

27 February 2019		ITEM: 11
Council		
Capital Strategy 2019/20		
Wards and communities affected: All	Key Decision: Yes	
Report of: Councillor Shane Hebb – Deputy Leader and Portfolio Holder for Finance		
Accountable Assistant Director: Jonathan Wilson, Assistant Director - Finance		
Accountable Director: Sean Clark, Director of Finance and IT		
This report is public		

Executive Summary

The Capital Strategy has been developed to apply from 2019/20 in accordance with revised guidance contained in The Chartered Institute of Public Finance & Accountancy (CIPFA) Code of Practice for Treasury Management in Public Services and the Prudential Code (The Code). This sets out the strategic framework underpinning capital expenditure and the associated financing at the Council. This also includes the Treasury Management Strategy which was previously considered in isolation up to 2018/19. It is also intrinsically linked to the council's ambitions of becoming a more commercially focused borough; one where sensible transactions are completed which create revenue returns which can then be allocated to spending on the services for Thurrock residents.

The Code requires local authorities to determine the Capital Strategy and the associated Prudential Indicators on an annual basis. The annual strategy also includes the Treasury Management Strategy that is a requirement of the Ministry for Housing, Communities and Local Government Investment Guidance.

In accordance with the above Codes, this report:

- a) sets out the Capital strategy for 2019/20;
- b) confirms the proposed Prudential Indicators; and
- c) sets out the Capital and Treasury Management projections for 2019/20.

1 Recommendation(s)

That the Council:

- 1.1 Approves the Capital Strategy for 2019/20 including approval of the Annual Minimum Revenue Provision (MRP) statement for 2019/20; and**
- 1.2 Approve the adoption of the Prudential Indicators as set out in Appendix 1; and**
- 1.3 Note the revised 2018/19 and 2019/20 Treasury Management projections as set out in Annex 1 paragraph 2.32.**

2. Introduction and Background

- 2.1 The Capital Strategy and the Annual MRP Statement are prepared under the terms of the CIPFA Prudential Code for Capital Finance in Local Authorities (the Code) and approval is sought for the adoption of the Prudential Indicators that have been developed in accordance with the Code.
- 2.2 The report also includes a forecast for Interest Receivable from Investments and the indicative Interest Payable on Borrowing.
- 2.3 The report covers a range of areas as set out below with the detailed document attached at Appendix 1.

Borrowing Activity 2017/18 and 2018/19

3. Issues, Options and Analysis of Options

- 3.1 The Capital strategy of the Council is attached as an appendix to this report and has been set with consideration of relevant legislation and appropriate guidance. This includes Annex 1 which incorporates the Treasury Management Strategy. The Prudential Indicators are governed by decisions made on the revenue and capital budgets.
- 3.2 The Capital Strategy sets out a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. It includes the following:
 - Details of capital expenditure and financing;
 - The governance arrangements around the identification and approval of capital bids;
 - Details on the sources of funding and projections on capital receipts;

- The strategic approach of the Council to borrowing and the governance arrangements in place;
- The proposed prudential indicators for 2019/20;
- Details of the Council's strategic approach to investments and commercial activities;
- Details of other liabilities and revenue implications arising from this strategy; and
- A further annex containing the detailed treasury management strategy that supports the capital strategy. This includes the annual statement on the Minimum Revenue Provision.

3.3 There are two key areas in this report for Members to be particularly mindful of:

- a) The Council has held significant levels of temporary borrowing since 2010 and hence there is potential exposure to interest rate changes. Officers continue to monitor this to ensure the Council can react to any changes in the economy; and
- b) The approach taken to the Minimum Revenue Provision (as set out in Annex 1).

4. Reasons for Recommendation

4.1 There is a statutory requirement for the Capital Strategy and the Annual Minimum Revenue Provision Statement to be ratified by Full Council. This report and appendices have been written in line with best practice and the Council's spending plans.

