ANNEX 3

COUNCIL MEETING – 20th FEBRUARY 2020

AGENDA ITEM NO. 5 (3)

ANNUAL TREASURY MANAGEMENT STRATEGY AND ANNUAL NON-TREASURY INVESTMENT STRATEGY 2020/21

A report from the meeting of Cabinet held on 4th February 2020

1 INTRODUCTION

1.1 This report sets out the proposed Treasury Management Strategy and Non-Treasury Investment Strategy for the year 2020/21, including the borrowing and investment strategies and treasury management indicators for capital finance for 2020/21 and the Minimum Revenue Provision Statement.

1.2 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 Non-Treasury Investment Strategy before the start of each financial year.

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 2020.

2 PURPOSE

2.1 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.

2.2 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).

2.3 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 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 second main 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 (A to C) set out the Treasury Management Strategy, Investment Strategy and Minimal Revenue Provision Statement for 2020/21 to 2023/24 and fulfil key legislative requirements as follows:

Appendix A

- The **Treasury Management Strategy** which sets out how the Council's treasury service 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 B

- 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 C

- 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 2018/19 in the sum of £45.58m in relation to its capital expenditure. Further borrowing to support the financing of its approved capital programme in the year 2019/20 will also be required. The Council therefore commences the year 2020/21 in a position where its investment holdings continue to remain significant (although, less than in previous financial years) but also carries significant 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) The Treasury Management Strategy, Annual Borrowing Strategy and Annual Investment Strategy attached at Appendix A;

(ii) The Non-Treasury Strategy attached at Appendix B; and

(iii) The Minimal Revenue Provision (MRP) Statement set out in Appendix C.

P G TAYLOR
PORTFOLIO HOLDER CORPORATE SERVICES

APPENDIX A

TREASURY MANAGEMENT STRATEGY 2020/21

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 B.

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)

2.1 **Economic background:** The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Council's treasury management strategy for 2020/21. The General Election has removed some uncertainty within the market, however following the expected Withdrawal Bill, uncertainties around the future trading relationship with the EU remain.

2.2 GDP growth rose by 0.4% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.1% from 1.2%. Services, construction and production added positively to growth, by 0.5%, 1.2% and 0.1% respectively, while agriculture recorded a fall of 0.1%. Looking ahead, the Bank of England's

Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

2.3 The headline rate of UK Consumer Price Inflation remained the same in November 2019 at 1.5% year-on-year, the same as October 2019, however continuing to fall from highs of 2.1% in July and April 2019 as accommodation services and transport continued to contribute to a level of inflation below the BOE target of 2%. Labour market data continues to be positive. The ILO unemployment rate continues to hold at historic lows at 3.8%, its lowest level since 1975. The 3-month average annual growth rate for pay excluding bonuses rose to 3.5% in November 2019 providing some evidence that a shortage of labour is supporting wages. However, adjusting for inflation this means real wages were only up by 0.9% in October 2019 and only likely to have a moderate impact on household spending.

2.4 Domestic inflationary pressures have abated, as domestic gas and electricity price freezes have taken effect until 2020. The price of oil has fallen through the year, despite a rise in prices in December 2019. The limited inflationary pressure from real wages will likely keep inflation below the Bank of England target of 2%. The Bank of England maintained Bank Rate to 0.75% in November following a 7-2 vote by the Monetary Policy Committee. Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report suggest the Committee may now be less convinced of the need to increase rates even if there is a Brexit deal.

2.5 The US economy has continued to perform relatively well compared to other developed nations; however, the Federal Reserve has started to unwind its monetary tightening through 2019. The Federal Reserve has cut rates three times to 1.5% - 1.75%, to stimulate growth as GDP growth has started to fall (to 2.1%).

2.6 The fallout from the US-China trade war continues which, risks contributing to a slowdown in global economic activity in 2019. Recent suggestions have been an initial compromise and potential unwinding of tariffs; however, this can change quickly. Slow growth in Europe, combined with changes in leadership at the ECB and IMF has led to a change of stance in 2019. Quantitative easing has continued and been extended.

