purchase • Private Finance Initiative • sale and leaseback

41.	The Council has previously raised the majority of its long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local authority loans and bank loans which may be available at more favourable rates.
42.	UK Municipal Bonds Agency plc (MBA) was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities may be required to provide bond investors with a joint and several guarantee over the very small risk that other local authority borrowers default on their loans; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. A report setting out in full the details, options and risks of the MBA was considered by full Council on 10 February 2016 and any initial proposal to borrow from the Agency will therefore need be the subject of a separate report to both Governance Committee and Full Council.
	Lender's Option Borrower's Option Loans (LOBOs)
43.	The Council holds £9M of LOBO loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOS have options during 2019/20 and although the Council understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so.
	Short Term and Variable Rates
44.	Included within the PWLB portfolio is £35M of variable rate Loans, which are currently averaging 0.77% and are helping to keep the overall cost of borrowing down. Whilst in the current climate of low interest rates this remains a sound strategy, these loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators (paragraph 70).
	Debt Rescheduling
45.	The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.
	INVESTMENT STRATEGY
46.	The Council invests its money for three broad purposes: • because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as **treasury management investments**), • to support local public services by lending to or buying shares in other organisations (**service investments**), and

	• to earn investment income (known as **commercial investments** where this is the main purpose).
	TREASURY MANAGEMENT INVESTMENTS
47.	The Authority typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and central government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy.
48.	During the financial year the Council's investment balances have ranged between £53M and £99M and are currently £54M. Projected balances indicate that on present levels of spend balances will be lower than last year, but this will be dependent on any borrowing decisions taken.
49.	The contribution that these investments make to the objectives of the Authority is to support effective treasury management activities
	Objectives
50.	The CIPFA Code require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested, however it should be noted that a lower rate is an acceptable offset for higher credit and less risk, for example a covered bond.
	Negative Interest Rates
51.	If the UK enters into a recession in 2019/20, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.
	Strategy
52.	Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to continue to diversify into more secure and/or higher yielding asset classes during 2019/20. This is especially the case for the estimated £40M that is currently available for longer-term investment. The majority cash used for cash flow purposes is invested in money market funds. Appendix 2 shows the makeup of the Council's current investments.
	Business Model
53.	Under the new IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

	Approved Counterparties
54.	The Council may invest its surplus funds with any of the following counterparty types, subject to the cash limits (per counterparty) and time limits detailed below. This is the absolute limit and the working limit will be monitored against actual cash flows and movement on reserves together with advice from our financial advisors and will be adjusted each quarter as necessary in agreement with the CFO.
	Table 2: Approved Investment counterparties and Limits

Credit Rating	Banks Unsecured £M	Banks Secured £M	Government & Local Authorities £M	Corporates £M	Registered Providers £M
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£5M 5 years	£20M 20 years	£20M 50 years	£5M 20 years	£10M 20 years
AA+	£5M 5 years	£20M 10 years	£20M 25 years	£5M 10 years	£10M 10 years
AA	£5M 4 years	£20M 5 years	£20M 15 years	£5M 5 years	£10M 10 years
AA-	£5M 3 years	£20M 4 years	£20M 10 years	£5M 4 years	£10M 10 years
A+	£5M 2 years	£20M 3 years	£10M 5 years	£5M 3 years	£10M 5 years
A	£5M 13 months	£20M 2 years	£10M 5 years	£5M 2 years	£10M 5 years
A-	£5M 6 months	£20M 13 months	£10M 5 years	£5M 13 months	£10M 5 years
None	£1M 6 months	n/a	£5M 25 years	£0.5M 5 years	£5M 5 years
Pooled funds	£10M per fund for MMF, other funds (e.g. CCLA or REITS) subject to specific advice				

55.	**Credit Rating:** Investment limits are set by reference to the lowest published long-term credit rating from a selection of external credit ratings. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.
56.	**Banks Unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