5. Consultation (including Overview and Scrutiny, if applicable)

5.1 As set out in section 4, the report is largely based on best practice and the Council's spending plans that have been scrutinised throughout recent months.

5.2 Corporate Overview and Scrutiny Committee considered the report at their meeting on 31 January 2019. Whilst there were no recommendations to Cabinet on the report, there was a question asking for assurance that there was sufficient funding identified for Thurrock Regeneration Ltd. Officers explained that the commitment agreed at Council in February 2018 was covered but, should more be required; officers could always bring a further report to Council at a later date.

6. Impact on corporate policies, priorities, performance and community impact

6.1 Treasury Management plays a significant role in funding the delivery of services to the community. The debt restructuring carried out in August 2010 will have contributed savings in the region of £29.3m by the end of 2018/19.

7. Implications

7.1 Financial

Implications verified by: **Chris Buckley**
Treasury Management Officer

The financial implications are included in the main body of the report and appendix. Investment income generated from the Investment Strategy contributes significantly to the council's financial position.

7.2 Legal

Implications verified by: **Tim Hallam**
Deputy Head of Law & Governance

The report is in accordance with the Local Government Act 2003, related secondary legislation and other requirements including the Prudential Code. Publication of the strategies is a statutory requirement and conforms to best practice as required by the CIPFA Code of Practice.

7.3 Diversity and Equality

Implications verified by: **Natalie Warren**
Strategic Lead, Community Development and Equalities

There are no direct diversity implications noted in this report.

8. Other implications (where significant) – i.e. Section 17, Risk Assessment, Health Impact Assessment, Sustainability, IT, Environmental

- Not applicable
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9. Background papers used in preparing the report (including their location on the Council's website or identification whether any are exempt or protected by copyright):

- Revised CIPFA Prudential Code
- Revised draft ODPM's Guidance on Local Government Investments
- Revised CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes

- Treasury Management Policy Statement
- 2017/18 Annual Investment Strategy
- Arlingclose Sector Briefings

10. Appendices to the report

- Appendix 1 – Capital Strategy Report 2019/20
- Annex 1 – Treasury Management Strategy 2019/20

Report Author:

Chris Buckley

Senior Financial Accountant

Corporate Finance

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Appendix 1 - Thurrock Council

Capital Strategy Report 2019/20

Introduction

This capital strategy is a new report for 2019/20, giving a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been written in an accessible style to enhance Members' understanding of these sometimes technical areas.

Capital Expenditure and Financing

Capital expenditure is where the Council spends money on assets, such as property or vehicles that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy or build assets. The Council has some limited discretion on what counts as capital expenditure, for example assets costing below £10k are not capitalised and are charged to revenue in year.

- Details of the Council's policy on capitalisation are included within the annual Statement of Accounts, which can be accessed through the Council's website.

In 2019/20, the Council is planning capital expenditure of £417.250m as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure in £m

	2017/18 actual	2018/19 forecast	2019/20 forecast	2020/21 forecast	2021/22 forecast
General Fund services	39.630	80.189	119.003	38.959	24.524
Council housing (HRA)	13.125	19.667	33.950	10.000	10.000
Capital investments	339.503	308.997	275.637	305.000	250.000
TOTAL	392.258	408.853	417.250	353.959	284.524

The main General Fund capital projects include the widening of the A13 (£33m), Purfleet redevelopment (£12m) and school expansions (£4m). The Council also plans to incur £275.637m of capital expenditure on investments, which are detailed later in this report.

The Housing Revenue Account (HRA) is a ring-fenced account which ensures that council housing does not subsidise, or is itself subsidised, by other local services. HRA capital expenditure is therefore recorded separately, and includes the building of 117 new homes over the forecast period (£24m).

Governance: Service managers bid annually in September to include projects in the Council's capital programme. Bids are collated by corporate finance who calculate the financing cost (which can be nil if the project is fully externally financed). The bids are then collated and prioritised by either Property Board, Digital Board or Service Review. The proposed programme is then considered by Director's Board. This includes a final appraisal of all bids including final consideration of service priorities and financing costs. The final proposed capital programmes is then collated and reported with recommendations to the Corporate Overview and Scrutiny committee. The final capital programme is then presented to Cabinet and to Council in February each year as part of the overall budget setting process.

