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RUSHMOOR BOROUGH COUNCIL

CORPORATE GOVERNANCE, AUDIT AND STANDARDS COMMITTEE

at the Council Offices, Farnborough on

Tuesday, 15th February, 2022 at 7.00 pm

To:

Cllr Sue Carter (Chairman)
Cllr P.J. Cullum (Vice-Chairman)

Cllr Jessica Auton
Cllr Jib Belbase
Cllr Sophia Choudhary
Cllr A.K. Chowdhury
Cllr Christine Guinness
Cllr A.J. Halstead
Cllr Prabesh KC
Cllr Sarah Spall
Cllr Jacqui Vosper

Mr. Tom Davies (Independent Member – Audit) (non-voting)

STANDING DEPUTIES

Cllr K. Dibble
Cllr J.B. Canty

Enquiries regarding this agenda should be referred to the Committee Administrator, Kathy Flatt, Democracy and Community, Tel. (01252 398829) or email kathy.flatt@rushmoor.gov.uk.

A G E N D A

1. **MINUTES –** (Pages 1 - 6)

   To confirm the Minutes of the Meeting held on 24th January, 2022 (copy attached).

2. **TREASURY MANAGEMENT AND NON-TREASURY INVESTMENT OPERATIONS 2021/22 –** (Pages 7 - 34)

   To consider the Executive Head of Finance Report No. FIN2211 (copy attached), which sets out the main activities of the treasury management and non-treasury investment operations during the first half of 2021/22.

3. **ANNUAL TREASURY MANAGEMENT STRATEGY AND ANNUAL NON-TREASURY INVESTMENT STRATEGY 2022/23 –** (Pages 35 - 70)

   To consider the Executive Head of Finance Report No. FIN2212 (copy attached), which seeks approval of the Treasury Management Strategy and Non-Treasury Investment Strategy (Investment Strategy) for the year 2022/23 for submission to Council on 24th February 2022.

4. **ANNUAL CAPITAL STRATEGY 2022/23 –** (Pages 71 - 86)

   To consider the Executive Head of Finance Report No. FIN2213 (copy attached) which seeks approval of the Council's Capital Strategy for the year 2022/23 for submission to the Council on 24th February 2022.

PUBLIC PARTICIPATION AT MEETINGS

Members of the public may ask to speak at the meeting on any of the items on the agenda by writing to the Committee Administrator at the Council Offices, Farnborough by 5.00 pm two working days prior to the meeting.

CORPORATE GOVERNANCE, AUDIT AND STANDARDS COMMITTEE

Meeting held on Monday, 24th January, 2022 at the Council Offices, Farnborough at 7.00 pm.

Voting Members

Cllr Sue Carter (Chairman)
Cllr P.J. Cullum (Vice-Chairman)

Cllr Jessica Auton
Cllr Jib Belbase
Cllr Sophia Choudhary
Cllr A.K. Chowdhury
Cllr Christine Guinness
Cllr Prabesh KC
Cllr Sarah Spall
Cllr Jacqui Vosper

Apologies for absence were submitted on behalf of Cllr A.J. Halstead.

Cllr K Dibble attended the meeting as a Standing Deputy.

Non-Voting Member

Mr. Tom Davies (Independent Member – Audit)

28. **MINUTES**

The Minutes of the Meeting held on 22nd November 2021 be agreed and signed as a correct record of the proceedings.

29. **MEETING ATTENDANCE - CLLR PRABESH KC**

At the previous meeting, the Committee was advised that Cllr Prabesh KC had been absent for three consecutive meetings of the Committee. The Committee had deferred making a decision on whether there were reasonable grounds for absence to give Cllr Prabesh KC the opportunity to make a full representation and remain a Member of the Committee. Since then, Cllr Prabesh KC had made contact with the Chairman and had explained the circumstances for his absence which were for personal reasons, and with some sensitivities. He had also provided a written apology and explanation which had been circulated to the Committee.

Having discussed the matter with Cllr Prabesh KC, the Chairman stated that she was content to accept Cllr KC's personal reasons, as reasonable grounds for non-attendance, and proposed that the Committee support this. During discussion, the point was made that it was good practice for every effort to be made to communicate apologies for absence to the Chairman and Democracy Team, even if this had to be made through a third party.

RESOLVED: That Cllr Prabesh KC's reasons for non-attendance at consecutive meetings of the Committee be accepted as reasonable grounds for absence.

30. **STATEMENT OF ACCOUNTS 2019/20 - UPDATE 7**

The Committee received the Executive Head of Finance Report No. FIN2207, which informed Members of audit progress for the Council's Statement of Accounts for 2019/20 and provision of the audit opinion since the previous meeting on 22nd November 2021.

The Committee was advised that the Council had responded positively to further queries raised by Ernst & Young (EY) in December 2021. Further asset valuation enquiries had been raised in January 2022. The Council would need to respond to these to enable EY to provide an audit opinion. It was noted that the Executive Director (Mr Ian Harrison) and the Executive Head of Finance would be meeting with EY on 26th January 2022 to discuss any unresolved queries for the Council to respond to. EY would then be able to set out for the Council the impact on the audit opinion of the incomplete asset valuation information. Subject to the outcome of this meeting, the Executive Head of Finance would draft the updated cashflow forecast and Going Concern Note to enable the audit to conclude. The basis on which the audit would be concluded was set out in the Report.

The Committee was updated on the impact of the delayed conclusion of the 2019/20 audit of the 2020/21 financial statement. It was further noted that the 2021/22 audit was likely to commence in Autumn 2022. Further discussions would need to take place with EY to schedule the 2020/21 and 2021/22 audit work, all of which would be dependent on the 2019/20 audit being concluded.

Officers from both the Council and EY would be working towards a formal completion of the 2019/20 audit in early 2022. Subject to the outcome of the meeting between the Council and EY on 26th January 2022, the Council was hoping to be able to bring the 2019/20 audited accounts and audit opinion to the meeting on 28th March 2022. However, it was acknowledged that there remained some risk around the exact timing given the need to agree the final accounts position, review any proposed adjustments and a revision to the Council's financial statements.

During discussion, Members raised questions regarding: the quality of property records kept by the Council; the amount of time needed to provide the information required by EY on asset valuations; the implications of EY providing a qualified audit opinion; and, the need for a review of the audit process for 2019/20 so that lessons can be learned by both the Council and EY.

RESOLVED: That

(i) the Executive Head of Finance Report No. FIN2207 be noted: and

(ii) the indicative timetable for the approval of the 2019/20 Statement of Accounts and receiving the audit opinion, as set out in the Report, be noted.

31. **TREASURY MANAGEMENT AND NON-TREASURY MANAGEMENT 2021/22 - MID-YEAR REPORT**

Consideration of this item was deferred to the Special Meeting of the Committee on 15th February 2022.

32. **DECISION TO OPT INTO THE NATIONAL SCHEME FOR AUDITOR APPOINTMENTS MANAGED BY PUBLIC SECTOR AUDIT APPOINTMENTS AS THE 'APPOINTING PERSON'**

The Committee considered the Executive Head of Finance Report No. FIN2208, which set out proposals and options available to the full Council for appointing the external auditor to the Authority for the accounts for the five-year period from 2023/24.

It was noted that the current auditor appointment arrangements covered the period up to, and including, the audit of the 2022/23 accounts. The Council had opted into the appointing 'appointing person' national auditor appointment arrangements which had been established by Public Sector Audit Appointments (PSAA) for the period covering the accounts for 2018/19 to 2022/23. PSAA was currently undertaking a procurement exercise for the next appointing period, covering audits for 2023/24 to 2027/28. During Autumn 2021, all local government bodies needed to make decisions about their external audit arrangements from 2023/24. Local government bodies had options to arrange their own procurement or they could join and take advantage of the national collective scheme administered by PSAA. The Committee was advised that the decision had to be taken in accordance with the Regulations (i.e. by the full Council) and that notice had to be given to PSAA of the Authority's intention to opt-in by 11th March 2022.

The Committee was being recommended to accept the PSAA's invitation to opt into the sector-led option for the appointment of external auditors to principal local government and police bodies for the five financial years from 1st April 2023.

The Committee

(i) **RECOMMENDED THE COUNCIL** to opt-in to the appointing person arrangements made by Public Sector Audit Appointments (PSAA) for the appointment of external auditors and authorise; and

(ii) **RESOLVED** that the Executive Head of Finance be authorised to sign the notice of acceptance on behalf of the Authority, subject to the decision of the full Council.

33. **INTERNAL AUDIT - AUDIT UPDATE**

The Committee received the Interim Audit Manager's Report No. AUD2201, which set out: work carried out by Internal Audit since the previous Report to the Committee in November 2021; an update on the overall progress on the 2021/22; and, an update on outstanding audit issues from reports issued in 2019/20 and 2020/21. Details of outstanding high risk issues for the two years 2019/20 and 2020/21 were set out in the appendix to the Report and included management updates and, in some cases, revised target dates.

Mr Thacker was thanked for his exceptional work as Interim Audit Manager and the Committee acknowledged the various working practices that had been put in place.

During discussion, further information was requested on various outstanding high-risk audit issues including: the card terminal at Princes Hall; estate management and commercial letting (debt write off); taxi licensing (manual inputting of data, 'Manage My Licence' IT based approach); and Alderwood Leisure Centre (payment records – system for manual reconciliations). Further clarification was sought on errors made and whether this was due to resource issues/staff absence due to sickness. The Committee was advised that, within the following year's Budget, there was an additional item for additional financial resources for corporate governance work. There was also a request for further information on the costs associated with the outstanding high-risk audit issues.

RESOLVED: That

(i) the audit work carried out in Quarter 3 to date be noted;

(ii) the update to the expected deliverables for Quarter 4 be noted; and

(iii) the outstanding high-risk audit issues and engagement by the Services to address them be noted.

34. **RUSHMOOR DEVELOPMENT PARTNERSHIP - SIX MONTHLY REPORT**

The Committee received the Executive Director Report (No. ED2201), as the Council Shareholder on the progress review received from the Rushmoor Development Partnership (RDP) on its business plan. The Report provided a commentary on the progress and delivery through the Partnership during 2021 on the key regeneration sites agreed as part of the initial RDP business plan.

The Report advised that there had been significant progress since the approval of the initial business plan, particularly on Union Street, Aldershot, where the RDP had secured a planning consent during 2020 despite the pandemic and had supported the Council through its due diligence process that had facilitated a construction start on site in November 2021. Work on the Civic Quarter Masterplan had progressed well with two public consultations having been undertaken during 2021 to support the submission of an outline planning application. The disposal of Parsons Barracks car park had been concluded to enable the development of a care home, with the proceeds being used to fund the work of the RDP to date, which had assisted with reducing pressure on the Council's financial position.

The Committee was advised that the partnership where Council and Hill staff worked together to continue to enable a commercial approach to be taken to bringing forward sites alongside the transition of the Council's and community's ambitions for both town centres. Overall, the Executive Director was of the opinion that the RDP had made a positive contribution to moving forward the Council's regeneration objectives over the past year.

RESOLVED: That the progress by the Rushmoor Development Partnership and the next steps for each of the current projects covered by the RDP business plan, as set out in the Executive Director Report No. ED2201, be noted.

The meeting closed at 8.38 pm.

CLLR SUE CARTER (CHAIRMAN)

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CORPORATE GOVERNANCE, AUDIT AND STANDARDS COMMITTEE
15 FEBRUARY 2022

EXECUTIVE HEAD OF FINANCE
REPORT NO: FIN2211

TREASURY MANAGEMENT AND NON-TREASURY INVESTMENT OPERATIONS 2021/22

SUMMARY:
This report sets out the main activities of the Treasury Management and non-Treasury Investment Operations during the first half of 2021/22. Prudential indicators for the 2021/22 financial year have been updated for all treasury management and non-treasury activity during the first half of 2021/22.

RECOMMENDATIONS:
Members are requested to:

(i) Note the contents of this report in relation to the treasury management and non-treasury investment operations carried out during the first half of 2021/22.

1. INTRODUCTION

1.1 This report sets out the Treasury Management and Non-Treasury Investment operations for the first half of the year 2021/22. This report is a statutory requirement under the CIPFA Code of Practice on Treasury Management.

1.2 The Council originally approved the Annual Treasury Management Strategy and Non-Treasury Investment Strategy for 2020/21 on 25 February 2021. The Council has 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. The successful identification, monitoring and control of risk remains central to the Council's treasury management and non-treasury investment strategies.

2. PURPOSE

2.1 The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management 2017 ("the Code"), which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year. The Code also recommends that members be informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing best practice in accordance with CIPFA's recommendations.

2.2 The appendices (1 to 4) set out the Treasury Management operations, Non-Treasury Investment Operations and Prudential Indicators for 2021/22 and fulfil key legislative requirements as follows:

Appendix 1

- The **Treasury Management operations** which sets out how the Council's treasury service operated during the first half of 2021/22 in accordance with CIPFA's Code of Practice on Treasury Management and Prudential Code;
- The **Treasury Management Borrowing operations** which sets out the Council's borrowing during the first half of 2021/22 in accordance with CIPFA's Code of Practice on Treasury Management, and;
- The **Treasury Management Investment operations** which sets out the Council's Treasury Management investment operations for the first half of 2021/22, in accordance with CIPFA's Code of Practice on Treasury Management.

Appendix 2

- The **Non-Treasury Investment operations** sets out the Council's Non-Treasury investment performance for the first half of 2021/22, in accordance with MHCLG Investment Guidance.

Appendix 3

- the **Prudential indicators forecast** sets out the forecast prudential indicators position at the end of 2021/22 based on 2021/22 half year position relating to treasury/non-treasury activities and capital financing for 2021/22. Performance is compared to the indicators set out in the Annual Capital Strategy for the year 2021/22.

Appendix 4

- Economic commentary from Arlingclose

Appendix 5

- Capital Finance system – Revision to CIPFA Codes and MHCLG improvement to the Capital Finance Framework

3 CONCLUSIONS ON THE TREASURY MANAGEMENT AND NON-TRESURY INVESTMENT OPERATIONS DURING 2021/22

3.1 The Council's treasury team continued to concentrate on the security of investments taking due regard for the returns available.

3.2 With increased levels of borrowing the treasury team continually reviews the borrowing strategy, weighing up interest rate levels and risk of refinancing. During the first half of the 2021/22 financial year short-term interest rates have remained at 0.10% and are forecast to remain low. Borrowing levels have remained the same during the year although the increase in short-term borrowing does increase the refinancing risk. All treasury management decisions are taken with due regard to refinancing risk.

3.3 Total borrowing at 30 September 2021 was £102m, no change from 2020/21 year-end position. Year-end borrowing is forecast to be below estimated levels due to timing capital expenditure (service loans) on Housing Matters. The lower level of borrowing and lower interest rates has resulted in forecast interest cost of borrowing reducing by £0.495m.