2.7 **Credit outlook**: The recent Bank of England stress tests assessed all seven UK banking groups. The tests scenarios include deep simultaneous recessions in the UK and global economies that are more severe overall than the global financial crisis, combined with large falls in asset prices and a separate stress of misconduct costs. All seven banks passed the test on both a CET1 ratio and a leverage ratio basis. Major banks have steadily increased their capital for many years now. However, there are a number of shortcomings in the Bank's approach; timeliness as the results are over 11 months of out date when they are published, being based on end-2018 balance sheets; ringfencing, as the tests ignore the restrictions on transferring capital between ringfenced "retail" banks and non-ringfenced "investment" banks within the larger groups and; coverage – the tests should be expanded to cover a wider range of UK banks and building societies.

2.8 The Bank of England will seek to address some of these issues in 2020, when Virgin Money/Clydesdale will be added to the testing group and separate tests will be included of ringfenced banks.

2.9 Challenger banks hit the news headlines in 2019 with Metro Bank and TSB Bank both suffering adverse publicity and falling customer numbers.

2.10 Looking forward, the potential for a "no-deal" Brexit and/or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits remains advisable.

2.11 **Interest rate forecast**: The Council's treasury management adviser Arlingclose is forecasting that Bank Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be significantly weighted to the downside, particularly given the upcoming general election, the need for greater clarity on Brexit and the continuing global economic slowdown. The Bank of England, having previously indicated interest rates may need to rise if a Brexit agreement was reached, stated in its November Monetary Policy Report and its Bank Rate decision (7-2 vote to hold rates) that the MPC now believe this is less likely even in the event of a deal.

2.12 Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose's interest rate projections. The central case is for 10-year and 20-year gilt yields to rise to around 1.00% and 1.40% respectively over the time horizon, with broadly balanced risks to both the upside and downside. However, short-term volatility arising from both economic and political events over the period is a near certainty.

2.13 A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix 1.

2.14 For the purpose of setting the budget, it has been assumed that investments will be made at an average rate of 4.9%, and that new short-term loans will be borrowed at an average rate of 1.1%, being the current blended rate for short and long term-borrowing.

3 LOCAL CONTEXT

3.1 On 31 December 2019, the Council held £90.0m of borrowing, long-term liabilities of £2.5m and £31.3m 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

	2018/19 actual	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget
Debt (incl. leases)	60.8	107.6	154.1	197.9	208.4
Capital Financing Requirement	154.1	197.9	208.4	217.8	224.3
Difference	93.3	90.3	54.3	19.9	15.9
Investments	24.2	22.9	22.9	22.9	22.9

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 £116.7m 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 2020/21.

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

	2018/19 actual	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget
Outstanding borrowing	60.8	107.6	154.1	197.9	208.4
Investment minimum	-10.0	-10.0	-10.0	-10.0	-10.0

Investments held that can be redeemed	-24.2	-22.9	-22.9	-22.9	-22.9
Liability benchmark	46.6	94.7	141.2	185.0	195.5

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 2019/20 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 at 31st December 2019:

- £21.9m 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

4.3 Local Authorities have adopted the new IFRS 9 accounting standard for the financial instruments including investments, borrowing, receivables and payables in 2019/20. A statutory override has been applied to the fair value movement on pooled investment fund. Any fair value movement can be reversed out from the General Fund to an unusable reserve called the Pooled Investment Fund Adjustment Account.

Table 3: Existing Investment & Debt Portfolio Position

	Actual Portfolio at 31/12/19 **£m**	**Average Rate** **%**
Total External Borrowing Borrowing from other Local Authorities	90	1.1
Total Gross External Debt	90	
Other long-term liabilities: Finance Leases	2.5	
Total other long-term liabilities	2.5	

Investments **Managed in-house:** Money Market Funds	9.39	0.69
Managed externally: **Pooled Funds:**		
CCLA LAMIT Property Fund	3.9	5.31
M&G Investments Strategic Corporate Bond Fund	4	3.8
UBS Multi Asset Fund	5	4.52
Kames	2	5.26
Columbia Threadneedle Investments	2	2.89
Schroder Income Maximiser Fund	5	10.63
Total Investments	31.29	4.22
Net Debt	61.21	

Table 3 Illustrates the Council's investment and debt portfolio position as at 31 December 2019.

5 ANNUAL BORROWING STRATEGY 2019/20

5.1 The Council currently holds £90.0m of loans, an increase of £29.2m on 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 £46.8m in 2020/21.

5.2 The Council has made use of funds from the Enterprise M3 (LEP) by borrowing £3m in an earlier year to progress the Aldershot regeneration schemes. External contributions were scheduled to be received over a seven-year period to fully finance this amount. At the commencement of 2019/20 £1.7m of this borrowed amount remained outstanding. The Council has fully repaid the LEP outstanding balance as at December 2019.