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

Table 2: Capital financing in £m

	2017/18 actual	2018/19 forecast	2019/20 forecast	2020/21 forecast	2021/22 forecast
External sources	26.794	46.374	66.575	16.257	16.309
Own resources	13.690	14.362	22.310	10.000	10.000
Debt	351.774	348.117	328.365	327.702	258.215
TOTAL	392.258	408.853	417.250	353.959	284.524

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

Table 3: Minimum Revenue Provision in £m

	2017/18 actual	2018/19 forecast	2019/20 forecast	2020/21 forecast	2021/22 forecast
Own resources	0.000	2.811	6.353	7.958	8.695

- The Council's full minimum revenue provision statement is included in the treasury management statement appended as an annex to this document.

The Council's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt. The CFR is expected to increase by £322.022m during 2019/20. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

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

	31.3.2018 actual	31.3.2019 forecast	31.3.2020 forecast	31.3.2021 forecast	31.3.2022 forecast
General Fund services	172.420	203.099	249.464	264.208	263.730
Council housing (HRA)	181.843	187.473	187.473	187.473	187.473
Capital investments	339.503	648.500	924.137	1,229.137	1,479.135
TOTAL CFR	693.766	1,039.072	1,361.074	1,680.818	1,930.338

Asset management: To ensure that capital assets continue to be of long-term use, the Council is further developing an asset management strategy which will be completed in 2019/20.

Asset disposals: When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. The Council is currently also permitted to spend capital receipts on service transformation projects until 2021/22. Repayments of capital grants, loans and investments also generate capital receipts. The Council plans to receive £10m of capital receipts (total includes both GF and HRA receipts) in the coming financial year as follows:

Table 5: Capital receipts in £m

	2017/18 actual	2018/19 forecast	2019/20 forecast	2020/21 forecast	2021/22 forecast
Asset sales	16.057	8.700	10.000	10.000	10.000
Loans repaid	0.036	5.037	0.039	0.041	0.043
TOTAL	16.093	13.737	10.039	10.041	10.043

Treasury Management

Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account.

Due to decisions taken in the past, the Council currently has £1.112bn borrowing at an average interest rate of 2.43% and £154.5m treasury investments at an average rate of 2.53%.

Borrowing strategy: The Council's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.75%) and long-term fixed rate loans where the future cost is known but higher (currently 2.0 to 3.0%).

Projected levels of the Council's total outstanding debt (which comprises borrowing, PFI liabilities, leases are shown below, compared with the capital financing requirement (see above).

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

	31.3.2019 forecast	31.3.2020 forecast	31.3.2021 forecast	31.3.2022 forecast
Debt (incl. PFI & leases)	1,074.889	1,353.349	1,656.951	1,900.306
Capital Financing Requirement	1,039.072	1,361.074	1,680.818	1,930.338

Statutory guidance is that debt should remain below the capital financing requirement over the medium to long term but can be over for the short term recognising borrowing requirements ahead of need for future capital expenditure. As can be seen from table 6, the Council complies with this requirement.

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

Table 7: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2018/19 Forecast	2019/20 limit	2020/21 limit	2021/22 limit
Authorised limit – borrowing	1,249.400	1,452.949	1,756.751	2,000.306
Authorised limit – PFI and leases	0.600	0.400	0.200	0.000
Authorised limit – total external debt	1,250.000	1,453.349	1,756.951	2,000.306
Operational boundary – borrowing	1,199.400	1,352.949	1,656.751	1,900.306
Operational boundary – PFI and leases	0.600	0.400	0.200	0.000
Operational boundary – total external debt	1,200.000	1,353.349	1,656.951	1,900.306

- Further details on borrowing are contained in the treasury management strategy as annex 1 on this report.