3.4 The Council is forecast to have non-treasury investments risk exposure of £137m of which £93.7m is funded via external loans.

Contact Details and Report author:

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david.stanley@rushmoor.gov.uk

APPENDIX 1

TREASURY MANAGEMENT OPERATION FOR FIRST HALF OF 2021/22

1 INTRODUCTION

1.1 The purpose of the treasury management operation is to ensure that cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in counterparties or instruments commensurate with the Council's low risk approach, pursuing optimum performance while ensuring that security of the investment is considered ahead of investment return. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure.

1.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure the Council can meet its capital spending obligations. The management of longer-term cash may involve the arrangement of long and/or short-term loans (external borrowing) or may use longer term cash flow surpluses in lieu of external borrowing (internal borrowing).

2 TREASURY MANAGEMENT ADVICE

2.1 The Council continued to engage the services of Arlingclose for independent treasury advice during the year 2021/22. Arlingclose provide specialist treasury support to 25% of UK local authorities. They provide a range of treasury management services including technical advice on debt and investment management and long-term capital financing. They advise on investment trends, developments and opportunities consistent with the Council's Treasury Management Strategy.

2.2 With the exception of pooled funds all investment activity is carried out by the Council's own treasury team with advice from Arlingclose, and having due regard to information from other sources such as the financial press and credit-rating agencies.

2.3 Pooled funds are managed at the discretion of the external fund managers associated with each fund. It should however be noted that whilst the funds are externally managed, the decision as to whether to invest lies solely with the Council in accordance with its Treasury Management Strategy.

2.4 The needs of the Council's treasury management staff for training in investment management are assessed on an ongoing basis and as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. During 2021/22, staff attended relevant virtual workshops provided by Arlingclose and other service providers.

3 EXTERNAL CONTEXT

3.1 The Council's treasury management advisors have provided commentary on the economic background that prevailed during the first half of 2021/22. This commentary is provided at **Appendix 4**.

4 LOCAL CONTEXT

4.1 On 30 September 2021, the Council had net borrowing of £102.0m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes for the 2020/21 financial year is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The projected CFR is summarised in **Appendix C**.

4.2 The treasury management position at 30 September 2021 and the change during the year is shown in Table 1 below.

Table 1: Treasury Management Summary

	Balance 31 March 2021 (£m)	Movement (£m)	Balance 30 Sept 2021 (£m)	Rate % 30 Sept 2021
Long-term borrowing	0.0	25.0	25.0	0.42%
Short-term borrowing	102.0	(25.0)	77.0	0.16%
Total borrowing	**102.0**	**0.0**	**102.0**	
Long-term investments	(21.9)	0.0	(21.9)	4.10%
Short-term investments	0.0	0.0	0.0	
Cash and cash equivalents	(4.8)	(20.2)	(25.0)	0.01%
Total investments	**(26.7)**	**(20.2)**	**(46.9)**	
Net borrowing/(investments)	**75.3**	**(20.2)**	**55.1**	

4.3 **Liability benchmark:** 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 CFR, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 2: Liability benchmark

	2021/22 Estimate (£m)	2021/22 Forecast (£m)
Outstanding borrowing	154.10	154.10
Investment min	(10.00)	(10.00)
Investments held that can be redeemed	(23.90)	(23.90)
Liability benchmark	131.20	131.20

5 BORROWING ACTIVITY IN 2020/21

5.1 At 30 September 2021 the Council held £102.0m of loans (no change since 31 March 2021) as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30 September 2021 are summarised in Table 3 below.

Table 3: Borrowing Position

	Balance 31 March 2021 (£m)	Movement (£m)	Balance 30 Sept 2021 (£m)	Rate % 30 Sept 2021
Long-term borrowing	0	25	25	0.42%
Short-term borrowing	102	(25)	77	0.16%
Total Gross External Debt	**102**	**0**	**102**	

5.2 The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

5.3 With short-term interest rates remaining much lower than long-term rates, the Council considered it to be more cost effective in the near term to use short-term loans.

6 INVESTMENT ACTIVITY IN 2021/22

6.1 The Council holds significant invested funds. During the year, the Council's investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	Balance 31 March 2021 (£m)	Movement (£m)	Balance 30 Sept 2021 (£m)	Rate % 30 Sept 2021
Managed in-house:				
Money Market Funds	4.8	20.2	25.0	0.01%
Managed externally:				
Pooled Funds:				
CCLA LAMIT Property Fund	3.9	0.0	3.9	1.92%
M&G Investments Strategic Corporate Bond Fund	4.0	0.0	4.0	1.26%
UBS Multi Asset Fund	5.0	0.0	5.0	2.62%
Aegon (Kames) Diversified Monthly Income Fund	2.0	0.0	2.0	2.97%
Threadneedle Investments	2.0	0.0	2.0	1.24%
Schroder Income Maximiser Fund	5.0	0.0	5.0	4.01%
Total Investments	**26.7**	**20.2**	**46.9**	

6.2 The following chart illustrates the spread of investment by type of investment (figure 1) along with maturity analysis (figure 2).

APPENDIX 1

Figure 1: Type of Counterparty

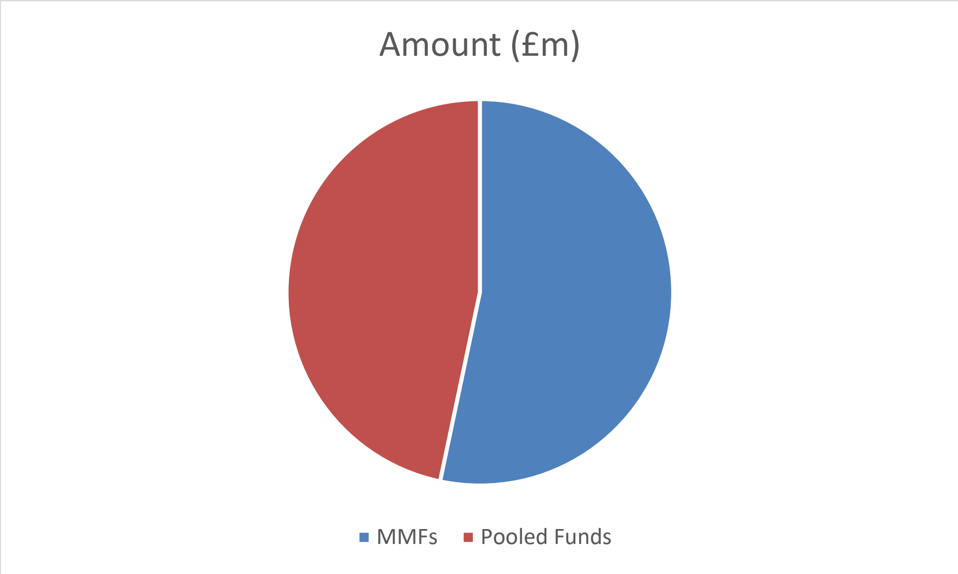


Figure 2: Maturity analysis

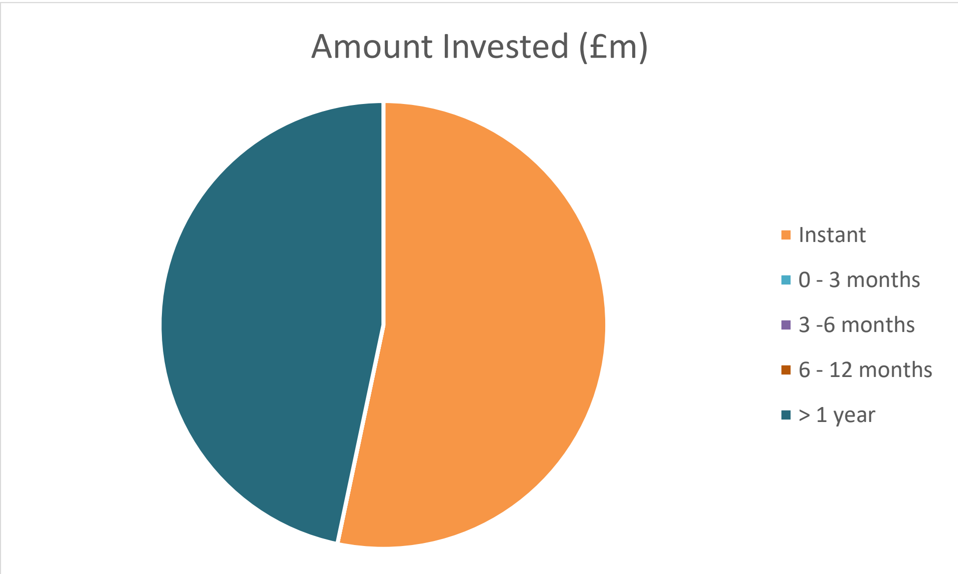


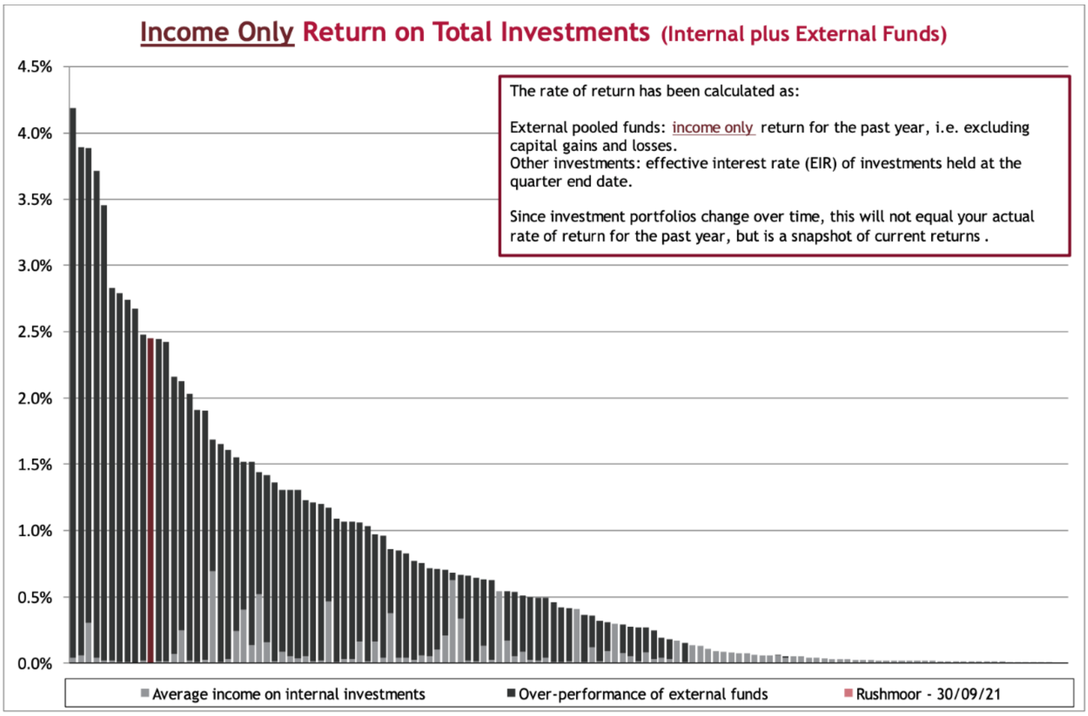
Table 5: Maturity analysis

Maturity Analysis for ALL INVESTMENTS	Type of Counter Party	Amount invested (£m)	% of total investments
Instant	MMF	25.0	53%
0 - 3 months	Pooled Fund	0.0	0%
3 -6 months	Pooled Fund	0.0	0%
6 - 12 months	Pooled Fund	0.0	0%
> 1 year	Pooled Fund	21.9	47%
Total for all duration periods		**46.9**	**100%**

6.3 Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum 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.

6.4 Investment Income Benchmarking: The graph below has been produced by Arlingclose and demonstrates that the Council income only returns on total investment portfolio for the last 12 months up to September 2021 was 4.71%.

Figure 3: Total income return on investment portfolio



6.5 The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 6 below.

Table 6: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure
31.03.2021 30.09.2021	5.32 4.88	A+ A+	100% 100%
Similar LAs **All LAs**	**4.15**	**A+**	**69%**

External Strategic Pooled Funds

6.6 £21.9m of the Council's investments are held in externally managed strategic pooled equity, multi-asset, bond and property funds where short-term security and liquidity are lesser considerations, and objectives are regular revenue income and long-term price stability. The pooled fund portfolio has generated an average total return during the first half of 2021/22 of 4.71%. Capital returns have increased by 9.69%. A summary of returns and diversification is set out below.

Figure 4: Pooled fund diversification

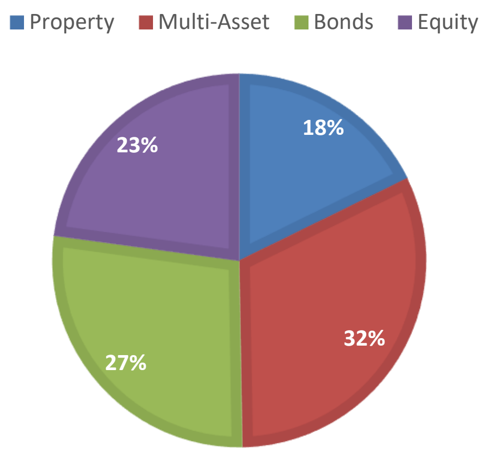


Table 7: Pooled fund diversification

Type of Pooled Fund	Amount invested £	% of total investments
Property	3,882,128	17.74%
Multi-Asset	7,000,000	31.99%
Bonds	6,000,000	27.42%
Equity	5,000,000	22.85%
Total	**21,882,128**	**100.00%**

Figure 5: Total returns year-on-year comparison

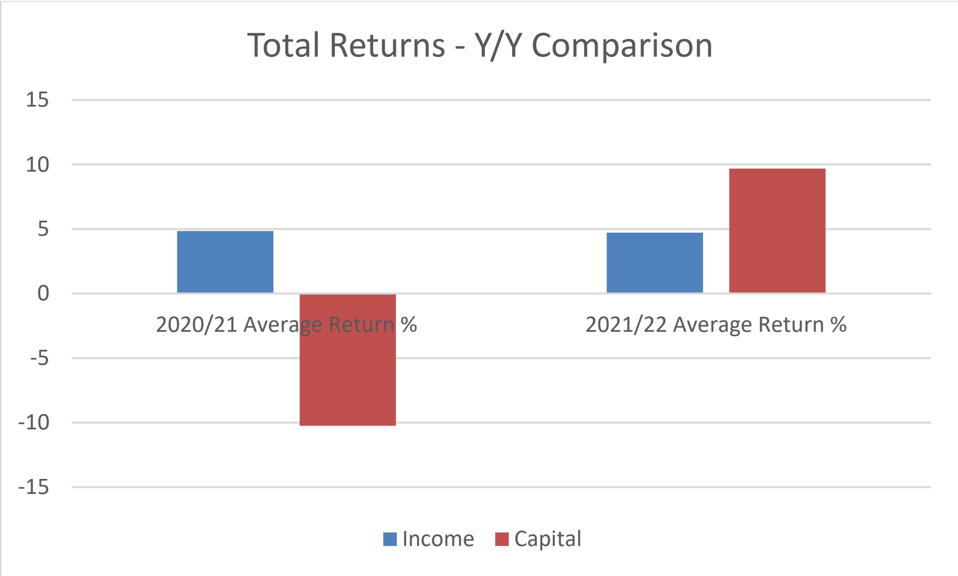


Table 8: Total return breakdown

Type of Return	2020/21 Average Return %	2021/22 Average Return %
Income	4.84	4.71
Capital	-10.25	9.69
Total Returns	**-5.41**	**7.48**