5.3 Capital expenditure in 2019/20 financial year is programmed to be substantial, including a significant amount for investment property acquisitions. Capital expenditure in relation to the Farnborough International Loan has been completed within 2019/20. Prudential code borrowing will therefore be required in order to achieve overall financing. The Council will incur some further borrowing during 2020/21 in order assist in the financing of its capital programme.

5.4 **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.

5.5 **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.

5.6 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.

5.7 Alternatively, the Council may arrange forward starting loans during 2020/21, 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:

- Public Works Loan Board (PWLB) and any successor body
- 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 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 plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities 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 full 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 2020/21

6.1 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. As at 31 December 2019 the Council's investment balance stood at £31.3m. The Council estimates that the level of investment held in Money Market Funds (MMFs) will reduce to £0m at the year end. In future years the Council estimates to hold on average £25m.

6.2 **Objectives**: Both the CIPFA Code and the MHCLG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

6.3 **Negative interest rates:** If the UK enters into a recession in 2020/21, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

6.4 **Strategy**: The Council continues to maintain a diverse range of secure and/or higher yielding asset classes during 2020/21. All the Council's surplus cash remains invested in short-term unsecured bank deposits, and money market funds.

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

Counterparty		**Cash limit per counterparty**	**Investment Limit (per type of counterparty)**	**Time limit**
Banks Unsecured whose lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's is:	AAA	£2m	£20m in total	5 Years
	AA+	£2m		5 Years
	AA	£2m		4 years
	AA-	£2m		3 years
	A+	£2m		2 years
	A	£2m		13 months
	A-	£2m		6 months
	BBB+	£1m		100 days
Banks Secured whose lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's is:	AAA	£4m	Unlimited	20 years
	AA+	£4m		10 years
	AA	£4m		5 years
	AA-	£4m		4 years
	A+	£4m		3 years
	A	£4m		2 years
	A-	£4m		13 months
	BBB+	£2m		6 months
	BBB or BBB-	£2m		100 days

Government whose lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's is:	AAA	£4m	Unlimited	50 Years
	AA+	£4m		25 Years
	AA	£4m		15 Years
	AA-	£4m		10 Years
	A+	£2m		5 Years
	A	£2m		5 Years
	A-	£2m		5 Years
	BBB+	£1m		2 Years
	None	£4m		25 Years
Corporates whose lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's is:	AAA	£2m	£6m in total	20 Years
	AA+	£2m		10 Years
	AA	£2m		10 Years
	AA-	£2m		10 Years
	A+	£2m		5 Years
	A	£2m		2 Years
	A-	£1m		13 months
	BBB+	£1m		6 months
	none	£0.5m		5 Years
Counterparty		**Cash limit per counterparty**	**Investment Limit (per type of counterparty)**	**Time limit**
Registered Providers whose lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's is:	AAA	£4m	£10m in total	20 Years
	AA+	£4m		10 Years
	AA	£4m		10 Years
	AA-	£4m		10 Years
	A+	£4m		5 Years
	A	£4m		5 Years
	A-	£4m		5 Years
	BBB+	£4m		5 Years
	None	£4m		5 Years
The Council's current account bank if it fails to meet the above criteria		£3m	£3m	next day
UK Building Societies without credit rating		£1m	£4m	1 Year
Money market funds		£5m	£25m in total	n/a

Collective Investment Schemes (pooled funds)	£5m per fund	£25m in total	These funds do not have a defined maturity date

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 2020. 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 £5 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:

- **Banks Unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.

- **Banks Secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

- **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

- **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.

  Investments in unrated small businesses may provide considerably higher rates of return. They will however only be made following a favourable external credit assessment and on the specific advice of the Council's treasury management adviser.

- **Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing and registered social landlords, formerly known as Housing Associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain a high likelihood of receiving government support if needed.

- **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.

- **Other 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 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 2011, 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 a reduction in the level of investment income earned but will protect the principal sum invested.

7 TREASURY MANAGEMENT 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 8.2

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	2020/21	2021/22	2022/23
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 **Investment Advisers:** The Council jointly tendered the treasury management service together with three other District Councils located within the Hampshire area, and appointed Arlingclose Limited for a further 3 years contract in April 2016. A contract extension was granted until April 2020. This contract enables the Council to receive specific advice on investment, debt and capital finance issues. The quality of this service will be reviewed on an ongoing basis as part of the process of monitoring the Council's investment portfolio.