57.	**Banks Secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.
58.	**Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.
59.	**Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £1M per company as part of a diversified pool in order to spread the risk widely.
60.	**Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.
61.	**Pooled Funds:** Shares or units in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods. Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.
62.	**Real estate investment trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.
63.	**Operational bank accounts**: The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring

	services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept to a minimum. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.
64.	The Chief Financial Officer (CFO), under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported quarterly to Cabinet.
	<u>Risk Assessment and Credit Ratings</u>
65.	Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then: • no new investments will be made, • any existing investments that can be recalled or sold at no cost will be, and • full consideration will be given to the recall or sale of all other existing investments with the affected counterparty. Where a credit rating agency announces that a rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.
	<u>Other Information on the Security of Investments</u>
66.	The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press and analysis and advice from the Authority's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.
67.	When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

	Investment Limits
68.	The Council's revenue reserves and balances available to cover investment losses (excluding Schools, capital and HRA) are forecast to be £60M at 31st March 2019. In order that there is no immediate pressure on available reserves in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government and specified investments such as property funds) will be £20M. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors in **Table 3** below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 3 –Investment Limits

	Cash limit
Any single organisation, except the UK Central Government and specified funds (subject to specific advice)	£20M each*
UK Central Government	unlimited
Any group of organisations under the same ownership	£20M per group*
Any group of pooled funds under the same management	25% per manager unless under specific advice
Negotiable instruments held in a broker's nominee account	£50M per broker
Foreign countries	£10M per country
Registered Providers and registered social landlords	£10M in total
Unsecured investments with Building Societies	£5M in total
Loans to unrated corporates	£1M in total
Real estate investment trusts (REITS)	£20M each*
Money Market Funds**	£10M* per fund and no more than 0.50% of any investments fund in total for non-government funds

**This is the absolute limit and the working limit will be monitored against actual cash flows and movement on reserves together with advice from our financial advisors and will be adjusted each quarter as necessary in agreement with the CFO.*

***We would not normally invest more than 50% of our overall investment portfolio in MMF on the advice of our advisors, however as part of our revised strategy to reduce short term investments and move into longer term investments, there will be occasions as bonds mature when this limit is exceeded. This advice is with regards to cash flow risk, however we feel this is mitigated by spreading over a number of funds and not just the highest yielding ones and having funds in other instant access accounts. In addition money can be borrowed short term from the market on the day.*

Liquidity Management

69. The Council undertakes high level cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.

TREASURY MANAGEMENT INDICATORS

70. The Council measures and manages its exposure to treasury management risks using the following indicators.

Security

71. The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	Target
Portfolio average credit rating	A

Liquidity

72. The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments and has set a £10M minimum threshold on cash available in instant access accounts, if balances were to fall below this limit we would consider taking short term loans which are available without given prior notice and at competitive rates.

Interest Rate Exposure

73. This indicator is set to control the Council's exposure to interest rate risk. The upper limits is based on the one-year revenue impact of a 1% rise or fall in interest rates for existing variable rates on long term loans and assumed short term borrowing, offset by variable investments. The main risk to the authority comes through the use of short term borrowing in place of fixed term long term debt which for 2019/20 is £133M, as shown in **Appendix 4 Table 22.** A 1% increase over those forecast would equate to £1.3M, plus any ongoing impact on an increase in the long term rate.

74. The Authority has more exposure to an increase in interest rates than a reduction as our debt portfolio is higher than our investments. A fall in interest rates of 1% would see investment income fall by about £0.5M but this would be offset by reduction in debt charges.

Table 4–Interest Rate Exposure

Interest rate risk indicator	**£M**
Upper limit on one-year revenue impact of a 1% **rise** in interest rates	1.5
Upper limit on one-year revenue impact of a 1% **fall** in interest rates	0.5

Maturity Structure of Borrowing

75. This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing as set out in **Table 5** below:

	Lower Limit %	Upper Limit %
Under 12 Months	0	45
12 months and within 24 months	0	45
24 months and within 5 years	0	50
5 years and within 10 years	0	55
10 years and within 20 years	0	60
20 years and within 30 years	0	65
30 years and above	0	75

76. Time periods start on the first day of each financial year and the maturity date of borrowing is the earliest date on which the lender can demand repayment. Although all LOBOs are now in their call options they are not expected to be called in the near future so are included within the appropriate classification above based on their maturity date.