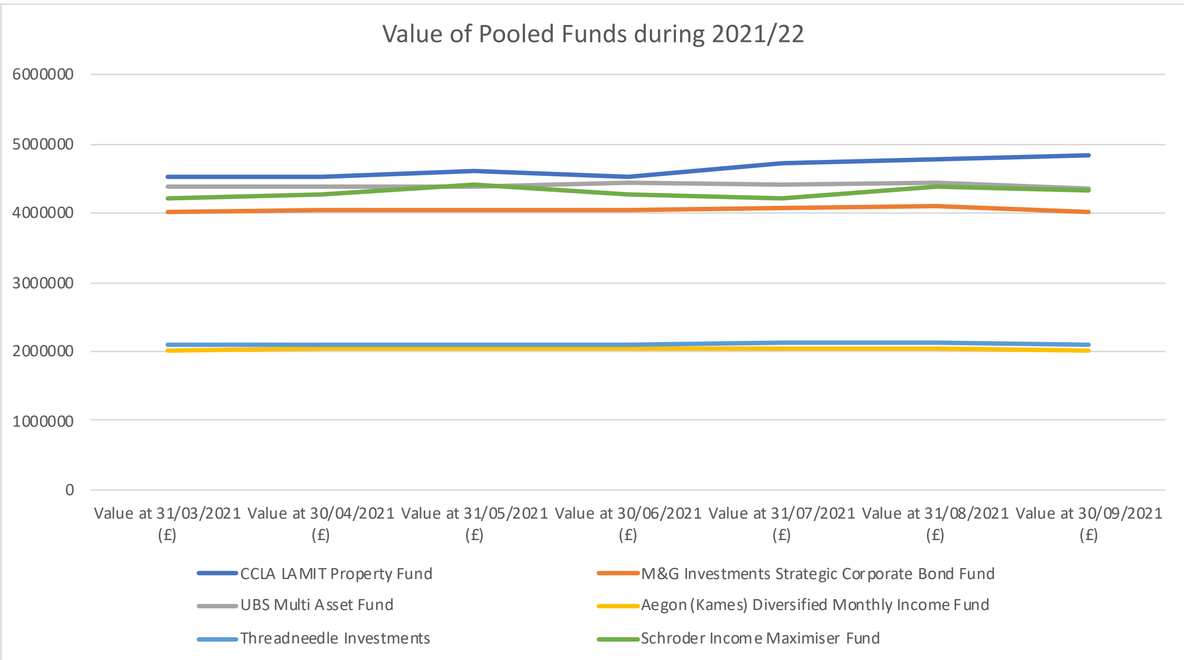
6.7 As these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives is regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three to five-year period total returns will exceed cash interest rates. In light of their performance over the medium-/long-term and the Council's latest cash flow forecasts, investment in these funds has been increased.

6.8 Details of the Council's investment activity together with returns generated during 2021/22 are outlined as follows:

6.9 **Capital returns** – the Council's pooled fund portfolio has continued to recover during 2021/22. Aggregation of the Council's pooled funds resulted in an overall net increase in fair value for the year 2021/22 of around £772,000 (an aggregate increase of 3.69% of overall pooled funds invested).

6.10 There is variation in performance across the portfolio as shown in figure 6 below.

Figure 6: Movement in capital value of pooled funds during 2021/22



6.11 **Income Returns**_– The income returned by fund for the period to 30 September 2021 is summarised below:

- <u>CCLA's Local Authorities' Mutual Investment Trust</u> - £4.5 million investment at commencement of the year. The Property Fund is designed to achieve long-term capital growth and income from investments in the commercial property sector. The fund has returned 4.45% annualised income during 2021/22.

- UBS Multi-Asset Income Fund - £5 million investment. This fund follows a strategy of reducing volatility exposure levels by spreading investments across a diversified range of asset classes. This fund has returned 4.85% annualised income during 2021/22.

- Threadneedle Strategic Bond Fund - £2 million investment. The fund aims to provide income and capital appreciation through investment grade and high yield bonds. This fund has returned 2.26% annualised income during 2021/22

- M & G Corporate Bond Fund - £4m investment. This fund aims for a target total return of 3-5% from a combination of investment income or capital appreciation. This fund has returned 2.66% annualised income during 2021/22.

- Schroder Income Maximiser Fund - £5m investment made in December 2018. The fund aims to provide both income and capital growth, delivering a target income of 7% per annum. The fund has returned 7.32% annualised during 2021/22.

- Kames Diversified Monthly Income Fund - £2m investment made in February 2019. The fund aims is to provide income with the potential for capital growth over the medium term. The fund has returned 4.52% annualised during 2021/22.

7 TREASURY MANGEMENT COMPLIANCE PERFORMANCE

7.1 The Council measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates.

7.2 **Compliance -** The Chief Finance Officer reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy with the exception of current account balance limits.

7.3 Compliance with specific investment limits is demonstrated in table 9 below.

Table 9: Investment Limits

	30 Sept 2021 Actual £m	2021/22 Limit £m	Complied?
Any group of pooled funds under the same management	**21.9**	**25.0**	Yes
Money Market Funds	**25.0**	**25.0**	Yes

8 TREASURY MANAGEMENT INDICATORS

8.1 The Council measures and manages its exposures to treasury management risks using the following indicators.

8.2 **Security:** 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.

	30 Sept 2021 Actual	2021/22 Target	Complied?
Portfolio average credit rating	A+	A-	YES

8.3 **Liquidity:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount it can borrow each period without giving prior notice.

	30 Sept 2021 Actual £m	2021/22 Target £m	Complied?
Total sum borrowed in past 3 months without prior notice	0	1.0	YES

8.4 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

8.5 **Maturity Structure of Borrowing:** This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	30 Sept 21 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	80%	100%	0%	YES
12 months and within 24 months	20%	100%	0%	YES
24 months and within 5 years	0%	100%	0%	YES
5 years and within 10 years	0%	100%	0%	YES
10 years and above	0%	100%	0%	YES

8.6 Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

8.7 **Principal Sums Invested for Periods Longer than a year:** 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 were:

	2021/22	2022/23	2023/24
Actual principal invested beyond year end	£21.9m	£21.9m	£21.9m
Limit on principal invested beyond year end	£90.0m	£90.0m	£90.0m
Complied?	YES	YES	YES

8.8 **Total Investment Yield:** The Council's revised estimates regarding investment yields and costs compared to the actual outturn for 2021/22 is shown in the table below.

Budgeted Income and Forecast Outturn	2021/22 Estimate (£'000)	2021/22 Forecast (£'000)	Variance (£'000)
Interest Receivable	(1,090)	(990)	100
Interest Payable	795	300	(495)
Net Amount	(295)	(690)	(395)

APPENDIX 2

NON-TREASURY INVESTMENT OPERATIONS FOR FIRST HALF OF 2021/22

1 INTRODUCTION

1.1 The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

1.2 The purpose of non-treasury investment management operations is to ensure that all investment decisions that are made primarily to generate a profit have a suitable level of security and liquidity. Ensuring risks and rewards are monitored regularly.

1.3 The second main function of investment management is to generate potential returns and monitor performance of returns on a regular basis.

1.4 The Council also holds £131.2m of such investments at as 30 September 2021 in:

- directly owned property £123.7m
- loans to local businesses and landlords £6.7m
- shareholding in subsidiaries £0.8m

2 PROPORTIONALITY

2.1 The Council is becoming increasingly dependent on profit generating investment activity to achieve a balanced revenue budget. Table 1 below shows the forecast proportion of gross service expenditure funded by investment activity.

Table 1: Proportionality of Investments

	2021/22 Estimate	2021/22 Forecast
Proportion	16.4%	15.6%

3 SERVICE IMPROVEMENT LOANS

3.1 The Council lends money to its subsidiaries, local businesses, and its employees to support local public services and stimulate local economic growth. The Council is a funding partner of Farnborough International Limited. The loans have enables to development of the Farnborough International exhibition and conference centre. Expanding the exhibition and conferencing capabilities in Farnborough brings increased economic capacity to the Borough and is a reinvestment in local business.

3.2 The Council performance and upper limits on the outstanding loans to each category of borrower have been set as follows:

Table 2: Loans for service purposes in £ millions

Category of borrower	2021/22	2021/22	2021/22
	Approved Limit	Actual	Forecast
Local businesses	6.7	6.7	6.7
Employees	0.1	0.1	0.1
Subsidies and Partnership	6.2	0.8	1.0
TOTAL	**13.0**	**7.6**	**7.8**

Service loans have generated a negligible rate of return (<0.25%) for the Council during the first 6 months of the 2021/22 financial year. The level of return is expected to be at this level for the full financial year. The rate of return is lower than estimated due to the following two events:

- delays in issuing loans to Rushmoor Homes Limited. No additional loan notes have been issued to date during 2021/22
- funding consortium partnership agreement to defer interest payment on loans provided to Farnborough International Limited (FIL) following cancellation of the 2020 Airshow.

4 SERVICE INVESTMENTS: SHAREHOLDING IN SUBSIDIARIES

4.1 The Council invests in the shares of its subsidiary and holds a financial share in a development partnership and Rushmoor Homes to support local public services and stimulate local economic growth.

4.2 The Council performance and upper limits on the sum invested in each category of shares have been set as follows:

Table 3: Shares held for service purposes in £ millions

Category of company	2021/22 Approved Limit	2021/22 Forecast
Subsidiaries and Partnerships	0.6	0.6
TOTAL	**0.6**	**0.6**

5 COMMERCIAL INVESTMENT: PROPERTY

5.1 The Council invests in local and regional commercial and residential property with the intention of making a profit that will be spent on local public services. No additional transactions are planned during 2021/22 in accordance with the Council's Capital Strategy.

Table 4: Property held for investment purposes in £ millions

Property by type	2020/21 Transactions		2021/22 estimated transactions	
	Purchase cost	Year End Value	Purchase cost	Estimated year-end Value
Mixed use	4.5	4.5	0.0	4.5
Industrial units	24.2	24.3	0.0	24.3
Retail	34.3	45.0	0.0	45.0
Offices	51.0	49.9	0.0	49.9
TOTAL	**114.0**	**123.7**	**0.0**	**123.7**

Return on Commercial investment

5.2 Commercial property investments generated £4.5m of net investment income for the Council after taking account of direct costs, cost of borrowing and Minimum Revenue Provision (MRP) representing a rate of return of 3.69%.

5.3 The return on commercial property is forecast to be higher that the reported level in the non-treasury investment strategy to Council in February 2021. This is due to lower cost of borrowing during the year.

6 NON-TREASURY INVESTMENT INDICATORS

6.1 The Council measures and manages its exposures to non-treasury investment risks using the following indicators.

6.2 **Total risk exposure:** This indicator shows the Council's total exposure to potential investment losses. This includes amounts the Council is contractually committed to lend but have yet to be drawn down and guarantees the Council has issued over third-party loans.

Table 5: Total investment exposure in £millions

Total investment exposure	2021/22 Estimate	2020/21 Forecast
Treasury management investments	23.9	21.9
Service investments: Loans	13.0	7.8
Service investments: Shares	0.6	0.6
Commercial investments: Property	124.4	123.7
TOTAL INVESTMENTS	161.9	154.0
Commitments to lend	4.9	4.9
TOTAL EXPOSURE	166.8	158.9

6.3 **How investments are funded:** Government guidance is that these indicators should include how investments are funded. Since the Council 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 Council's investments are funded by usable reserves and income received in advance of expenditure.

Table 6: Investments funded by borrowing in £millions

	2021/22 Estimate	2021/22 Forecast
Service investments: Loans	8.4	3.2
Service investments: Shares	0.6	0.6
Commercial investments: Property	89.9	89.9
TOTAL FUNDED BY BORROWING	98.9	93.7

6.4 **Rate of return received:** This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. 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 7: Investment rate of return (net of all costs)

	2021/22 Estimate	2020/21 Forecast
Treasury management investments	3.7%	2.6%
Service investments: Loans	2.2%	0.2%
Service investments: Shares	0%	0%
Commercial investments: Property	3.5%	3.7%
ALL INVESTMENTS	3.4%	3.3%

6.5 The above table shows a forecast reduction in Treasury management investments and Service Investment Loans net of all finance costs in 2021/22. This is due to lower service investment returns and lower interest rates on short-term liquid treasury management investments. Commercial Property shows a forecast improvement in return net of all finance costs in 2021/22 due to the reduced cost of borrowing.

PRUDENTIAL INDICATORS

1.1 **Prudential Indicators:** The following indications are required by the CIPFA “Prudential Code” 2017 edition

1.2 **Estimates of Capital Expenditure:** The Council’s planned capital expenditure and financing may be summarised as follows.

Table 1: Capital Expenditure and Financing in £ million

	2021/22 Estimate	2021/22 Forecast
General Fund services	38.5	14.6
TOTAL	38.5	14.6
External sources	10.3	4.6
Own resources	0.0	0.0
Debt	28.2	10.0
TOTAL	**38.5**	**14.6**

1.3 Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue, which is known as minimum revenue provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and use of capital receipts are as follows:

Table 2: Replacement of debt finance in £ million

	2021/22 Estimate	2020/21 Forecast
Own resources	2.5	2.5

1.4 **Estimates of Capital Financing Requirement:** The Capital Financing Requirement (CFR) measures the Council’s underlying need to borrow for a capital purpose.

Table 3: Estimates of Capital Financing Requirement in £ millions

	2021/22 Estimate	2021/22 Forecast
General Fund services	148.0	125.2
MRP	-2.5	-2.5
IFRIC 4 Lease Adjustment	-0.4	-0.4
TOTAL CFR	**145.1**	**122.3**

1.5 **Gross Debt and the Capital Financing Requirement:** In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Table 4: Gross Debt and the Capital Financing Requirement in £ millions

	2021/22 Estimate	2021/22 Forecast
Debt (incl. leases)	145.1	145.1
Capital Financing Requirement	143.8	143.8
Difference	-1.3	-1.3

1.6 **Affordable borrowing limit:** The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

Table 5: Affordable borrowing limit in £m

	2021/22 limit	2020/21 Forecast
Authorised limit – total external debt	160.1	160.1
Operational boundary – total external debt	155.1	155.1

1.7 **Ratio of Financing Costs to Net Revenue Stream:** This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Table 6: Ratio of financing cost to net revenue stream

	2021/22 Estimate	2021/22 Forecast
Financing costs (£m)	3.2	2.8
Proportion of net revenue stream	31.8%	26.3%

MARKET COMMENTARY REGARDING THE YEAR 2021/22 FROM THE COUNCIL'S TREASURY MANAGEMENT ADVISORS ARLINGCLOSE

Commentary relates to the economic position in October 2021 and will not take into account changes to the economic climate in Q3 and Q4 of 2021/22.

