ANNEX 2

COUNCIL MEETING – 24TH FEBRUARY 2022

AGENDA ITEM NO. 4 (2)

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

A report from the meeting of Corporate Governance, Audit and Standards Committee held on 15 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 B) must be approved before April 2021.

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 Appendices (1 to 3) set out the Treasury Management Strategy, Investment Strategy and Minimal Revenue Provision Statement for 2021/22 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 £12m 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.

4 RECOMMENDATIONS

4.1 The Council is recommended to approve:

(i) Treasury Management Strategy 2022/23, Annual Borrowing Strategy 2022/23 attached at Appendix 1;

(ii) Annual Non-Treasury Investment Strategy attached 2022/23 at Appendix 2; and

(iii) Minimum Revenue Provision (MRP) Statement set out in Appendix 3.

SUE CARTER
CHAIR CORPORATE GOVERNANCE, AUDIT AND STANDARDS COMMITTEE

APPENDIX 1

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 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

APPENDIX 1

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.

APPENDIX 3

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