77. Details of our current level of debt and maturity is shown in **Table 6** below. This shows that all debt is within existing levels.

78. **Table 6 – Current Debt**

Debt	Lower Limit %	Upper Limit %	Actual Debt as at 31/12/2018 £M	Average Rate as at 31/12/2018 %	% of Debt	Compliance with set Limits?
Under 12 months	0	45	31.11	1.68%	13	Yes
12 months and within 24 months	0	45	50.49	2.05%	22	Yes
24 months and within 5 years	0	50	5.24	3.45%	2	Yes
10years and within 20 years	0	55	16.00	4.81%	7	Yes
20 years and within 30 years	0	65	8.00	4.66%	3	Yes
30 years and within 40 years	0	75	92.60	3.77%	39	Yes
40 years and within 50 years	0	75	31.25	3.56%	13	Yes
			234.69	**3.35%**	**100**	

Principal Sums Invested for Periods Longer than a Year

79. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end is shown in **Table 7**.

Table 7 – Principal sums invested for periods longer than a year

	Current £M	2019/20 £M	2020/21 £M	2021/22 £M	2022/23 £M
Limit on principal invested beyond year end	40	100	100	100	100

OTHER ITEMS

80.	There are a number of related matters that the CIPFA Code requires the Council to include in its Treasury Management Strategy.
	<u>Policy on Use of Financial Derivatives</u>
81.	Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).
82.	The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.
83.	Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.
	<u>Markets in Financial Instruments Directive</u>
84.	The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.
	<u>Housing Revenue Account Self-Financing</u>
85.	On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account.
86.	Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance. This balance will be measured and interest transferred between the General Fund and HRA at an agreed rate. Housing Legislation does not allow impairment losses to be charged to the HRA and consequently any credit related losses on the Council's investments will be borne by the General Fund alone. It is therefore appropriate that the General Fund is compensated for bearing this risk, and all interest transferred to the HRA should be adjusted downwards. The rate will be based on investments with the Debt Management Office. The rate of return on comparable investments with the government is lower and often referred to as the risk-free rate.

INVESTMENT STRATEGY (NON- TREASURY)

Service Investments: Loans

87. The Council is able to lend money to its subsidiaries, its suppliers, local businesses, local charities, housing associations, local residents and its employees to support local public services and stimulate local economic growth.

88. The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Authority, upper limits on the outstanding loans to each category of borrower have been set as in Table 8:

Table 8 – Loans for service purposes

Category of Borrower	2019/20 Approved Limit
Subsidiaries	£2.0M
Suppliers	£2.0M
Other Public Sector Bodies	£20.0M
Charities	£0.5M

89. Accounting standards require the Authority to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Authority's statement of accounts from 2018/19 onwards will be shown net of this loss allowance. However, the Authority makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

90. The Council does not currently have any material loans but loans to subsidiaries may 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 will be considered when all of the following criteria are satisfied:

- The loan is given towards expenditure which would, if incurred by the Council, be capital expenditure;
- The purpose for which the loan is given is consistent with the Council's corporate / strategic objectives and priorities;
- Due diligence is carried out that confirms the Council's legal powers to make the loan, and that assesses the risk of loss over the loan term;
- A formal loan agreement is put in place which stipulates the loan period, repayment terms and loan rate (which will be set at a level that seeks to mitigate any perceived risks of a loss being charged to the General Fund, and takes appropriate account of state aid rules) and any other terms that will protect the Council from loss.

Service Investments: Shares

91. The Council is able to invest in the shares of its subsidiaries, its suppliers, local businesses, local charities, housing associations, local residents and its employees to support local public services and stimulate local economic growth.

92. One of the risks of investing in shares is that they fall in value meaning that the initial outlay may not be recovered. The Council does not currently have any material investment in shares nor is there any intention to do so at present. If this changed the Council would undertake a risk assessment before entering purchase and would establish appropriate Prudential Indicators.