External Context

Economic background: The economic recovery from coronavirus pandemic continued to dominate the first half of the financial year. By the end of the period over 48 million people in the UK had received their first dose of a COVID-19 vaccine and almost 45 million their second dose.

The Bank of England (BoE) held Bank Rate at 0.1% throughout the period and maintained its Quantitative Easing programme at £895 billion, unchanged since the November 2020 meeting. In its September 2021 policy announcement, the BoE noted it now expected the UK economy to grow at a slower pace than was predicted in August, as the pace of the global recovery had shown signs of slowing and there were concerns inflationary pressures may be more persistent. Within the announcement, Bank expectations for GDP growth for the third (calendar) quarter were revised down to 2.1% (from 2.9%), in part reflecting tighter supply conditions. The path of CPI inflation is now expected to rise slightly above 4% in the last three months of 2021, due to higher energy prices and core goods inflation. While the Monetary Policy Committee meeting ended with policy rates unchanged, the tone was more hawkish.

Government initiatives continued to support the economy over the quarter but came to an end on 30th September 2021, with businesses required to either take back the 1.6 million workers on the furlough scheme or make them redundant.

The latest labour market data showed that in the three months to July 2021 the unemployment rate fell to 4.6%. The employment rate increased, and economic activity rates decreased, suggesting an improving labour market picture. Latest data showed growth in average total pay (including bonuses) and regular pay (excluding bonuses) among employees was 8.3% and 6.3% respectively over the period. However, part of the robust growth figures is due to a base effect from a decline in average pay in the spring of last year associated with the furlough scheme.

Annual CPI inflation rose to 3.2% in August, exceeding expectations for 2.9%, with the largest upward contribution coming from restaurants and hotels. The Bank of England now expects inflation to exceed 4% by the end of the calendar year owing largely to developments in energy and goods prices. The Office of National Statistics' (ONS') preferred measure of CPIH which includes owner-occupied housing was 3.0% year/year, marginally higher than expectations for 2.7%.

The easing of restrictions boosted activity in the second quarter of calendar year, helping push GDP up by 5.5% q/q (final estimate vs 4.8% q/q initial estimate). Household consumption was the largest contributor. Within the sector breakdown production contributed 1.0% q/q, construction 3.8% q/q and services 6.5% q/q, taking all of these close to their pre-pandemic levels.

The US economy grew by 6.3% in Q1 2021 (Jan-Mar) and then by an even stronger 6.6% in Q2 as the recovery continued. The Federal Reserve maintained its main interest rate at between 0% and 0.25% over the period but in its most recent meeting made suggestion that monetary policy may start to be tightened soon.

The European Central Bank maintained its base rate at 0%, deposit rate at -0.5%, and asset purchase scheme at €1.85 trillion.

Financial markets: Monetary and fiscal stimulus together with rising economic growth and the ongoing vaccine rollout programmes continued to support equity markets over most of the period, albeit with a bumpy ride towards the end. The Dow Jones hit another record high while the UK-focused FTSE 250 index continued making gains over pre-pandemic levels. The more internationally focused FTSE 100 saw more modest gains over the period and remains below its pre-crisis peak.

Inflation worries continued during the period. Declines in bond yields in the first quarter of the financial year suggested bond markets were expecting any general price increases to be less severe, or more transitory, that was previously thought. However, an increase in gas prices in the UK and EU, supply shortages and a dearth of HGV and lorry drivers with companies willing to pay more to secure their services, has caused problems for a range of industries and, in some instance, lead to higher prices.

The 5-year UK benchmark gilt yield began the financial year at 0.36% before declining to 0.33% by the end of June 2021 and then climbing to 0.64% on 30th September. Over the same period the 10-year gilt yield fell from 0.80% to 0.71% before rising to 1.03% and the 20-year yield declined from 1.31% to 1.21% and then increased to 1.37%.

The Sterling Overnight Rate (SONIA) averaged 0.05% over the quarter.

Credit review: Credit default swap spreads were flat over most of period and are broadly in line with their pre-pandemic levels. In late September spreads rose by a few basis points due to concerns around Chinese property developer Evergrande defaulting but are now falling back. The gap in spreads between UK ringfenced and non-ringfenced entities continued to narrow, but Santander UK remained an outlier compared to the other ringfenced/retail banks. At the end of the period Santander UK was trading the highest at 53bps and Lloyds Banks Plc the lowest at 32bps. The other ringfenced banks were trading between 37-39bps and Nationwide Building Society was 39bps.

Over the period Fitch and Moody's upwardly revised to stable the outlook on a number of UK banks and building societies on our counterparty list, recognising their improved capital positions compared to last year and better economic growth prospects in the UK.

Fitch also revised the outlooks for Nordea, Svenska Handelsbanken and Handelsbanken plc to stable from negative. The rating agency considered the improved economic prospects in the Nordic region to have reduced the baseline downside risks it previously assigned to the lenders.

The successful vaccine rollout programme is credit positive for the financial services sector in general and the improved economic outlook has meant some institutions have been able to reduce provisions for bad loans. While there is still uncertainty around the full extent of the losses banks and building societies will suffer due to the pandemic-related economic slowdown, the sector is in a generally better position now compared to earlier this year and 2020.

At the end of the period Arlingclose had completed its full review of its credit advice on unsecured deposits. The outcome of this review included the addition of NatWest Markets plc to the counterparty list together with the removal of the suspension of Handelsbanken plc. In addition, the maximum duration for all recommended counterparties was extended to 100 days.

As ever, the institutions and durations on the Authority's counterparty list recommended by treasury management advisors Arlingclose remain under constant review.

APPENDIX 5

REVISION TO CIPFA CODES

In February 2021 CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These followed the Public Accounts Committee's recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes. In June, CIPFA provided feedback from this consultation.

In September CIPFA issued the revised Codes and Guidance Notes in draft form and opened the latest consultation process on their proposed changes. The changes include:

- Clarification that (a) local authorities must not borrow to invest primarily for financial return (b) it is not prudent for authorities to make any investment or spending decision that will increase the Capital Financing Requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority.
- Categorising investments as those (a) for treasury management purposes, (b) for service purposes and (c) for commercial purposes.
- Defining acceptable reasons to borrow money: (i) financing capital expenditure primarily related to delivering a local authority's functions, (ii) temporary management of cash flow within the context of a balanced budget, (iii) securing affordability by removing exposure to future interest rate rises and (iv) refinancing current borrowing, including replacing internal borrowing.
- For service and commercial investments, in addition to assessments of affordability and prudence, an assessment of proportionality in respect of the authority's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services).
- Prudential Indicators
    - New indicator for net income from commercial and service investments to the budgeted net revenue stream.
    - Inclusion of the liability benchmark as a mandatory treasury management prudential indicator. CIPFA recommends this is presented as a chart of four balances – existing loan debt outstanding; loans CFR, net loans requirement, liability benchmark – over at least 10 years and ideally cover the authority's full debt maturity profile.
    - Excluding investment income from the definition of financing costs.
- Incorporating ESG issues as a consideration within TMP 1 Risk Management.
- Additional focus on the knowledge and skills of officers and elected members involved in decision making

Note: Revised Codes were published by CIPFA in December 2021

MHCLG Improvements to the Capital Finance Framework: MHCLG published a brief policy paper in July outlining the ways it feels that the current framework is failing and potential changes that could be made. The paper found that “while many authorities are compliant with the framework, there remain some authorities that continue to engage in practices that push the bounds of compliance and expose themselves to excessive risk”.

The actions announced include greater scrutiny of local authorities and particularly those engaged in commercial practices; an assessment of governance and training; a consideration of statutory caps on borrowing; further regulations around Minimum Revenue Provision (MRP) and ensuring that MHCLG regulations enforce guidance from CIPFA and the new PWLB lending arrangements.

A further consultation on these matters is expected soon.

Note: Further consultation on MRP commenced on 30 November 2021 with a closing date for responses of 08 February 2022

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CORPORATE GOVERNANCE, AUDIT AND STANDARDS COMMITTEE

EXECUTIVE HEAD OF FINANCE
REPORT NO. FIN2212

15 FEBRUARY 2022

KEY DECISION? ~~YES~~/NO

ANNUAL TREASURY MANAGEMENT STRATEGY AND ANNUAL NON-TREASURY INVESTMENT STRATEGY 2022/23

SUMMARY AND RECOMMENDATIONS:

SUMMARY:

The Council is required to approve a Treasury Management Strategy and Non-Treasury Investment Strategy (Investment Strategy) for 2022/23 before 1 April 2022.

The attached Treasury Management Strategy Statement (TMSS) for 2022/23 (Appendix 1) and Non-Treasury Investment Strategy (Appendix 2) is prepared in accordance with the “Prudential Code” and the “Treasury Management Code of Practice” in 2017, and the Ministry of Housing, Communities and Local Government (MHCLG) revised guidance on Local Government Investment.

RECOMMENDATION:

Members are requested to recommend to Council:

(i) Approval of the Treasury Management Strategy 2022/23, Annual Borrowing Strategy 2022/23 attached at Appendix 1, and
(ii) Approve Annual Non-Treasury Investment Strategy attached 2022/23 at Appendix 2;
and
(iii) Approval of the Minimum Revenue Provision (MRP) Statement set out in Appendix 3.
(iv) Prudential Indicators for 2022/23 will be reviewed by the Council’s Treasury Management advisors Arlingclose for completeness with any update included in the report to Council on 24 February 2022

1 INTRODUCTION

1.1 This report sets out the proposed Treasury Management Strategy and Non-Treasury Investment Strategy for the year 2022/23, including the borrowing and investment strategies and treasury management indicators for capital finance for 2022/23 and the Minimum Revenue Provision Statement.

1.2 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 Authority 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.

1.3 The CIPFA “Prudential Code” 2017 edition, “Treasury Management Code of Practice” 2017 edition and MHCLG revised guidance February 2018 focus on “non- treasury” investments. Resulting in a requirement for a separate Non-Treasury Investment Strategy (Appendix 2) must be approved before April 2022.

1.4 CIPFA has published the new Prudential Code for Capital Finance in Local Authorities (Prudential Code) and Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (the Treasury Management Code) following a consultation period. These two statutory and professional codes are important regulatory elements of the capital finance framework within which local authorities operate. Local authorities are required by regulation to 'have regard to' their provisions.

1.5 The updated Prudential Code includes the following as the focus of the substantive changes:

- The provisions in the code, which present the approach to borrowing in advance of need in order to profit from additional sums borrowed, have been strengthened. The relevant parts of the code have augmented to be clear that borrowing for debt-for-yield investment is not permissible under the Prudential Code. This recognises that commercial activity is part of regeneration but underlines that such transactions do not include debt-for yield as the primary purpose of the investment or represent an unnecessary risk to public funds.
- Proportionality has been included as an objective in the Prudential Code. New provisions have been added so that an authority incorporates an assessment of risk to levels of resources used for capital purposes.
- A new requirement has been added so that capital strategies are required to report investments under the following headings: service, treasury management and commercial investments.

1.6 The main changes to the updated Treasury Management Code and the accompanying guidance for local authorities are as follows:

- Investment management practices and other recommendations relating to non-treasury investments are included within the Treasury Management Practices (TMPs) alongside existing TMPs.
- The guidance will recommend the introduction of the Liability Benchmark as a treasury management indicator for local government bodies (note that CIPFA has issued a toolkit to assist local authorities with the production of this indicator).
- Environmental, Social and Governance (ESG) risks are incorporated into TMP1 (Risk Management) rather than a separate TMP 13.
- The purpose and objective of each category of investments should be described within the Treasury Management Strategy.

1.7 The Government consulted on changes to regulations to better enforce the duty of local authorities to make prudent Minimum Revenue Provision (MRP) each year. Where authorities borrow to finance capital spend, they are required under regulations to set aside money each year from their revenue account. This is referred to as MRP and is to make sure they can afford to repay the principal of their debt.

1.8 The consultation sought to address concerns the Government have around compliance by some local authorities with the duty to make prudent provision, resulting in an underpayment of MRP. Specifically, the Government have highlighted two concerns:

- Local authorities using sales from assets (capital receipts) in place of a charge to revenue. Authorities may use capital receipts to reduce overall debt and thereby reduce MRP through the calculation. Capital receipts may not, however, be used in lieu of a prudent charge to revenue.
- Local authorities are not charging MRP on debt related to certain assets. The evidence is that while some authorities are making MRP for commercial investments funded by borrowing, some are still not paying MRP in relation to borrowing associated with investment assets or capital loans. The statutory guidance is clear that financing for investment assets and capital loans requires provision to be made.

2 PURPOSE

2.1 The primary purpose of the treasury management operation is to ensure that cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in counterparties or instruments commensurate with the Council’s low risk approach, pursuing optimum performance while ensuring that security of the investment is considered ahead of investment return. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure.

2.2 The secondary function of the treasury management operation 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 the Council can meet its capital spending obligations. The management of longer-term cash may involve the arrangement of long and/or short-term loans (external borrowing) or may use longer term cash flow surpluses in lieu of external borrowing (internal borrowing).

2.3 Accordingly, the Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as: *"The management of the Council's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".*

2.4 The primary purpose of non-treasury investment management operations is to ensure that all investment decisions that are made primarily to generate a profit have a suitable level of security and liquidity. Ensuring risks and rewards are monitored regularly.

2.5 The secondary function of investment management is to generate potential returns and monitor performance of returns on a regular basis.

2.6 The purpose of the Indicators is to set a framework for affordable, prudent and sustainable capital investment.

2.7 The appendices (1 to 3) set out the Treasury Management Strategy, Investment Strategy and Minimal Revenue Provision Statement for 2022/23 and fulfil key legislative requirements as follows:

Appendix 1

- The **Treasury Management Strategy** which sets out how the Council's treasury operation will support capital decisions taken during the period, the day to day treasury management and the limitations on activity through treasury prudential indicators, in accordance with CIPFA's Code of Practice on Treasury Management and Prudential Code;
- The **Annual Borrowing Strategy** which sets out the Council's objectives for borrowing together with the approved sources of long and short-term borrowing and;
- **Annual Treasury Management Investment Strategy** which sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss, in accordance with CIPFA's Code of Practice on Treasury Management.