8.6 **Financial Implications - Investments:** The budget for investment income in 2020/21 is £1.6 million (gross of borrowing interest), based on an average investment portfolio of £25 million at interest rates ranging from 0.35% liquid MMF and other short-term investments to 10.63% 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.

8.7 **Financial Implications - Borrowing:** The budget for interest costs in relation to borrowing in 2020/21 is £1.37m (not including IFRIC 4 lease accounting interest). It is determined using the current average rate of interest on borrowing incurred for 2019/20. The Council's actual borrowing at the end of 2020/21 is estimated to be in the region of £154.1m

8.8 **Other Options Considered:** The CIPFA Code do 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 December 2019

Underlying assumptions:

- The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased.

- Some positivity on the trade negotiations between China and the US has prompted worst case economic scenarios to be pared back. However, information is limited, and upbeat expectations have been wrong before.

- Brexit has been delayed until 31 January 2020. While the General Election has maintained economic and political uncertainty, the opinion polls suggest the Conservative position in parliament may be strengthened, which reduces the chance of Brexit being further frustrated. A key concern is the limited transitionary period following a January 2020 exit date, which will maintain and create additional uncertainty over the next few years.

- UK economic growth has stalled despite Q3 2019 GDP of 0.3%. Monthly figures indicate growth waned as the quarter progressed and survey data suggest falling household and business confidence. Both main political parties have promised substantial fiscal easing, which should help support growth.

- While the potential for divergent paths for UK monetary policy remain in the event of the General Election result, the weaker external environment severely limits potential upside movement in Bank Rate, while the slowing UK economy will place pressure on the MPC to loosen monetary policy. Indeed, two MPC members voted for an immediate cut in November 2019.

- Inflation is running below target at 1.7%. While the tight labour market risks medium-term domestically-driven inflationary pressure, slower global growth should reduce the prospect of externally driven pressure, although political turmoil could push up oil prices.

- Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- Although we have maintained our Bank Rate forecast at 0.75% for the foreseeable future, there are substantial risks to this forecast, dependant on General Election outcomes and the evolution of the global economy.
- Arlingclose judges that the risks are weighted to the downside.
- Gilt yields have risen but remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy.
- We expect gilt yields to remain at relatively low levels for the foreseeable future and judge the risks to be broadly balanced.

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.21**
Arlingclose Central Case	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**
3-month money market rate														
Upside risk	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.30	0.30	0.30	0.30	0.30	**0.25**
Arlingclose Central Case	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**
1yr money market rate														
Upside risk	0.10	0.20	0.20	0.20	0.20	0.20	0.20	0.25	0.30	0.30	0.30	0.30	0.30	**0.23**
Arlingclose Central Case	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**
Downside risk	-0.30	-0.50	-0.55	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	**-0.60**
5yr gilt yield														
Upside risk	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.45	0.45	0.45	**0.37**
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.55**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.57**
Downside risk	-0.35	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	**-0.56**
10yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	**0.37**
Arlingclose Central Case	**0.75**	**0.75**	**0.80**	**0.80**	**0.85**	**0.85**	**0.90**	**0.90**	**0.95**	**0.95**	**1.00**	**1.00**	**1.00**	**0.88**
Downside risk	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.45**
20yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	**0.37**
Arlingclose Central Case	**1.20**	**1.20**	**1.25**	**1.25**	**1.25**	**1.30**	**1.30**	**1.30**	**1.35**	**1.35**	**1.35**	**1.40**	**1.40**	**1.30**
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	**-0.45**
50yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	**0.37**
Arlingclose Central Case	**1.20**	**1.20**	**1.25**	**1.25**	**1.25**	**1.30**	**1.30**	**1.30**	**1.35**	**1.35**	**1.35**	**1.40**	**1.40**	**1.30**
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	**-0.45**

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 1.80%
PWLB Local Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

APPENDIX B

ANNUAL NON-TREASURY INVESTEMENT STRATEGY 2020/21

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 is due to establish a Wholly Owned Company (WOC) subsidiary, called Rushmoor Homes (RH) in April 2020. The Council will lend to RH at a commercial rate to enable to 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	2018/19 Actual	19/20 Forecast	2020/21 Approved Limit
Local businesses	5.6	6.7	6.7
Subsidiaries and Partnerships	0	0	3.5
Employees	0.1	0.1	0.1
TOTAL	**5.7**	**6.8**	**10.3**

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.