Commercial Investments: Property

93. The Council is able to invest in local, regional and UK commercial and residential property with the intention of making a profit that will be spent on local public services. Between 2016 and 2017, SCC implemented a strategy to invest in commercial properties with the expected return on investment being used to fund council services, known as the Property investment fund (PIF). To date the authority has purchased 3 properties; however following the latest guidance regarding property investments published by central government, SCC has halted this strategy for the foreseeable future. Details of the properties purchased are shown in **table 9** below.

94. **Table 9: Property Investment Fund**

Property	***Actual***	***31.03.2018 actual***		***31.03.2019 expected***		***Outstanding Debt 31.03.2019***
	Purchase Cost £M	***Value in Accounts***	***Gain or (Loss)***	*Value in Accounts*	***Gain or (Loss)***	***£M***
Property 1	*6.47*	*6.03*	*(0.44)*	*6.27*	*0.24*	*5.98*
Property 2	*14.69*	*13.79*	*(0.90)*	*13.79*	*0*	*13.68*
Property 3	*8.53*	*8.08*	*(0.45)*	*8.17*	*0.09*	*8.01*
	29.69	***27.90***	***(1.79)***	***28.23***	***0.33***	***27.67***

95. ***Security:*** In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than the amount of debt currently outstanding for the asset. As can be seen from the table above the fair value assessment of these properties at the 31 March 2018 was below the purchase price, this was primarily due to cost associated with the purchase rather than a fall in the value of the assets. In line with the MRP policy in place at the time the difference of £1.79M was charged to revenue in 2017/18. No further material reduction in fair value is expected during 2018/19. Debt repayments are now being made on the annuity basis and debt will reduce by £235k in 2018/19 and £243k in 2019/20.

96. **Risk assessment:** The council assess the risk of loss before purchasing investment property and monitors both the fair value and the return on the assets to assess the benefits of either retaining or disposing of the assets. This is reported to Capital Board on at least a quarterly basis.

97. **Liquidity:** Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice. Therefore, in order to assess liquidity, the Council monitors the income stream attached to property purchases, a much

	more liquid asset, comparing budgets to forecasts and actuals. For the PIF properties income for both 2017/18 and current year are in line with the budgeted figure and there are no current indicators to suggest that the forecast future income will not be achieved. If there is any change in this then this would be reported to Capital Board.
98.	In addition to the properties purchased under PIF, the council holds an extensive historic property portfolio. Information relating to purchase price and any associated debt is not held, as local authority legislation does not require this information to be held. The fair value of these properties at the 31 March 2018 was £125.1M an increase of £2.4M from the year before. The Valuation and Estates section are responsible for the ongoing management and monitoring of the portfolio (including PIF) and for 2017/18 net income was for the total portfolio was £7.5M a return of 5.96%.
	Capacity and Skills
99.	**Elected members and statutory officers:** CIPFA's Code of Practice requires the CFO to ensure that all Members tasked with TM responsibilities, including scrutiny of the TM function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. Treasury training is offered to all members annually, which is undertaken by our advisors, Arlingclose. Further training is also provided if the need arises, for example there was a change in leadership and the makeup of Governance committee changed during 2018, so as part of Members induction Arlingclose provided an introduction to treasury training session. We would also arrange additional training if there was to be a material change in the Treasury Strategy, explaining the reasoning behind it, so that Members understand what they are being asked to approve. For Officers the Council adopts a continuous performance and development programme to ensure staff are regularly appraised and any training needs addressed. Relevant staff also attend regular training sessions, seminars and workshops which ensure their knowledge is up to date. Details of training received are maintained as part of the performance and development process.
100.	**Commercial deals:** As detailed in paragraph 92 above the Council has currently suspended any further purchases of Investment property. Future purchase would be subject to a detailed business plan and need approval from capital board. In addition any potential investments would be subjected to a detailed checking process which ensures that relevant checks and authorisations had been sought prior to the purchase. The process requires 11 desirable criteria, 2 of which are low risk investment properties which had a long term lease and a single let. Should a property be suitable, further financial checks are conducted on the tenants within the property to evidence their financial stability and risk level. An independent valuation would then be conducted on the property to obtain a level of assurance that the price quoted and the rent charged were in line with the expected market rate. Once all criteria is met final sign off is required by the S151 officer and the Leader of the Council.
	Investment Indicators
101.	The Authority has set the following quantitative indicators to allow elected members and the public to assess the Authority's total risk exposure as a result of its investment decisions.
102.	***Total risk exposure***: This indicator shows the Authority's total exposure to potential investment losses. This includes amounts the Authority is contractually

committed to lend but have yet to be drawn down and guarantees the Authority has issued over third party loans.