Appendix 2

- The new **Non-Treasury Investment Strategy** sets out the Council's investment decisions taken during the period and monitors performance and security, in accordance with MHCLG Investment Guidance.

Appendix 3

- The Council's **Minimum Revenue Provision (MRP) Statement,** which sets out how the Council will pay for capital assets through revenue each year, as required by the Local Government Act 2003 (Regulations 27 and 28 in the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003).

2.8 These policies and parameters provide an approved framework within which officers undertake the day-to-day capital, treasury and non-treasury investment activities.

3 SCOPE

3.1 This report covers the Council's treasury management and investment activities as set out in paragraphs 2.1 to 2.5 above. The funds invested consist of short-term cash available due to timing of income and expenditure, prudential borrowing and the Council's capital receipts.

3.2 Arlingclose advice continues to indicate that the Council should diversify investment risk (spreading smaller amounts over an increasing number of counterparties) wherever possible.

3.3 The Council incurred prudential code borrowing in 2020/21 of £xm in relation to its capital expenditure. Further borrowing to support the financing of its approved capital programme in 2022/23 will also be required. The Council therefore commences 2022/23 in a position where its investment holdings continue to remain significant (although, less than in previous financial years) but also carries significant and accumulating debt. There will be an inevitable requirement to incur some further borrowing to service capital expenditure in future years.

3.4 Careful observation of the "gross debt v capital financing requirement" indicator will need to be undertaken progressively throughout the financial year.

3.5 Where a material change to the attached strategies occurs during the year a revised strategy will be presented to Full Council before the change is implemented.

BACKGROUND DOCUMENTS:

1. Treasury Management in the Public Services (CIPFA) 2017 Edition
2. The Prudential Code for Capital Finance (CIPFA)2017 Edition
3. SI 2003/3146 - Local Authorities (Capital Finance and Accounting) (England) Regulations 2003
4. SI 2004/3055 - Local Authorities (Capital Finance and Accounting) (Amendment)
5. Capital Finance: Guidance on local government investment (third edition) (Issued under section 15 (1)(a) of the Local Government Act 2003)
6. Prudential Property Investment 2019

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TREASURY MANAGEMENT STRATEGY 2022/23

1 INTRODUCTION

1.1 Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. 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. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

1.2 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. The Licensing, Audit and General Purposes Committee is the nominated Committee responsible for the effective scrutiny of the Treasury Management Strategy and policies.

1.3 Investments held for service purposes or for commercial profit are considered in a separate report, the Investment Strategy at **Appendix 2**.

1.4 This strategy covers:

- External context
- Current borrowing and investment portfolio position
- Annual Borrowing Strategy
- Annual Investment Strategy
- Performance Indicators

2 EXTERNAL CONTEXT (commentary provided by Arlingclose in November 2021, updated where relevant in February 2022)

2.1 **Economic background [Nov 2021]:** The ongoing impact on the UK from coronavirus, together with higher inflation, the likelihood of higher interest rates, and the country's trade position post-Brexit, will be major influences on the Authority's treasury management strategy for 2022/23.

2.2 The Bank of England (BoE) held Bank Rate at 0.10% in November 2021 and maintained its Quantitative Easing programme at £895 billion. The Monetary Policy Committee (MPC) voted 7-2 to keep rates on hold and 6-3 to maintain the asset purchase programme. Within the announcement the MPC suggested interest rates would be increased soon, but not to the 1% level expected by financial markets. Within the

November 2021 Monetary Policy Report, the Bank expected consumer price index (CPI) inflation to peak at around 5% in April 2022 before falling back as the impact from higher energy prices fade and demand slows.

2.3 UK CPI for September 2021 registered 3.1% year on year, slightly down from 3.2% in the previous month. Core inflation, which excludes the more volatile components, fell to 2.9% y/y from 3.1%. The most recent labour market data for the three months to August 2021 showed the unemployment rate fell to 4.5% while the employment rate rose to 75.3%. Both measures were helped by the extension of the government's furlough scheme, but this ended in September 2021 and while this may put some pressure on the jobs market, it is not expected to be material, with the BoE forecasting unemployment will only increase modestly in Q4 2021 according to its November 2021 Monetary Policy Report but remain low overall.

2.4 In August 2021, the headline 3-month average annual growth rate for wages were 7.2% for total pay and 6.0% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 4.7% while regular pay was up 3.4%. These figures should be interpreted with caution, however, as pay growth is now being impacted by base effects compared to 12 months ago when earnings were first affected by the coronavirus pandemic. Moreover, there has also been a fall in the number and proportion of lower paid jobs, helping to push up the average earnings figure.

2.5 Gross domestic product (GDP) grew by 5.5% in the second calendar quarter of 2021, compared to a fall of -1.6% q/q in the previous three months, with the annual rate jumping to 23.6% from -6.1%. Here too, base effects from 2020 have resulted in the high Q2 2021 data. Monthly GDP estimates have shown the economy is recovering, with the economy now just 0.8% below its pre-pandemic level. Looking ahead, the BoE's November 2021 Monetary Policy Report forecasts economic growth will rise by 1.5% in Q3 2021, 1.0% in Q4 2021 with the economy expected to get back to its pre-pandemic level in Q1 2022. GDP growth is now expected to be around 5% in 2022 (revised down from 6%), before slowing to 1.5% in 2023 and 1% in 2024

2.6 GDP growth in the euro zone increased by 2.2% in calendar Q3 2021 following a gain of 2.1% in the second quarter and a decline of -0.3% in the first. Headline inflation has been strong, with CPI registering 4.1% year-on-year in October, the fourth successive month of inflation. Core CPI inflation was 2.1% y/y in October, the third month of successive increases from July's 0.7% y/y. At these levels, inflation is above the European Central Bank's target of 'below, but close to 2%', putting some pressure on its long-term stance of holding its main interest rate of 0%.

2.7 The US economy expanded at an annualised rate of 2.0% in Q3 2021, slowing sharply from gains of 6.7% and 6.3% in the previous two quarters. In its November 2021 interest rate announcement, the Federal Reserve continue to maintain the Fed Funds rate at between 0% and 0.25% but outlined its plan to reduce its asset purchase programme. Having bought $120 billion of bonds each month during the pandemic to keep interest rates low, the Fed confirmed that purchases will be scaled back, starting with a $15 billion reduction in November 2021. In terms of the timing of any interest rate hikes, Fed Chair Jerome Powell said the central bank can be patient about doing so

2.8 **Credit outlook [Nov 2021]**: Since the start of 2021, relatively benign credit conditions have led to credit default swap (CDS) prices for the larger UK banks to remain low and have steadily edged down throughout the year to almost pre-pandemic levels. The improved economic outlook during 2021 helped bank profitability and reduced the level of impairments many had made as provisions for bad loans. However, the relatively recent removal of coronavirus-related business support measures by the government means the full impact on bank balance sheets may not be known for some time.

2.9 The improved economic picture during 2021 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several financial institutions, revising them from negative to stable.

2.10 Looking ahead, while there is still the chance of bank losses from bad loans as government and central bank support is removed, the institutions on the Authority's counterparty list are well-capitalised and general credit conditions across the sector are expected to remain benign. Duration limits for counterparties on the Authority's lending list are under regular review and will continue to reflect economic conditions and the credit outlook.

2.11 **Interest rate forecast [Feb 2022]**: The Council's treasury management adviser Arlingclose therefore expects Bank Rate to rise to 0.75% in March and 1.0% in May. Despite this expectation, risks to the forecast remain weighted to the upside for 2022, becoming more balanced over time. The Arlingclose central forecast remains below the market forward curve.

2.12 Gilt yields will remain broadly flat from current levels, which have risen sharply since mid-December 2021. Significant volatility is, however, likely which should offer tactical opportunities for borrowing and investment. The risks around the gilt yield forecasts are broadly balanced. While gilt yields may face downward pressure as Bank Rate expectations ease from current levels, the runoff of the Bank's corporate bond portfolio, and later the gilt portfolio, as it reverses QE, could impact some upward pressure on yields.

2.13 An updated economic and interest rate forecast provided by Arlingclose in February 2022 is included at the end of this Appendix.

2.14 For the purpose of setting the budget, it has been assumed that investments will be made at an average rate of 2.7%, and that new loans will be borrowed at an average rate of 0.92%, being the current blended rate for short and long term-borrowing.

3 LOCAL CONTEXT

3.1 On 31 December 2021, the Council held £102.0m of borrowing, long-term liabilities of £1.7m and £44.9m of investments. This is set out in further detail below in table 3. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet (Capital Expenditure, Gross Debt and Capital Financing Requirement summary) in £ millions

	2020/21 Actual	**2021/22 Forecast**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**
Debt (incl. leases)	102.0	128.2	155.6	185.5	188.4
Capital Financing Requirement	119.5	142.9	167.2	194.0	193.2
Difference	17.5	14.7	11.6	8.2	4.8
Investments	26.7	23.9	23.9	23.9	23.9

3.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

3.3 The Council has an increasing CFR due to the capital programme, stable level of investments and will therefore be required to borrow up to £65m over the forecast period.

3.4 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 2022/23 and following two financial years.

3.5 **Liability benchmark:** 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, minimise credit risk and maintain Market in Financial Instrument Directive II (MiFID II) status.

Table 2: Liability benchmark

	2020/21 actual	2021/22 forecast	2022/23 budget	2022/23 budget	2023/24 budget
Outstanding borrowing	102.0	128.2	155.6	185.8	188.4
Investment minimum	-10.0	-10.0	-10.0	-10.0	-10.0
Investments held that can be redeemed	-26.7	-23.9	-23.9	-23.9	-23.9
Liability benchmark	85.3	114.3	141.7	171.9	174.5

4 CURRENT BORROWING & INVESTMENT PORTFOLIO POSITION

4.1 The Guidance on Local Government Investments in England gives priority to security and liquidity, and the Council's aim has been to achieve a yield commensurate with these principles. The Council continues to follow Arlingclose advice in the knowledge that whilst long-term interest rate forecasts remain low it should generate enhanced returns with counterparties other than banks and to invest across a diverse investment portfolio.

4.2 During 2020/21 the Council has generated returns from existing long-term pooled fund investments together with diversification within the Council's investment portfolio. The Council held the following investments on 31 December 2021:

- £22.2m in pooled funds (providing a balance across a range of 6 different types of fund).
- Various temporary investments of minor amounts held in Money Market funds all for durations of 6 months or less

Table 3: Existing Investment & Debt Portfolio Position

	Actual Portfolio at 31/12/21 £m	Average Rate %
Total External Borrowing Borrowing from other Local Authorities	102	0.2
Total Gross External Debt	102	
Other long-term liabilities: Finance Leases	2.1	
Total other long-term liabilities	2.1	
Investments		
Managed in-house:		
Money Market Funds	22.7	0.01
Managed externally:		
Pooled Funds:		
CCLA LAMIT Property Fund	3.9	5.09
M&G Investments Strategic Corporate Bond Fund	4	2.67
UBS Multi Asset Fund	5	3.93
Kames	2	4.66
Columbia Threadneedle Investments	2	2.37
Schroder Income Maximiser Fund	5	5.6
Total Investments	44.6	2.0
Net Debt	59.5	

Table 3 Illustrates the Council's investment and debt portfolio position as at 31 December 2021.

5 ANNUAL BORROWING STRATEGY 2022/23

5.1 The Council currently holds £102.0m of loans, representing no change the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Council expects to borrow up to £27m in 2022/23.

5.2 Capital expenditure in 2021/22 financial year includes expenditure on the Union Yard regeneration project. Prudential borrowing will therefore be required in order to achieve overall financing. The Council will incur some further borrowing during 2022/23 in order assist in the financing of its capital programme.

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

5.4 **Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is more cost effective to borrow at short-term rates. The Council is balancing short-term refinancing risk by holding a mixed portfolio of short and long-term loans. The Council is anticipating undertaking refinancing of some of its existing debt portfolio as it becomes due and move a proportion of the debt to longer-term more stable interest rates.

5.5 By adopting this approach the Council is able to reduce net borrowing costs and reduce overall treasury risk. The benefits of short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years, however long-term borrowing rates are forecast to remain flat over the medium term. 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 2022/23 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

5.6 On 26 November 2020 Public Works and Loan Board (PWLB) reversed the previous year 1% increase in standard rate. Alongside the reduction of the standard rate the terms of engagement were revised making it conditional that Local Authorities have no intention to buy investment assets primarily for yield in the current and following two financial years. To access this facility the Council has revised its capital programme excluding all investment assets primarily for yield. The s151 Officer is required on application to the PWLB to submit strategic capital and financial plans.

5.7 Alternatively, the Council may arrange forward starting loans, 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.

5.8 In addition, the Council may borrow further short-term loans to cover unplanned cash flow shortages.

5.9 **Sources of borrowing**: The approved sources of long-term and short-term borrowing are summarised below:

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- Money market loans (long term & temporary)
- Any bank or building society authorised to operate in the UK
- UK Local Authorities
- UK public and private sector pension funds (except the Local Government Pension Scheme administered by Hampshire County Council)
- Capital market bond investors
- UK Municipal Bond Agency plc and other special purpose companies created to enable local authority bond issues.
- Lottery monies

5.10 **Other sources of debt finance:** 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

5.11 The Council has previously raised the majority of its borrowing from Local Authorities, but it continues to investigate other sources of finance, that may be available at more favourable rates.

5.12 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to Council.

5.13 **Short-term and variable rate loans**: These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators in Section 7.

6 ANNUAL TREASURY MANAGEMENT INVESTMENT STRATEGY 2022/23

6.1 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. As at 31 December 2021 the Council's investment balance stood at £44.9m. The Council estimates that the level of investment held in Money Market Funds (MMFs) will reduce to £2m at the financial year end. In future years the Council estimates to hold on average £25m.

6.2 **Objectives**: The CIPFA Code requires the Authority to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority'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 Authority 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.

6.3 **Negative interest rates:** The COVID-19 pandemic has increased the risk that the Bank of England will 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. Since investments cannot pay negative income, negative rates will be applied by reducing the value of investments. 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.

6.4 **Strategy**: Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to maintain a diverse range of secure and/or higher yielding asset classes during 2022/23. The majority of the Council's surplus cash is currently invested in short-term money market funds. This diversification will represent a continuation of the strategy adopted in 2020/21.

6.5 **Business models:** Under the IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council 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.

6.6 **Approved counterparties:** The Council may invest its surplus funds with any of the counterparty types in table 4 below, subject to the cash limits (per counterparty) and the time limits shown. The schedule of approved counterparties is underpinned by a detailed list of named counterparties. This list is maintained within Financial Services for treasury management operational purposes.