3 SERVICE INVESTMENTS: SHARES

3.1 **Contribution:** The Council invests in the shares of its subsidiary and holds a financial share in a development partnership to support local public services and stimulate local economic growth.

3.2 The creation of a Wholly Owned Company (WOC) subsidiary, called Rushmoor Homes (RH) will assist to develop new homes to meet the Council's regeneration priorities and desire to improve the availability of quality housing within the Borough. It will enable the Council to hold existing properties, acquire and develop rented homes, responding to housing needs in the Borough and providing social and economic benefits. It is anticipated that approximately 57 houses and apartments will be constructed on up to 15 sites initially. Other foreseeable potential sites for development may be pursued once RH is operating. RH could create a number of jobs and training opportunities during the construction and operational phase, stimulating economic growth and regeneration. The income and capital growth generated can be reinvested in delivering Council services.

3.3 The purpose of Rushmoor Development Partnership (RDP) is 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	19/20 Forecast	2020/21 Approved Limit
Subsidiaries and Partnerships	0.2	0.5
TOTAL	**0.2**	**0.5**

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 excellent knowledge of the market planned for RH developments, as each of the initial 15 sites that may be developed by the RH are currently in the ownership of the Council. Given that RH aim is to provide private sector rental units the Council (as 100% shareholder of the RH) on sites of limited space and accessibility then the nature and level of competition is considered to be low. There is every expectation that the market demand for private rentals will continue to grow within the local economy, particularly as the possibility of home ownership for a significant element of the local population becomes less achievable as time progresses. The Council considers that exit from the RH (and market) is viable (if required) as RH investment is locked into quality housing stock, which has the potential for sale disposal as soon as it is developed.

3.7 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 the most appropriate mechanism to achieve the developments required. 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.

3.8 The Council has 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 The market for RH and RDP is localised to the Borough of Rushmoor only in the first instance but noting that it possible that RH may look for development potential outside of the local economy at some time in the future. The local market cannot be compared to any global information issued by credit agencies. Hence, no element of the risk assessment utilises credit ratings.

3.11 In the circumstances of RH and RDP no credit ratings have been used.

3.12 The relatively asset stability of RH assists to significantly lower the financial risk. A detailed financial model has been developed by Council staff to enable it to provide monthly budget/target achievement information. This model can be used to identify development risk, which (if it occurred) is limited mainly to asset creation achieved within RH budget plan. There is a perception that risk is greater during site development(s) as work in progress has lesser value when compared to a finished product article. RH development team will monitor developments to ensure minimisation of risk.

3.13 The RDP Investment team will monitor developments to ensure minimisation of risk. None of the site developments would proceed if there were considerations that no financial return would be achieved. 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. Data and advice from the developer is paramount to assess and monitor risk for each development.

3.14 **Liquidity:** The creation of RH will commit funds initially a period of 26 years. There is potential to extend the commitment to 40 years. RDP funds will be committed for an estimated period of 10 years

3.15 **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 invests in local and regional commercial and residential property with the intention of making a profit that will be spent on local public services.

Table 3: Property held for investment purposes in £millions

Property by type	2018/19 Carry forward	2019/20 Transactions		2020/21 estimated transactions	
		Purchase cost	Estimated Value in accounts	Purchase cost	Estimated year end Value
Mixed use	4.54	0.00	4.54	5.0	9.5
Industrial units	24.14	0.00	24.14	5.0	29.1
Retail	30.68	0.02	30.70	0.0	30.7
Offices	15.58	35.82	51.40	5.0	56.4
TOTAL	74.93	35.84	**110.78**	**15.0**	**125.8**

4.2 **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.

4.3 *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.

4.4 Should the 2019/20 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.

4.5 *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:

- Review of the portfolio during 2020/21 by external agency

- An assessment from the Executive Head of Regeneration and Property that the best course of action is to hold the assets as values will increase over the long term. Giving consideration to the soundness of the assets with strong covenants/dependable income streams.

4.6 **Risk assessment:** The Council assesses the risk of loss before entering into 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

4.7 **Liquidity:** Compared with other investment types, property is relatively difficult to sell and convert t 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.

4.8 To management Commercial Property effectively the Council's commercial property consultants (Lambert Smith Hampton Investment Management Ltd (LSHIM)) have constructed a strategy that is contained in a separate report being taken to Cabinet on 4th February.

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 not contractually committed any loans for 2020/21.