Table 10:Total investment exposure

Total Investment Exposure	***31.03.2018 Actual***	***31.03.2019 Forecast***	***31.03.2020 Forecast***
	£M	***£M***	***£M***
Treasury management investments	***72.4***	***50.0***	***50.0***
Service investments: Loans	***0.0***	***0.0***	***0.0***
Commercial Investments: PIF	***27.9***	***27.7***	***27.4***
TOTAL EXPOSURE	***100.3***	***77.9***	

103. ***How investments are funded***: Government guidance is that these indicators should include how investments are funded. Since the Authority does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by borrowing. The remainder of the Authority's investments are funded by usable reserves and income received in advance of expenditure.

Table 11: Investments funded by borrowing and loan to value ratio

Investment funded by borrowing	***31.03.2018 Actual***	***Loan to Value Ratio***	***31.03.2019 Forecast***	***Loan to Value Ratio***	***31.03.2020 Forecast***	***Loan to Value Ratio***
	£M	***%***	***£M***	***%***	***£M***	***%***
Commercial Investments: Property	***27.9***	***100***	***27.7***	***99***	***27.4***	***98***
Service investments: Loans	***0.0***		***0.0***		***0.0***	

The maximum loan to value indicator is set at 100% if the fair value of the asset was to fall below the outstanding loan value then this would be reported to Council and the authority would look to take steps to assess the viability of holding the investment.

104. ***Rate of return received***: This indicator shows the investment income received less the associated costs, including the cost of borrowing, as a proportion of the debt outstanding. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Table 12: Investment rate of return (net of all costs)

Investment net rate of return	***2017/18 Actual*1***	***2018/19 Forecast***	***2019/20 Forecast***
	%	***%***	***%***
Property 1	***-4.09***	***2.25***	***2.27***
Property 2	***-3.55***	***2.14***	***2.16***
Property 3	***-3.95***	***0.78***	***0.79***
Total Average Rate of Return	***-3.78***	***1.77***	***1.79***

	**1 negative rate of return is due to the cost of purchase of £1.78M being written off to reflect the Fair Value of the assets*
105.	***Voids and Maintenance***: Budgeted income for investment income allows for voids and maintenance costs, but in addition the council has set aside an earmarked reserve of £200k to cover unforeseen void and maintenance costs. To ensure the reserve is maintained at the correct level balances are reviewed as part of budget monitoring and individual property balances are monitored to ensure they continue to provide the correct level of risk management.
	2019/20 MINIMUM REVENUE PROVISION (MRP) STATEMENT
106.	Where the council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008, the council is required to make a prudent provision. The Local Government Act 2003 requires the Council to have regard to the Department for Communities and Local Government's Guidance on Minimum Revenue Provision (the CLG Guidance) most recently issued in 2018.
107.	The broad aim of the CLG guidance is to ensure that MRP charges on unsupported borrowing should be made over a period commensurate with the period the assets financed from borrowing continue to provide benefit. Where it is practical or appropriate to do so, the Council may make voluntary revenue provision, or apply capital receipts, to reduce debt over a shorter period.
108.	The CLG Guidance requires the Council to approve an Annual MRP Statement each year. For borrowing prior to the prudential regime we use the regulatory method (over a 50 year life) and for prudential borrowing the asset life method, this now also includes MRP for investment property, as the depreciation method which was previously used, is no longer available for Investment property following the revised guidance.
109.	We will continue to review MRP and it is proposed that delegated powers should be given to the CFO to change the proposed methods to aid good financial management whilst maintaining a prudent approach. Any changes to the original MRP Statement during the year will be reported as part of quarterly financial and performance monitoring and in revisions to the TM strategy as part of the year end and midyear reviews.
110.	Where loans are made to other bodies for their capital expenditure and are to be repaid in annual instalments, no MRP will be charged. However, the capital receipts generated by the annual repayment on those loans will be put aside to repay debt instead. MRP will be charged where there is no repayment.