Table 4: Approved Investment Counterparties

Sector	**Time limit**	**Counterparty limit**	**Sector limit**
Money market funds	n/a	£7m	£30m
Strategic pooled funds	n/a	£5m	£30m

6.7 Investments may be made with banks or any public or private sector organisations that meet the above credit rating criteria. The Council may also invest with organisations and pooled funds without credit ratings, following an external credit assessment and advice from the Council's treasury management adviser.

6.8 **Credit rating:** Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. 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.

6.9 **Investment limits**: The Council's revenue reserves available to cover investment losses are forecast to be £2 million on 31 March 2022. In order that no more than 20% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £7 million. 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 as 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. Detail of investment limits are given in table 4 above.

6.10 Further information as to why certain counterparties have been included in Table 4 is set out below:

- **Money Market Funds**: These funds are pooled investment vehicles consisting of money market deposits and similar instruments. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. The Council will continue to use funds that offer same-day liquidity as an alternative to instant access bank accounts, while funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

- **Strategic Pooled Funds**: Shares or units in diversified investment vehicles consisting of the 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.

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.

6.11 **Risk Assessment and Credit Ratings**: Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify the Council of 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 with that entity
- 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.

6.12 Where a credit rating agency announces that a credit 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.

6.13 **Liquidity management**: The Council reviews cash flow daily 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.

6.14 **Other Information on the Security of Investments**: 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, reports in the quality financial press and analysis and advice from the Council'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.

6.15 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not reflected in general credit-ratings. In these circumstances, where the Council feels the whole market has been affected, it 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. 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, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

7 TREASURY MANAGEMENT PRUDENTIAL INDICATORS

7.1 The Treasury Management Code requires that local authorities set a number of indicators for treasury management performance, which have been set as below. A voluntary measure for credit risk as set out in paragraph 7.2

7.2 **Credit Risk (Credit Score Analysis)**: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating / credit score 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.

The advice from Arlingclose is to aim for an average A-, or higher, average credit rating, with an average score of 7 or lower. The scores are weighted according to the size of our deposits (value-weighted average) and the maturity of the deposits (time-weighted average).

Credit Risk Indicator	**Target**
Portfolio average credit rating	A-
Portfolio average credit score	7.0

7.3 **Liquidity:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount cash available within three months, including bank deposits, call accounts and money market funds.

Liquidity risk indicator	**Target**
Total cash available within 3 months	£1m

7.4 **Interest Rate Exposures**: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	**Limit**
Upper limit on one-year revenue impact of a 1% rise in interest rates	£500,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	£500,000

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

7.5 **Maturity Structure of Borrowing**: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Maturity Structure	Upper	Lower
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

7.6 **Principal Sums Invested for Periods Longer than a Year**: 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 will be:

Principal Sums Invested	2021/22	2022/23	2023/24
Limit on principal invested beyond year end at any one time	£90m	£90m	£90m

8 OTHER ITEMS

8.1 The CIPFA Code requires the Council to include the following in its treasury management strategy.

8.2 **Policy on Use of Financial Derivatives**: Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk, and to reduce costs or increase income at the expense of greater risk. The general power of competence in Section 1 of the Localism Act 2011 removes much of the

uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).
The 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. Embedded derivatives, including those present in pooled funds, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

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.

8.3 **Markets in Financial Instruments Directive**: 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 with the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Executive Head of Finance believes this to be the most appropriate status.

8.4 **Investment Training**: The investment training needs of the Council's treasury management staff are assessed on a continuous basis, discussed as part of the staff development reviews and reviewed as the responsibilities of individual members of staff change.

Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA.

8.5 **Financial Implications - Investments:** The budget for investment income in 2022/23 is £1.25m (gross of borrowing interest), based on an average investment portfolio of £30m at interest rates ranging from 0.01% liquid MMF and other short-term investments to 6.9% on the highest yielding long-term pooled investment fund. Performance of investments against budget will be reviewed on an ongoing basis and as part of our quarterly budget monitoring process.

8.6 **Financial Implications - Borrowing:** The budget for interest costs in relation to borrowing in 2022/23 is £1.25m (not including IFRIC 4 lease accounting interest). It is determined using the current average rate of interest on borrowing incurred for 2021/22 and taking into account recent interest rate movements and the borrowing strategy. The Council's actual borrowing at the end of 2022/23 is estimated to be in the region of £155m

8.7 **Other Options Considered:** The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt.

The Executive Head of Finance continues to believe 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.

Alternative	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 may 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 may 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 may 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 may be less certain

Arlingclose Economic & Interest Rate Forecast February 2022

- The post COVID global economy has entered a higher inflationary phase, driven by a combination of resurgent demand and supply bottlenecks in goods and energy markets. Geopolitics are also playing a role, driving energy prices upwards which are being passed onto consumers. Tighter labour markets due to reduced participation rates have prompted concerns about wage-driven inflation, leading central banks to tighten policy to ensure inflation expectations remain anchored.

- Global inflation is riding high. While some indicators suggest supply bottlenecks in goods markets are easing, oil and gas prices have risen significantly and threaten a more sustained level of uncomfortably high inflation than previously expected. In the UK, Ofgem has confirmed a significant rise in retail energy prices, which will maintain relatively high CPI rates throughout 2022.

- Supply constraints are also evident in the labour market. Underlying wage growth is running above pre-COVID levels despite employment being lower now than in early 2020. Evidence suggests that labour pools have diminished. Higher wage growth will be a contributory factor to sustained above-target inflation this year.

- The lower severity of Omicron means that the economic impact should be limited. The UK economy had a weak Q4 2021 due to the virus, but growth is likely to bounce back in Q1 2022.

- However, higher inflation will dampen demand. In the UK, households face a difficult outlook. Fiscal and monetary headwinds alongside a sharp reduction in real income growth will weigh on disposable income, ultimately leading to slower growth.

- The Bank of England will tighten policy further over the next few months to ensure that aggregate demand slows to reduce business pricing power and labour wage bargaining power. Markets have priced in a significant rise in Bank Rate, but we believe the MPC will be more cautious given the medium-term outlook, assessing the impact of the first round of rises rather than following the market higher.

- Bond yields have risen sharply to accommodate tighter monetary policy, including the runoff of central bank bond portfolios. The interplay between slowing growth and falling inflation, and tightening policy, will likely keep yields relatively flat.

Interest Rate Forecast

- The MPC will raise Bank rate further to dampen aggregate demand and reduce the risk of sustained higher inflation.
- • Arlingclose therefore expects Bank Rate to rise to 0.75% in March and 1.0% in May. Despite this expectation, risks to the forecast remain weighted to the upside for 2022, becoming more balanced over time. The Arlingclose central forecast remains below the market forward curve.
- • Gilt yields will remain broadly flat from current levels, which have risen sharply since mid-December 2021. Significant volatility is, however, likely which should offer tactical opportunities for borrowing and investment.
- • The risks around the gilt yield forecasts are broadly balanced. While gilt yields may face downward pressure as Bank Rate expectations ease from current levels, the runoff of the Bank's corporate bond portfolio, and later the gilt portfolio, as it reverses QE, could impact some upward pressure on yields.

	Current	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.50	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Downside risk	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
3-month money market ra													
Upside risk	0.00	0.05	0.20	0.35	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.50	0.85	1.20	1.25	1.15	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10
Downside risk	0.00	-0.25	-0.25	-0.30	-0.30	-0.30	-0.35	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50
5yr gilt yield													
Upside risk	0.00	0.35	0.45	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55
Arlingclose Central Case	1.22	1.20	1.20	1.20	1.20	1.20	1.20	1.15	1.15	1.15	1.15	1.15	1.15
Downside risk	0.00	-0.20	-0.25	-0.25	-0.30	-0.35	-0.40	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
10yr gilt yield													
Upside risk	0.00	0.40	0.45	0.55	0.60	0.65	0.65	0.70	0.70	0.70	0.70	0.70	0.70
Arlingclose Central Case	1.37	1.35	1.35	1.35	1.35	1.35	1.35	1.35	1.35	1.35	1.35	1.35	1.35
Downside risk	0.00	-0.20	-0.30	-0.35	-0.40	-0.45	-0.50	-0.55	-0.55	-0.55	-0.60	-0.60	-0.60
20yr gilt yield													
Upside risk	0.00	0.40	0.45	0.50	0.55	0.60	0.60	0.65	0.65	0.65	0.65	0.65	0.65
Arlingclose Central Case	1.54	1.55	1.55	1.55	1.55	1.55	1.55	1.55	1.55	1.55	1.55	1.55	1.55
Downside risk	0.00	-0.30	-0.35	-0.40	-0.40	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
50yr gilt yield													
Upside risk	0.00	0.40	0.45	0.50	0.55	0.60	0.60	0.65	0.65	0.65	0.65	0.65	0.65
Arlingclose Central Case	1.22	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20
Downside risk	0.00	-0.30	-0.35	-0.40	-0.40	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%
PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%

ANNUAL NON-TREASURY INVESTEMENT STRATEGY 2022/23

1 INTRODUCTION

1.1 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).

1.2 This investment strategy meets the requirements of statutory guidance issued by the government in January 2018 and focuses on the second and third of these categories.

2 SERVICE IMPROVEMNTS: LOANS

2.1 **Contribution:** The Council lends money to its subsidiaries, local businesses, and its employees to support local public services and stimulate local economic growth. The Council is a funding partner of Farnborough International Limited. The loans have enabled the development of the Farnborough International exhibition and conference centre. Expanding the exhibition and conferencing capabilities in Farnborough brings increased economic capacity to the Borough and is a reinvestment in local business. The Council established a Wholly Owned Company (WOC) subsidiary, called Rushmoor Homes Limited (RHL) in April 2020. The Council will lend to RHL at a commercial rate to enable procurement of property.

2.2 **Security:** 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 Council, upper limits on the outstanding loans to each category of borrower have been set as follows:

Table 1: Loans for service purposes in £ millions

Category of borrower	2020/21 Actual	2021/22 Forecast	2022/23 Estimate
Local businesses	6.7	6.7	6.7
Subsidiaries and Partnerships	0.1	1.0	7.7
Employees	0.1	0.1	0.1
TOTAL	**6.9**	**7.6**	**14.5**

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

2.4 **Risk assessment:** The Council assesses the risk of loss before entering into lending agreements and whilst holding service loans by assessing the counterparty's resilience, the service users' needs that the loan is designed to help meet and how these will evolve over-time. During the life of the loan any change in original assumptions will be monitored. The Council will use external advisors if felt appropriate by the Executive Head of Finance. All loans will be subject to contract agreed by the Corporate Manager – Legal Services. All loans must be approved by full Council and will be monitored by the Executive Head of Finance.

2.5 **FIL loan interest deferral:** The Council has two loan agreements with FIL. As reported to members in the Revenue Budget Monitoring Report for P1 (FIN2115) the Council and the other funding consortium funding partners as part of the original FIL loan agreed to defer interest payments to provide cashflow support to Farnborough International Limited (FIL) following the cancellation of the 2020 Airshow. A revised Intercreditor Agreement was signed during 2021 that includes the capitalisation of interest and deferral of repayments to the public sector funding partners by 2 years. The first loan repayments will now de due in June 2026 with a further payment in June 2028. Therefore, the Council will not receive the full payment of interest covering the period from March 2020 to March 2022 until March 2024 subject to the covenant agreements within the agreement being been met.

3 SERVICE INVESTMENTS: SHARES

3.1 **Contribution:** The Council invests in the shares of its subsidiary Rushmoor Homes Limited and holds a financial share in a development partnership, Rushmoor Development Partnership (RDP), as vehicles which can be used to support development in housing and regeneration and support local public services and stimulate local economic growth.

3.3 The Rushmoor Development Partnership (RDP) was established to assist the Council to redevelop sites in Farnborough and Aldershot. In particular, it directly contributes to the delivery of the following Place Making strategic objective which underpins the Vision: "Great Places to Live – to make Aldershot and Farnborough town centres great places to live with a wide variety of quality new homes attractive to a diverse range of people"

3.4 **Security:** One of the risks of investing in shares is that they fall in value meaning that the initial outlay may not be recovered. In order to limit this risk, upper limits on the sum invested in each category of shares have been set as follows:

Table 2: Shares held for service purposes in £ millions

Category of company	2021/22 Forecast	2022/23 Estimate
Subsidiaries and Partnerships	0.6	0.6
TOTAL	**0.6**	**0.6**

3.5 **Risk assessment:** The Council assesses the risk of loss before entering into and whilst holding shares in line with paragraph 41 of *Capital Finance: Guidance on local government investment (third edition)*

3.6 The Council has good knowledge of the RDP intended developments. RDP is effectively a closed market, and it will provide development in accordance with agreement between the Council and the developer. Competition has effectively been evaluated at the time of the creation of RDP. The Council considers that RDP (an LLP) is an appropriate mechanism to undertake development. Hence, the barriers to entry have been lifted (by creation of RDP) and barriers to exit are eliminated because RDP has a specific set of defined initiatives and project plans from the RDP need to be agreed by the Council.

3.8 The Council used three external advisors regarding the potential for creation and development of the WOC and development of the RDP. These three advisors are Freeths (legal and financial advice), Regenco (housing and economic advice) and Arlingclose (treasury management and financial advice).

3.9 The Council observes strict procedure regarding its procurement of external advisors. They are appointed utilising specific competitive tendering procedure processes, relevant to the category of advice and guidance that is sought. Maintenance of the quality of advice is reviewed within the relatively frequent tender engagement process.

3.10 In the circumstances of RDP no credit ratings have been used.

3.11 The RDP Investment Team will monitor developments undertaken by the RDP to ensure minimisation of risk. Developments would not be agreed if there were considerations that insufficient financial return would be delivered. The developer would not participate in any venture that did not deliver financial return. Both partners are insistent on the creation of specific and clearly defined development plans for all sites. Experience and advice from the developer is paramount to assess and monitor risk for each development..

3.12 **Liquidity:** RDP funds will be committed for an estimated period of 10 years.

3.13 **Non-specified Investments:** Shares are the only investment type that the Council has identified that meets the definition of a non-specified investment in the government guidance. The limits above on share investments are therefore also the Council's upper limits on non-specified investments. The Council has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

4 COMERCIAL INVESTMENTS: PROPERTY

4.1 **Contribution:** The Council has investments in local and regional commercial and residential property with the intention of making a profit that will be spent on local public services.

4.2 In November 2020 the Public Works and Loan Board (PWLB) issued new lending terms (subsequently clarified in August 2021) making it conditional that Local Authorities have no intention to buy investment assets primarily for yield in the current and follow two financial years. To access this facility the Council revised its capital programme and will not be acquiring any further investment assets primarily for yield.

Table 3: Property held for investment purposes in £millions

Property by type	2020/21 Carry forward	2021/22 Transactions		2022/23 estimated transactions	
		Purchase cost	Estimated Value in accounts	Purchase cost	Estimated year end Value
Mixed use	4.5	0.0	4.5	0.0	4.5
Industrial units	24.3	0.0	24.3	0.0	24.3
Retail	45.0	0.0	45.0	0.0	45.0
Offices	49.9	0.0	49.9	0.0	49.9
TOTAL	**123.7**	**0.0**	**123.7**	**0.0**	**123.7**

4.4 **Security:** In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

4.5 *Where value in accounts is at or above purchase cost:* A fair value assessment of the Council's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment.