6 PROPORTIONALITY

6.1 The Council plans to 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 Plan. Should it fail to achieve the expected net profit, the Council has earmarked reserves available to cover any immediate shortfall in income. The Executive Head of Regeneration and Property would review the cause of any shortfall and identify any actions needed to ensure the income shortfall is mitigated or remidied.

Table 4: Proportionality of Investments in £ millions

	2018/19 Actual	**2019/20 Forecast**	**2020/21 Budget**
Gross service expenditure	75.9	58.8	61.5
Investment income	4.7	8.5	8.8
Proportion	6.2%	14.4%	14.3%

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) have been appointed as the Council's external investment advisor during 2019/20. LHSIM manage property investment portfolios for institutions, local authorities and private family offices. The LSHIM investment team are all RICS qualified and have over 85 years of 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	2018/19 Actual	2019/20 Forecast	2020/21 Forecast
Treasury management investments	24.2	22.9	22.9
Service investments: Loans	5.7	6.8	10.3
Service investments: Shares	0	0.2	0.5
Commercial investments: Property	74.93	110.8	125.8
TOTAL INVESTMENTS	104.9	140.7	159.5
Commitments to lend	1.1	0	0
TOTAL EXPOSURE	106.0	140.7	159.5

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

	2018/19 Actual	2019/20 Forecast	2020/21 Forecast
Treasury management investments	0	0	0
Service investments: Loans	1.1	2.2	4.4
Service investments: Shares	0	0.2	0.5
Commercial investments: Property	36.3	72.2	87.2
TOTAL FUNDED BY BORROWING	37.4	74.6	92.1

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	2018/19 Actual	2019/20 Forecast	2020/21 Forecast
Treasury management investments	2.7%	4.2%	4.9%
Service investments: Loans	4.02%	3.98%	3.87%
Service investments: Shares	0%	0%	0%
Commercial investments: Property	4.6%	3.9%	2.3%
ALL INVESTMENTS	3.9%	4.0%	2.7%

9.5 The above table shows a forecast increase in return on treasury management investments. This is due to a restructure of the Council's pooled fund portfolio, which has increased diversification of fund holding and income yield. There is a reduction in commercial property investment return net of all finance costs in 2019/20 and 2020/21. This is due to the additional borrowing and MRP costs accrued when purchasing investment property with the aid of external loans.

9.6 The Council has considered the following additional indicators prudent to report given the investment activities.

Table 8: Other investment indicators

Indicator	2018/19 Actual	2019/20 Forecast	2020/21 Forecast
Debt to net service expenditure ratio	2.4	8.8	13.7
Commercial income to net service expenditure ratio	0.19	0.69	0.8

APPENDIX C

MINIMUM REVENUE PROVISION STATEMENT

1.1 Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008.

1.2 The Local Government Act 2003 requires the Council to have regard to the Ministry for Housing, Communities and Local Government's *Guidance on Minimum Revenue Provision* (the MHCLG Guidance) most recently issued in 2018.

1.3 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.

1.4 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.

1.5 For any unsupported capital expenditure incurred after 31st 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.

1.6 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.

1.7 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 2019/20 the Council had, a Capital Financing Requirement (CFR) of £60.8m in relation to a specific elements of capital expenditure incurred in the previous financial year (2018/19). The Council has incurred further amounts of capital expenditure in 2019/20 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 2019/20 will require MRP to be charged to the Council's General Fund Revenue Account in 2020/21 and future years.

1.9 The implementation of International Financial Reporting Standards (IFRS) has meant that the accounting treatment for assets used within major contracts may result in embedded finance leases appearing on the Balance Sheet, leading to a requirement for MRP. This is purely an accounting requirement and does not give rise to any requirement to borrow to fund these assets.

1.10 Capital expenditure incurred during 2020/21 will not be subject to MRP charge until 2021/22.

1.11 Based on the Council's latest estimate of its capital financing requirement (CFR) on 31st March 2020, the MRP budget for 2020/21 has been set at (£2.2m).

1.12 **Overpayments:** The Council is planning to make voluntary overpayments of MRP that are available to reduce the revenue charges in later years. It is planned to make a further £0.45m overpayment in 2020/21.

MRP Overpayments in £ millions

Actual balance 31.03.2019	0
Approved overpayment 2019/20	0.45
Expected balance 31.03.2020	0.45
Planned overpayment 2020/21	0.45
Forecast balance 31.03.2021	0.9