111.	There is no requirement for the HRA to make debt repayments but it has opted to make voluntary repayments and provision has been made within its business plan to show that it can pay down debt over the life of the 30 year business plan.
112.	MRP in respect of leases and Private Finance Initiative schemes brought on Balance Sheet under the International Financial Reporting Standards (IFRS) based Accounting Code of Practice will match the annual principal repayment for the associated deferred liability.
113.	Capital expenditure incurred during 2019/20 and funded from borrowing will not be subject to a MRP charge until 2020/21.
114.	Based on the Council's latest estimate of its Capital Financing Requirement on 31 March 2019 the budget for MRP has been set on the assumption that we will be using the regulatory method for borrowing prior to the prudential regime (over the remainder of a 50 year life) and using the asset life method for prudential borrowing where it applies. As previously reported the Council has been taking a holiday from MRP payments due to over provision in the past, the balance of which will be used during 2019/20, hence the main increase in MRP liability.
115.	The current and estimated levels of MRP and CFR are shown in **Table 13** below:

Table 13 - Current and Estimated MRP and CFR for 2019/20

	31/03/2018 Actual CFR £M	2018/19 MRP Liability £M	31/03/2019 Estimated CFR £M	2019/20 Estimated MRP £M
Capital expenditure before 01.04.2008	96.60	1.84	94.75	1.83
Unsupported capital expenditure after 31.03.2008	152.03	3.81	173.25	4.43
Transferred debt	14.55	0.37	14.19	0.37
Finance leases and Private Finance Initiative	58.84	2.10	56.74	3.01
Total General Fund CFR and MRP Liability	**322.02**	**8.12**	**338.93**	**9.64**
MRP Holiday	0.00	(0.55)	0.00	0.00
Net General Fund CFR and MRP Liability *(Table 11)*	**322.02**	**7.57**	**338.93**	**9.64**
Assets in the Housing Revenue Account	61.33	Nil	76.91	Nil
HRA subsidy reform payment	96.60	5.50	94.76	Nil
Total Housing Revenue Account *(Table 17)*	**157.93**	**5.50**	**171.67**	**0.00**
Total	**479.95**	**13.07**	**510.60**	**9.64**

<u>MONITORING AND REPORTING</u>

116.	The Chief Financial Officer will report to the Governance Committee on TM activity / performance as follows: (a) A mid-year review against the strategy approved for the year. (b) An outturn report on its treasury activity, no later than 30 September after the financial year end.
117.	In addition, a quarterly update will be presented to Cabinet as part of Quarterly Revenue Financial Monitoring.

HRA Limit on Indebtedness

118.	Following the Chancellor's announcement in the 2018 Autumn Budget, restrictions relating to HRA borrowing have been lifted. This means that the previous HRA debt cap of £199.6m has been removed, and there is now the emphasis for councils to plan their new build strategy and financing at a local level. The process for identifying priorities and sites for new build developments is now taking place and is expected to form the basis of a new delivery strategy

	in 2019, incorporating affordability and prudence. As part of the new build strategy relevant Prudential Indicators will be agreed.
119.	The HRA Business Plan supports a number of council strategies, including the Medium Term Financial Strategy, to ensure plans are affordable and budgets are aligned to the assumptions detailed in those strategies. The specific HRA Business Plan priorities are summarised below, further details can be seen in the report being submitted to Council on 29 February 2019. • All HRA debt is sustainable and can be serviced over the life of the Business Plan. • Investment in existing HRA stock can be achieved within the Government's previously set borrowing limit of £199.6M as shown in **Table 14** below. • Currently, large scale new stock provision is not provided for in the Business Plan, any new build development will be subject to a business case and financial appraisal to assess the financial viability of the scheme.
120.	**Table 14 - Borrowing Forecast for Existing Stock**