4.6 Should the 2021/22 year-end accounts preparation and audit process value these properties below their purchase cost, then an updated investment strategy will be presented to Full Council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

4.7 *Where value in accounts is below purchase cost:* The fair value of the Council's investment property portfolio is no longer sufficient to provide security against loss, and the Council will therefore take mitigating actions to protect the capital invested. These actions include:

- Quarterly review of the portfolio
- Consideration of advice from the Council's commercial property advisers by the Council's Property Investment Advisory Group (PIAG). Currently is agreed that the best course of action is to hold the majority of the assets as values will increase over the long term and most assets within the portfolio are considered sound with strong covenants/dependable income streams. Assets identified for disposal will be taken forward to market.

4.8 **Risk assessment:** The Council assesses the risk of loss before entering and whilst holding property investments by:

- Assessment of the relevant market sector(s) including the level of

competition, barriers to entry/exit, future market prospects
- Assessment of exposure to particular market segments to ensure adequate diversification
- Use of external advisors if considered appropriate by the Executive Head of Finance
- Full and comprehensive report on all new investments to Cabinet
- Continual monitoring of risk across the whole portfolio and specific assets

4.9 **Liquidity:** Compared with other investment types, property is relatively difficult to sell and convert into liquid asset at short notice and will be subject to market conditions in terms of timescales involved. However, to ensure that invested sums could be accessed when they are needed the portfolio will be regularly reviewed and prioritised to ensure that commercial property could be sold as a going concern within a period of six months.

5 LOAN COMMITMENTS AND FINANCIAL GUARANTEES

5.1 Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Council and are included here for completeness.

5.2 The Council has contractually committed £6.8m of loans to RHL for 2022/23 and £2.9m for 2023/24.

6 PROPORTIONALITY

6.1 The Council has become increasingly dependent on profit generating investment activity to achieve a balanced revenue budget. Table 4 below shows the extent to which the expenditure planned to meet the service delivery objectives and/or place making role of the Council is dependent on achieving the expected net profit from investments over the lifecycle of the Medium Term Financial Strategy. Should it fail to achieve the expected net profit, the Council has earmarked reserves available to cover any immediate shortfall in income. The Head of Service resposnisble for the Council's property and estates functions would review the cause of any shortfall and identify any actions needed to ensure the income shortfall is mitigated or remidied.

6.2 With the introduction the revised PWLB lending terms, the Council has no intention to purchase investment assets primarily for yield in the current and following two financial years. With no further expenditure planned on investment assets primarily for yield the proportion of investment to Gross service expenditure will fluctuate as a result of changes in investment income from existing holdings and changes in Gross service expenditure.

Table 4: Proportionality of Investments in £ millions

	2020/21 Actual	2021/22 Forecast	2021/22 Estimate
Gross service expenditure	58.3	61.9	64.9
Investment income	8.0	9.0	9.2
Proportion	13.8%	14.5%	14.2%

7 BORROWING IN ADVANCE OF NEED

7.1 Government guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed.

7.2 The Council may, in supporting the delivery of the Council's Capital Programme, borrow in advance of need where it is expected to demonstrate the best longer-term value for money position. 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 (ie: the cost of holding does not outweigh the benefits of early borrowing) and that the Council can ensure the security of such funds.

7.3 The Council is aware that it will be exposed to the risk of loss of the borrowed sums, and potential interest rate changes. These risks will be managed as part of the Council's overall management of its treasury risks and will be reported through the standard reporting method.

8 CAPACITY, SKILLS AND CULTURE

8.1 **Elected members and statutory officers:** The Council recognises that those elected Members and statutory officers involved in the investment decision making process must have appropriate capacity, skills and information to enable them to:

- take informed decisions as to whether to enter into a specific investment;
- to assess individual assessments in the context of the strategic objectives and risk profile of the Council; and
- to enable them to understand how new decisions have changed the overall risk exposure of the Council.

The Council will ensure that the relevant officers and the Members of Cabinet have appropriate skills, providing training and advisor support where there is a skills gap.

8.2 **Agents:** Lambert Smith Hampton Investment Management (LSHIM) were appointed as the Council's external investment advisor during 2019/20. LSHIM manage property investment portfolios for institutions, local authorities, and private family offices. The LSHIM investment team are all RICS qualified and have significant combined commercial experience. The assigned investment team can call on the wider expertise and resource of the parent company (Lambert Smith Hampton-LSH) that have offices throughout the UK

8.3 **Commercial deals:** The Council will ensure that the Cabinet, officers and agents negotiating commercial deals are aware of the core principles of the prudential framework and of the regulatory regime within which local authorities operate.

8.4 **Corporate governance:** Any investment decisions will be scrutinised by Executive Leadership Team, Property Investment Activity Group (PIAG) and Cabinet before final approval. The Overview and Scrutiny committee review all decisions made by the Cabinet. Although after the event the Committee can make any recommendations to the Council if it sees fit.

9 INVESTMENT INDICATORS

9.1 The Council has set the following quantitative indicators to allow elected members and the public to assess the Council's total risk exposure as a result of its investment decisions.

9.2 **Total risk exposure:** The first indicator shows the Council's total exposure to potential investment losses. This includes amounts the Council is contractually committed to lend but have yet to be drawn down and guarantees the Council has issued over third-party loans.

Table 5: Total investment exposure in £millions

Total investment exposure	**2020/21 Actual**	**2021/22 Forecast**	**2022/23 Estimate**
Treasury management investments	26.7	23.9	23.9
Service investments: Loans	7.6	7.8	14.5
Service investments: Shares	0.35	0.4	0.6
Commercial investments: Property	123.7	123.7	123.7
TOTAL INVESTMENTS	158.4	155.8	162.7
Commitments to lend	0.0	9.6	2.9
TOTAL EXPOSURE	158.4	165.4	165.6

9.3 **How investments are funded:** Government guidance is that these indicators should include how investments are funded. Since the Council 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 Council's investments are funded by usable reserves and income received in advance of expenditure.

Table 6: Investments funded by borrowing in £millions

	2020/21 Actual	**2021/22 Forecast**	**2022/23 Estimate**
Treasury management investments	0	0	0
Service investments: Loans	3.0	3.2	909
Service investments: Shares	0.35	0.4	0.6
Commercial investments: Property	90.3	90.3	90.3
TOTAL FUNDED BY BORROWING	93.7	93.9	100.8

9.4 **Rate of return received:** This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. 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 7: Investment rate of return (net of all costs)

Investments net rate of return	2020/21 Actual	2021/22 Forecast	2022/23 Estimate
Treasury management investments	3.6%	3.7%	4.0%
Service investments: Loans	1.3%	0.2%	0.2%
Service investments: Shares	0%	0%	0%
Commercial investments: Property	2.6%	3.7%	2.6%
ALL INVESTMENTS	2.7%	3.3%	2.7%

9.5 Treasury management returns are forecast to continue to recover in 2021/22. Service investment loan returns are forecast to remain low during 2022/23 due to the interest deferral on Farnborough International Limited loan, which the Council entered into as part of a funding consortium. Commercial property investment return is forecast to improve during 2021/22 with a decrease expected in 2022/23 due to reduced income from vacancies at the end of tenancy periods.

MINIMUM REVENUE PROVISION STATEMENT 2022/23

1.1 Where the Authority 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 Local Government Act 2003 requires the Authority to have regard to the former Ministry of Housing, Communities and Local Government's Guidance on Minimum Revenue Provision (the MHCLG Guidance) most recently issued in 2018.

1.2 The broad aim of the MHCLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

1.3 The MHCLG Guidance requires the Council to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP. This statement only incorporates options recommended in the Guidance.

1.4 For any unsupported capital expenditure incurred after 31 March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant assets, starting in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure for all other assets or on capital expenditure not related to fixed assets but which has been capitalised by regulation or direction (revenue expenditure financed by capital under statute), will be charged over the useful economic life (UEL) of the asset up to a maximum of 50 years. MRP will be applied in the year following expenditure was incurred.

1.5 For assets acquired by finance lease or private finance initiative, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

1.6 Where former operating leases have been brought onto the balance sheet on 1st April 2022 due to the adoption of the IFRS 16 Leases accounting standard, and the asset values have been adjusted for accruals, prepayments, premiums and/or discounts, then the annual MRP charges will be adjusted so that the total charge to revenue remains unaffected by the new standard

1.7 Where loans are made to other bodies and designated as capital expenditure, no MRP will be charged. However, the capital receipts generated by the repayments on those loans will be set aside to repay debt instead.

1.8 At the commencement of 2021/22 the Council had, a Capital Financing Requirement (CFR) of £119.4m in relation to a specific elements of capital expenditure incurred in the previous financial year (2020/21). The Council has incurred further amounts of capital expenditure in 2021/22 and will need to engage in an element of Prudential Code borrowing in that financial year to achieve total financing of its capital programme. It is inevitable therefore that the borrowing that is required in 2021/22 will require MRP to be charged to the Council's General Fund Revenue Account in 2022/23 and future years.

1.9 Capital expenditure incurred during 2022/23 will not be subject to MRP charge until 2023/24.

1.10 Based on the Council's latest estimate of its capital financing requirement (CFR) on 31 March 2022, the MRP budget for 2022/23 has been set at (£2.7m).

1.11 **Overpayments:** In earlier years, the Authority has made voluntary overpayments of MRP that are available to reduce the revenue charges in later years. No further overpayment is planned.

MRP Overpayments in £ millions

Actual balance 31.03.2021	0.45
Approved overpayment 2021/22	nil
Expected balance 31.03.2022	0.45
Planned overpayment 2022/23	nil
Forecast balance 31.03.2023	0.45

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CORPORATE GOVERNANCE, AUDIT AND STANDARDS COMMITTEE

EXECUTIVE HEAD OF FINANCE REPORT NO. FIN2213

15 FEBRUARY 2022

KEY DECISION? ~~YES~~/NO

ANNUAL CAPITAL STRATEGY 2022/23

SUMMARY AND RECOMMENDATIONS:

SUMMARY:

The Council is required to approve a Capital Strategy for 2022/23 before 1 April 2022.

The Capital Strategy 2022/23 (Appendix 1) is in accordance with CIPFA's "Prudential Code" and the "Treasury Management Code of Practice" 2017, and the Ministry of Housing, Communities and Local Government (MHCLG) guidance on Local Government Investment.

RECOMMENDATION:

Members are requested to recommend to Council:

(i) Approval of the Capital Strategy for 2022/23 to 2024/25 and Prudential Indicators for 2022/23 (subject to (ii) below)

(ii) The Prudential Indicators for 2022/23 will be reviewed by the Councils Treasury Management advisors Arlingclose for completeness with any update included in the report to Council on 24 February 2022.

1 INTRODUCTION

1.1 This report sets out the proposed Capital Strategy for the year 2022/23, including the Prudential indicators for capital finance for 2022/23.

1.2 This capital strategy report gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been written in an accessible style to enhance members' understanding of these sometimes technical areas.

1.3 Decisions made this year on capital and treasury management will have financial consequences for the Authority for many years into the future.

They are therefore subject to both a national regulatory framework and to local policy framework, summarised in this report.

1.4 The Council has adopted 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 and Investment Strategy before the start of each financial year.

1.5 The CIPFA "Prudential Code" 2017 edition, "Treasury Management Code of Practice" 2017 edition and MHCLG revised guidance 2018 have resulted in the creation of a new Capital Strategy which is required to be approved by the Council before the start of each financial year.

2 PURPOSE

2.1 The purpose of the Capital Strategy is to give an overview of how capital expenditure; capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability.

2.2 The purpose of investment management operations is to ensure that all investment decisions that are made primarily to generate a profit have a suitable level of security and liquidity. Ensuring risks and rewards are monitored regularly.

2.3 The second main function of the Capital Strategy is to set the Prudential indicators for affordable, prudent and sustainable capital investment.

2.4 Appendix 1 sets out the Capital Strategy for 2022/23 to 2024/25 and fulfil key legislative requirements as follows:

- The **Capital Strategy** sets out a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been written in accordance with CIPFA's Code of Practice on Treasury Management, the CIFPA Prudential Code and MHCLG guidance on local government investments.

2.5 These policies and parameters provide an approved framework within which officers undertake the day-to-day capital, treasury and non- treasury investment activities.

3 SCOPE

3.1 This report covers the Council's capital management activities as set out in paragraphs 2.1 to 2.3 above. A summary of Treasury Management and commercial investments and the Council's borrowing requirements to fund the Capital strategy are set out. Prudential indicators are identified to set measures for affordability, prudent and sustainable. The funds invested consist of short-term cash available due to timing of income and expenditure, prudential borrowing and the Council's capital receipts.

3.2 The Council has incurred prudential borrowing of £102m in relation to its capital expenditure. Further borrowing to support the financing of its approved capital programme in 2021/22 will also be required. It therefore commences the year 2022/23 in a position where its investment holdings continue to remain significant, but it also carries some accumulating debt. There will be an inevitable requirement to incur some further borrowing to service capital expenditure in future years.

3.3 In November 2020 the Public Works and Loan Board (PWLB) issued new Lending Terms that were subject to further clarification in August 2021. This makes it a condition of access to the PWLB funding that Local Authorities have no intention to buy investment assets primarily for yield in the current and following two financial years. No expenditure has been incurred on the acquisition of such assets since November 2020 and the Council does not plan to incur expenditure on investment assets primarily for yield within the capital programme. The s151 Officer is required on application to the PWLB to submit strategic capital and financial plans covering a 3-year period.

3.4 Careful observation of the "gross debt v capital financing requirement" indicator will need to be undertaken progressively throughout the financial year.

3.5 Where a material change occurs to the attached strategies during the year a revised strategy will be presented to full council before the change is implemented.

BACKGROUND DOCUMENTS:

1. Treasury Management in the Public Services (CIPFA) 2017 Edition
2. The Prudential Code for Capital Finance (CIPFA)2017 Edition
3. SI 2003/3146 - Local Authorities (Capital Finance and Accounting) (England) Regulations 2003
4.SI 2004/3055 - Local Authorities (Capital Finance and Accounting) (Amendment)
5. Capital Finance: Guidance on local government investment (third edition) (Issued under section 15 (1)(a) of eth Local Government Act 2003)
6. Prudential Property Investment 2019

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CAPITAL STRATEGY 2022/23

1 INTRODUCTION

1.1 This capital strategy is a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed, and the implications for future financial sustainability. It has been written in an accessible style to enhance members' understanding of these sometimes technical areas.