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

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

- Further details on treasury investments are contained in the treasury management strategy as annex 1 to this report.

Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Finance and staff, who must act in line with the treasury management strategy approved by Full Council.

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

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	100%	0%
12 months and within 24 months	60%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	60%	0%
10 years and within 40 years	60%	0%
Over 40 years	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.

Investments for Service Purposes

The Council can make investments to assist local public services, including making loans to and buying shares in local service providers, local small businesses to promote economic growth, the Council's subsidiaries that provide services. In light of the public service objective, the Council is willing to take more risk than with treasury investments, however it still plans for such investments to break even after all costs.

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

- Further details on service investments are contained in the treasury management strategy in annex 1 2 to this report.

Commercial Activities

With central government financial support to local public services declining, the Council decided to investigate various options to increase income and has subsequently made investments in line with the principles set out in the Council's Investment Strategy.

To this end on 20 November 2018 a Long Term Investment Strategy was taken to the Corporate Overview and Scrutiny Committee outlining the Council's approach to Service/Non-Treasury/Commercial Investments rather than the standard treasury investments. The report outlined the key principles involved, governance arrangements and the considerations required to ensure all investments are thoroughly scrutinised before completion.

Liabilities

In addition to debt detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £178.5m at 31 March 2018). It has also set aside £6.7m to cover risks of business rates appeals and insurance claims.

Governance: Decisions on incurring new discretionary liabilities are taken by service managers in consultation with corporate finance and, where appropriate, the Director of Finance. The risk of liabilities crystallising and requiring payment is monitored by corporate finance.

Revenue Budget Implications

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

Table 9: Prudential Indicator: Proportion of net financing income to net revenue stream

	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget
Financing costs (£m)	5,485	16,713	18,891	20,000
Proportion of net revenue stream	4.78%	14.99%	16.91%	17.54%

Sustainability: Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend into the future. The Director of Finance & IT is satisfied that the proposed capital programme is prudent, affordable and sustainable as set out annually in the s25 statement accompanying the setting of the annual budget.

Knowledge and Skills

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Director of Finance & IT is a qualified accountant with 32 years' experience. The Council pays for junior staff to study towards relevant professional qualifications including CIPFA, ACT (treasury), AAT & ACCA.

Where Council staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. This approach is more cost effective than employing such staff directly, and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

Treasury Management Strategy 2019/20

The Treasury Management Strategy is a critical component of the way Thurrock Council manages cash-flow. It is also intrinsically linked to the council's ambitions of becoming a more commercially focused borough; one where sensible transactions are completed which create revenue returns which can then be allocated to spending on the services for Thurrock residents.

Treasury risk management at the Council is conducted within the framework of CIPFA'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.

In accordance with the above Codes, this report:

- a) sets out the Treasury Management strategy for 2019/20; and
- b) sets out the Treasury Management projections for 2019/20.

2 Introduction and Background

- 2.1 The Treasury Management Strategy and Annual MRP Statement are prepared under the terms of the CIPFA Prudential Code for Capital Finance in Local Authorities (the Code).
- 2.2 The report also includes a forecast for Interest Receivable from Investments and the indicative Interest Payable on Borrowing.

Borrowing Activity 2018/19 and 2019/20

- 2.3 The underlying need to borrow for capital purposes, as measured by the Capital Financing Requirement (CFR), together with the level of balances and reserves, are the core drivers of Treasury Management activity. The estimates, based on the current revenue budget and capital programmes are:

	31/3/2020 Estimate £m	31/3/2021 Estimate £m	31/3/2022 Estimate £m
General Fund Borrowing CFR	249.464	264.208	263.730
Housing Revenue Account Borrowing CFR (includes effects of Housing Finance Reform based on current available figures)	187.473	187.473	187.473
Capital Investments	924.137	1,229.137	1,479.135