HRA Borrowing Forecast for Existing Stock	2017/18 Actual £M	2018/19 Forecast £M	2019/20 Forecast £M	2020/21 Forecast £M	2021/22 Forecast £M	2022/23 Forecast £M
Brought Forward	163.19	157.92	171.67	181.99	190.53	192.83
Maturing Debt	(5.51)	(5.50)	0.00	0.00	(1.31)	0.00
New Borrowing Requirement	0.81	19.25	10.32	8.54	3.61	6.91
Appropriations (to) from GF	(0.57)	0.00	0.00	0.00	0.00	0.00
Housing Capital Financing Requirement	**157.92**	**171.67**	**181.99**	**190.53**	**192.83**	**199.74**
Less Borrowing for Regeneration Schemes*			**(9.51)**	**(15.76)**	**(17.52)**	**(20.86)**
Carried forward	**157.92**	**171.67**	**172.48**	**174.77**	**175.31**	**178.88**
HRA Limit on Debt for Existing Stock	199.60	199.60	199.60	199.60	199.60	199.60
Headroom	**41.68**	**27.93**	**27.12**	**24.83**	**24.29**	**20.72**

121.	The HRA by default will underwrite any programmes that are unable to self-fund

RESOURCE IMPLICATIONS

Capital/Revenue

122.	The revenue and capital implications are considered as part of ongoing monitoring which is reported to Cabinet each quarter and as part of the budget setting process.
123.	The forecast for borrowing costs in 2019/20 is £15.9M. This is made up of borrowing of £9.1M based on an average debt portfolio of £316.9M at an average interest rate of 2.76% plus MRP and other costs of £6.8M. Investment income for 2019/20 is forecast at £1.4M based on an average portfolio of £42M at an average of 3.36%. If actual levels of investments and borrowing, and/or interest rates differ from those forecast, performance against budget will be correspondently different

Property/Other

124.	None

LEGAL IMPLICATIONS

Statutory power to undertake proposals in the report:

125.	Local Authority borrowing is regulated by Part 1, of the Local Government Act 2003, which introduced the new Prudential Capital Finance System.
126.	From 1 April 2004, investments are dealt with, not in secondary legislation, but through guidance. Similarly, there is guidance on prudent investment practice, issued by the Secretary of State under Section 15(1) (a) of the 2003 Act. A local authority has the power to invest for "any purpose relevant to its functions under any enactment or for the purposes of the prudent management of its financial affairs". The reference to the "prudent management of its financial affairs" is included to cover investments, which are not directly linked to identifiable statutory functions but are simply made in the course of treasury management. This also allows the temporary investment of funds borrowed for the purpose of expenditure in the reasonably near future; however, the speculative procedure of borrowing purely in order to invest and make a return remains unlawful.
Other Legal Implications:	
127.	None
POLICY FRAMEWORK IMPLICATIONS	
128.	This report has been prepared having regard with the CIPFA Code of Practice on Treasury Management.

KEY DECISION?	No
WARDS/COMMUNITIES AFFECTED:	None
SUPPORTING DOCUMENTATION	
Appendices	
1.	Policy Statement
2.	Existing Investment & Debt Portfolio Position and Projections
3.	Economic and Interest Outlook
4.	Capital Strategy – Prudential and Local Indicators
5.	Treasury Management Practices
6.	Glossary of Treasury Terms
Documents In Members' Rooms	
1.	None
Equality Impact Assessment	
Do the implications/subject of the report require an Equality Impact Assessment (EIA) to be carried out.	**No**
Privacy Impact Assessment	
Do the implications/subject of the report require a Privacy Impact Assessment (PIA) to be carried out.	**No**
Other Background Documents	

<table>
<tr><td colspan="2">Title of Background Paper(s)</td><td colspan="2">Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)</td></tr>
<tr><td>1.</td><td colspan="2">Prudential Limits and Treasury Management Strategy 2018/19 to 2021/22</td><td>Item 64</td></tr>
<tr><td>2.</td><td colspan="2">Prudential Limits and Treasury Management Mid Year Review 2018/19</td><td>Item 15</td></tr>
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