1.2 Decisions made this year on capital and treasury management will have financial consequences for the Authority for many years into the future. They are therefore subject to both a national regulatory framework and to local policy framework, summarised in this report

2 CAPITAL EXPENDITURE AND FINANCING

2.1 Capital expenditure is where the Authority spends money on assets, such as property or vehicles, that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. The Authority has some limited discretion on what counts as capital expenditure, for example assets costing below £20,000 (land and buildings) and £10,000 (plant, vehicles and equipment) are not capitalised and are charged to revenue in year. Expenditure that maintains but does not add to an asset's potential to deliver future economic benefits or service potential (i.e. repairs and maintenance) is charged as an expense when it is incurred

2.2 In 2022/23, the Council is planning capital expenditure of £37m as summarised below:

Table 1: Prudential Indicator: Estimate of Capital Expenditure in £ millions

	2020/21 Actual	2021/22 Forecast **	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
General Fund services	22.3	31.1	37.0	31.3	3.7
TOTAL	22.3	31.1	37.0	31.3	3.7

*** The forecast for 2021/22 is based the revised capital programme for 2021/22 and maintains capital expenditure budgets for the major Regeneration schemes at the original budget level. The P2 monitoring* *position as reported to Cabinet in January 2022 indicated a forecast spend of £14.6m.*

2.3 The main General Fund capital projects in 2022/23 includes Regeneration activity across 2 main sites - Union Yard (Aldershot) and Farnborough Civic Quarter. The capital programme for 2022/23 includes a further £23m of regeneration expenditure.

2.4 In November 2020 the Public Works and Loan Board (PWLB) issued new Lending Terms that were subject to further clarification in August 2021. This makes it a condition of access to the PWLB funding that Local Authorities have no intention to buy investment assets primarily for yield in the current and following two financial years. No expenditure has been incurred on the acquisition of such assets since November 2020 and the Council does not plan to incur expenditure on investment assets primarily for yield within the capital programme.

2.5 The Council's capital programme is predominantly financed through prudential borrowing. The Council has adopted a strategy to generate capital receipts to mitigate the current financing position given forecast level of prudential borrowing set out in the Treasury Management Strategy.

2.6 Several assets have been identified for disposal (subject to market appraisal) that would generate future capital receipts. The Council's Regeneration scheme in Farnborough (Civic Quarter) will require an approach to financing that will bring in capital receipts to provide funding for the infrastructure requirements and to facilitate and cash flow the wider site development.

2.7 Whilst the Council has undertaken an initial assessment of the potential capital receipts, there is considerable uncertainty around the timing and value and have not been included in the projections for capital receipts.

2.8 **Governance**: For service led capital projects Service managers prepare working papers to include projects in the Council's capital programme in line with the budget development timeline. The Finance service calculate the financing cost (which can be nil if the project is fully externally financed) so that the full cost of the project is understood. Larger property and regeneration projects are managed through the Council's regeneration and Property and Major Works programmes. These projects undergo scrutiny and review by the Project Board at different stages (e.g. feasibility, design, planning, due diligence) and costs and financing are reviewed by the finance service. All projects to be recommended for inclusion in the Capital programme appraised by the Executive Team before being included in the draft budget. The final capital programme is then presented to Cabinet early February and to Full Council in late February each year. Variation to capital bids and new capital bids can be received during the year, usually on the basis of a business case or in relation to urgent and unforeseen works.

- For full details of the Council's Capital Programme, including the project appraisals undertaken, see: Appendix 3, FIN2210 Revenue Budget, Capital Programme and Council Tax, as presented to Cabinet on 08 February 2022.

2.9 All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

Table 2: Capital financing in £ millions

	2020/21 Actual	2021/22 Forecast	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
External sources	2.1	4.5	8.6	1.1	1.1
Own resources	2.5	0.4	1.0	0.0	0.0
Debt	17.7	26.2	27.4	30.2	2.6
TOTAL	**22.3**	**31.1**	**37.0**	**31.3**	**3.7**

2.10 Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue, which is known as Minimum Revenue Provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and use of capital receipts are as follows:

Table 3: Replacement of debt finance in £ millions

	2020/21 Actual	2021/22 Forecast	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Own resources	1.9	2.5	2.7	3.0	3.0

- The Council's full Minimum Revenue Provision statement is available in Appendix 3, FIN2212 Annual Treasury Management Strategy and Non-Treasury Investment Strategy

2.11 The Council's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt. The CFR is expected to increase to £167m during 2022/23. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement in £ millions

	2020/21 Actual	2021/22 Forecast	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
General Fund services	121.8	145.8	170.3	197.4	196.6
MRP	-1.8	-2.5	-2.7	-3.0	-3.0
IFRIC 4 Lease Adjustment	-0.4	-0.4	-0.4	-0.4	-0.4
TOTAL CFR	**119.5**	**142.9**	**167.2**	**194.0**	**193.2**

2.12 **Asset management:** The Council uses experienced asset managers (currently Lambert Smith Hampton Investment Management (LSHIM)) to provide services to support the Council's property portfolio. A new property management system will go live during 2022 and will support the delivery of the Council's asset management plan which is currently being prepared. The plan will help ensure that the Council's capital assets are properly maintained and developed and continue to contribute effectively to the delivery of the Council's services, support the local economy or provide income in line with expectations

2.13 **Asset disposals:** When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. The Council is currently also permitted to spend capital receipts on service transformation projects for a further 3 years until 2024/25 (subject to guidance from Government). Repayments of capital grants, loans and investments also generate capital receipts. The Council is forecasting to receive the following capital receipts over the medium term. Paragraphs 2.5 to 2.7 reference the Council's position around capital receipts.

Table 5: Capital receipts in £ millions

	2020/21 Actual	2021/22 Forecast	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Asset sales	0	1.3	0.0	0.0	0.0
TOTAL	**0**	**1.3**	**0.0**	**0.0**	**0.0**

- The Council's Flexible Use of Capital Receipts Policy is available here: Appendix 4, FIN2210 Revenue Budget, Capital Programme and Council Tax, as presented to Cabinet on 08 February 2022

3 TREASURY MANAGEMENT

3.1 Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Council is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

3.2 Due to decisions taken in the past, the Council currently has £102.0m borrowing at an average interest rate of 0.19% and £41.8m treasury investments at an average rate of 2.45%.

3.3 **Borrowing strategy:** The Council's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between lower-cost short-term loans (currently available at around 0.75%) and long-term fixed rate loans where the future cost is known but higher (currently 1.5% to 2.5%).

3.4 Projected levels of the Council's total outstanding debt (which comprises borrowing and leases are shown below, compared with the capital financing requirement (table 4).

Table 6: Prudential Indicator: Gross Debt and the Capital Financing Requirement in £ millions

Gross Debt and the Capital Financing Requirement in £ millions	**2020/21 Actual**	**2021/22 Forecast**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**
Debt (incl. leases)	102.0	128.2	155.7	185.8	188.5
Capital Financing Requirement	119.4	142.9	167.2	194.0	193.2
Difference	17.4	14.6	11.5	8.1	4.7

3.5 Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 6, the Council expects to comply with this in the medium term.

3.6 **Liability benchmark:** 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 that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity, minimise credit risk and maintain Market in Financial Instrument Directive II (MiFID II) status. This benchmark is currently £114.3m and is forecast to rise to £174.6m over the next three years.

Table 7: Borrowing and Liability Benchmark in £ millions

	2020/21 Actual	2021/22 Forecast	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Outstanding borrowing	102.0	128.2	155.7	185.8	188.5
Investment minimum	-10.0	-10.0	-10.0	-10.0	-10.0
Investments held that can be redeemed	-4.8	-23.9	-23.9	-23.9	-23.9
Liability benchmark	107.2	114.3	141.8	171.9	174.6

3.7 The table shows that the Council expects to remain borrowed above its liability benchmark. This is because a deliberate decision has been made to maintain investment fund balances and not deplete to cover potential borrowing costs.

3.8 **Affordable borrowing limit:** The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

Table 8: Prudential Indicators: Authorised limit and Operational Boundary for External Debt in £ millions

	2020/21 limit	2021/22 limit	2022/23 limit	2023/24 limit
Authorised limit – total external debt	143.2	170.7	200.8	203.5
Operational boundary – total external debt	138.2	165.7	195.8	198.5

- Further details on borrowing are contained in the Treasury Management Strategy – Appendix 1 FIN2212 Annual Treasury Management Strategy and Non-Treasury Investment Strategy being considered at the meeting of Corporate Governance, Audit and Standards Committee on 15 February 2022.

3.9 **Treasury Management Investment Strategy:** Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management.

3.10 The Council's policy on treasury investments is to prioritise security and liquidity over yield, that is to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Council may request its money back at short notice.

Table 9: Treasury Management Investments in £ millions

	2020/21 Actual	2021/22 Forecast	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Near-term investments	4.8	2.0	2.0	2.0	2.0
Longer-term investments	21.9	21.9	21.9	21.9	21.9
TOTAL	**26.7**	**23.9**	**23.9**	**23.9**	**23.9**

3.11 **Risk management:** The effective management and control of risk are prime objectives of the Council's treasury management activities. The treasury management strategy therefore sets out various indicators and limits to constrain the risk of unexpected losses

- Further details on Treasury Investments are contained in the Treasury Management Strategy - Appendix 1 FIN2212 Annual Treasury Management Strategy and Non-Treasury Investment Strategy being considered at the meeting of Corporate Governance, Audit and Standards Committee on 15 February 2022.

3.12 **Governance:** Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Executive Head of Finance and staff, who must act in line with the treasury management strategy approved by Full Council. Year-end report and half-yearly reports on treasury management activity are presented to Corporate Governance, Audit and Standards Committee. CGAS committee is responsible for scrutinising treasury management decisions.

4 NON-TREASURY INVESTMENTS FOR SERVICE PURPOSES

4.1 The Council makes investments to assist local public services, including making loans to local businesses to promote economic growth, the Council's subsidiaries that provide services. In light of the public service objective, the Council is willing to take more risk than with treasury investments, however it still plans for such investments to break-even / generate a profit after all costs.

4.2 **Governance:** Decisions on service investments are made by the relevant service manager in consultation with the Executive Head of Finance and must meet the criteria and limits laid down in the investment strategy. Most loans and shares are capital expenditure and purchases will therefore also be approved as part of the capital programme.

- Further details on Service Investments are contained in the Investment Strategy: Appendix 2 FIN212 Annual Treasury Management Strategy and Investment Strategy being considered at the meeting of Corporate Governance, Audit and Standards Committee on 15 February 2022.

5 COMMERCIAL ACTIVITIES

5.1 Between 2016 and 2021 in the context of central government financial support for local public services declining, the Council undertook some investment in commercial properties purely or mainly for financial gain. These investments were acquired and managed in line with the Council's Commercial property strategy. Total commercial investments for 2021/22 are forecast to be £132.1m, the portfolio providing a net return after all costs of 3.5%.

5.2 With financial return being the main objective, the Council accepts higher risk on commercial investment than with treasury investments. The principal risk exposures for commercial investments include level of competition, barriers to entry/exit, and future market prospects. For commercial properties, risks include quality and financial security of tenants, building quality and relevance.

These risks are managed by:

- Assessment of the relevant market sector(s) including the level of competition, barriers to entry/exit, future market prospects
- Assessment of exposure to particular market segments to ensure adequate diversification
- Appointment of external advisor to manage designated commercial property investments
- Use of further external advisors if considered appropriate by the Executive Head of Finance
- Full and comprehensive report on all new investments to Cabinet
- Continual monitoring of risk across the whole portfolio and specific assets

5.4 With the introduction of revised PWLB lending terms the Council can confirm it has no intention to acquire investment assets primarily for yield in the current and following two financial years.

5.5 The Council will during 2022/23 revise its strategy to increasingly focus its commercial activities on housing and regeneration in line with the new code

5.5 **Governance:** Decisions on the day-to-day management of commercial investments are made by the Head of Service responsible for the Council's Property and Estates functions in line with the criteria and limits as set out in the Council's constitution. Property and most other commercial investments are also capital expenditure and will therefore also be approved as part of the capital programme approval process or as a result of a specific proposal or business case considered by the Cabinet and Council.

- Further details on Commercial Investments and limits on their use are contained in of the Investment Strategy: Appendix 2 FIN2212 Annual Treasury Management Strategy and Investment Strategy being considered at the meeting of Corporate Governance, Audit and Standards Committee on 15 February 2022.

6 LIABILITIES

6.1 In addition to debt detailed above, the Council is committed to making future payments to cover its pension fund deficit. It has also set aside funds to cover risks of Business Rate Appeals.

6.2 **Governance:** Decisions on incurring new discretional liabilities are taken by service managers in consultation with the Executive Head of Finance. The risk of liabilities crystallising and requiring payment is monitored by

Finance and reported quarterly to committee. New liabilities exceeding £2m are reported to full council for approval/notification as appropriate.

- Further details on liabilities and guarantees are on page 47 and 50 of the 2020/21 Statement of Accounts:

  Rushmoor Borough Council - 2020/21 Statement of Accounts

7 REVENUE BUDGET IMPLICATIONS

7.1 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, Business Rates and general government grants.

Table 10: Prudential Indicator: Proportion of Financing Costs to Net Core Revenue Stream in £ million

	2020/21 Actual	**2021/22 Forecast**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**
Financing Costs	2.4	2.8	3.9	5.3	5.8
Proportion of Net Core Revenue Stream	22.7%	26.3%	36.5%	53.1%	56.2%

Note: The indicator above shows that the proportion of financing costs to the net core revenue stream increases significantly from 2023/24. This is due to (a) the estimate of retained business rates being reduced down to the current baseline level and (b) the impact gross financing cost includes interest costs of the regeneration programme that in the construction phase are likely to be capitalised and from 2024/25 will be supported by income from the regeneration assets.

- Further details on the evenue implications of capital expenditure are contained in the 2022/23 Revenue Budget: Appendix 1, FIN2210 Revenue Budget, Capital Programme and Council Tax, as presented to Cabinet on 08 February 2022

7.2 **Sustainability:** Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 50 years into the future. The Executive Head of Finance is satisfied that the proposed capital programme is prudent, affordable and sustainable because the net budget demand on the Council and the risks within the programme have been reviewed and are within the Council's risk appetite and tolerances.

8 KNOWLEDGE AND SKILLS

8.1 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Executive Head of Finance is a qualified accountant (Chartered Institute of Public Finance and Accountancy) with 20 years' experience of local government finance, the Property and Estates Service and Regeneration teams include permanent and contract resources who are appropriately qualified and including and number of Chartered Surveyors). The Council pays for staff to study towards relevant professional qualifications including CIPFA, ACT (treasury) and RICS..

8.2 Where Council staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers and Lambert Smith Hampton Investment Management Ltd (LSHIM) as commercial property consultants as required depending on the nature of the professional advice sought This approach is more cost effective than employing such staff directly and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

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