Total Borrowing CFR	1,361.074	1,680.818	1,930.338
Less: External Borrowing	1,353.349	1,656.951	1,900.306
Internal/(Over) Borrowing	7.725	23.867	30.032
Less: Useable Reserves	(11.000)	(11.000)	(11.000)
Borrowing Requirement	(3.275)	12.867	19.032

- 2.4 The increases above demonstrate the size of the council's capital programme needs in both recent and future years. Repayments of prudential debt are made through the annual MRP provision and where surplus cash balances are accumulated. However, the amounts needed to finance the capital programme, even just essential operational requirements, are in excess of these repayments and so lead to an annual increase in net debt.
- 2.5 The Council's levels of borrowing and investments are calculated by reference to the balance sheet. The Council's key objectives when borrowing money are to secure low interest costs and achieve cost certainty over the period for which funds are required, all underpinned with sound Return on Investment principles. A further objective is to provide the flexibility to renegotiate loans should the Council's long term plans change.
- 2.6 In light of the ongoing reductions to Local Government funding, the Council's focus of the treasury management strategy remains on the balance between affordability and the longer term stability of the debt portfolio. Given the availability of low short term interest rates it remains cost effective to borrow over short term periods or utilise internal balances. The table above shows that it should not be necessary for the Council to borrow further funds above the current levels and this will be monitored on a regular basis by officers to assess the most appropriate form of borrowing. In the short term, these balances are generating investment returns to support service delivery.
- 2.7 This further enables the Council to reduce borrowing costs and hence the overall treasury management risk. While such a strategy may be beneficial over the next 2 to 3 years as official interest rates remain low, it is unlikely to be sustainable in the medium to long-term. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long term borrowing rates are forecast to rise. This will help inform whether the Council borrows additional sums at long term fixed rates in 2019/20.
- 2.8 In addition, the Council may use short term loans (normally up to one month) to enable management of the Council's cash flow and, where possible, generate a return on investment
- 2.9 In conjunction with advice from its treasury advisors, the Council will keep under review the following sources for long term and short term borrowing:
- Public Works Loan Board (PWLB) loans and its successor body;
 - UK Local Authorities;
 - Any institution approved for investments;

- Any other bank or building society authorised by the Prudential Regulation Authority to operate in the UK;
 - Public and private sector pension funds;
 - Capital market bond investors;
 - UK Municipal Bonds Agency;
 - Special purpose companies created to enable joint local authority bond issues;
 - Local Authority bills; and
 - Structured finance, such as operating/finance leases, hire purchase, Private Finance Initiative or sale and leaseback.
- 2.10 With regards to debt rescheduling, the PWLB allows Councils to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Some lenders may also be prepared to negotiate premature repayment terms. The Council has in 2018/19 reviewed the debt portfolio to identify opportunities expected to lead to an overall saving or reduction in risk. At this time, it is not financially prudent to take any options of early repayment, owing to early redemption fees.
- 2.11 Borrowing and rescheduling activity will be reported to the Cabinet on a regular basis during 2019/20.
- 2.12 In August 2010 the Council repaid its entire PWLB portfolio of loans (£84 million) to obtain significant interest savings. The re-financing was undertaken by utilising short term funds from the money markets, mainly other Local Authorities, at substantially lower rates than taking longer term fixed debt. To the end of 2017/18 the rescheduling had saved £25.9m of interest costs and is estimated to have saved £29.3m by the end of 2018/19. Currently financing from short term money market debt is expected to continue into 2019/20 and beyond. The inherent risk of this strategy is noted with potentially higher rates and increased debt costs in the future.
- 2.13 The Council retains the ability to fix interest rates. This can be achieved within a matter of days of the decision being made or profiled against the maturity schedule of the short term debt. Forecasts from the council's current advisors show the interest rate increasing from 0.75% to 1.25% by September 2019 with the official rate remaining at that level after that date for the foreseeable future. There is both a downside and upside risk to the forecast with the downside risk being larger, but, the overall forecast is for rates follow the course outlined. However, even if the base rate increases to 1.25% this will still be below the level of current long term rates that the Council could borrow at. In addition, as the Council borrows from other public bodies, rates are not fixed to the bank base rate and are generally lower. The normalised level of the bank base rate post this period is expected to be between 2.50% to 3.50%.
- 2.14 Based on this outlook, the council may borrow on a short term basis when deemed beneficial to the taxpayer while monitoring interest rates to ensure borrowing is fixed if required. Prudently, the Medium Term Financial Strategy (MTFS) does assume rate increases over the 5 year period.
- 2.15 The Council has £29 million of loans which are LOBO loans (Lenders Option Borrowers Option) where the lender has the option to propose an increase in

the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. All of these loans, excluding one with Barclays, could now be amended at the request of the lender only and, although the Council understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. In the event the lender exercises the option to change the rate or terms of the loan, the Council will consider the terms being provided and also repayment of the loan without penalty. The Council may utilise cash resources for repayment or may consider replacing the loan by borrowing from the PWLB or capital markets. Barclays have taken out the option to increase the rate of their loan thereby effectively turning the loan into a fixed rate deal. LOBO loans have become less attractive to Banks and there may be opportunities in the future to redeem these loans. Officers will continue to monitor any developments in this area.

- 2.16 On 1 April 2012, the Council notionally split each of its existing long-term loans into General Fund and Housing Revenue Account (HRA) pools. New long-term loans will be assigned in their entirety to one pool or the other. Interest payable and other costs and income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged or credited to the respective revenue account. The Council will credit interest to the HRA based on the average balances of its reserves and revenue account balance at the average 7 day LIBID rate for the year.
- 2.17 The Council continues to undertake a series of new housing related building schemes utilising borrowing. With the abolition of the Housing Debt Cap the Council will investigate whether further schemes can be undertaken.
- 2.18 Finally, there may be significant regeneration programmes to consider investment vehicles for. The need to borrow for investment will be on a case by case basis after considering investment returns, risk and the result of due diligence.

Investments

- 2.19 The Council holds significant invested funds, representing loans received in advance of expenditure plus balances and reserves held. It is envisaged that investment balances held internally will be approximately £15 million at the financial year end. The Council may invest its surplus funds with any of the counterparties detailed in Appendix 1 to this Annex.
- 2.20 The Council holds a £75m investment in the CCLA Property Fund that is estimated to provide a gross return in 2018/19 of 4.25% with income in the region of £3.2m. The Council has also invested in a number of bonds of various durations since 2016/17 that provides finance to the private sector for, as an example, the purchase of solar farms, whilst providing significant net returns to the council to support front line services in a move towards financial sustainability.
- 2.21 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 Authorities use of standalone financial derivatives. The CIPFA code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

- 2.22 The Council will only use standalone derivatives (such as swaps, forward, futures and options) where they can be clearly demonstrated to reduce the Council's overall exposure to financial risks. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds, will not be subject to this policy, although the risks they present will be managed in line with the overall Treasury Management strategy.
- 2.23 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. The Local Authority will only use derivatives after seeking expertise, a legal opinion and ensuring officers have the appropriate training for their use.
- 2.24 The Authority has opted up to professional client status with its providers of financial services, including, banks, brokers and fund managers, allowing it access to a greater range of services, but, without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities the Director of Finance & IT believes this to be the most appropriate status.
- 2.25 The Council complies with the provisions of s32 of the Local Government Finance Act 1992 to set a balanced budget.
- 2.26 The needs of the Council's Treasury Management staff for relevant training are assessed as part of the annual staff appraisal process and additionally where the responsibilities of individual members of staff change. Staff attend courses, seminars and conferences provided by the Council's advisors and CIPFA. Corporate Finance staff are encouraged to study for professional accountancy qualifications from appropriate bodies.
- 2.27 Under the new IFRS standard the accounting for certain investments depends on the 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.

Annual Minimum Revenue Provision Statement

- 2.28 Local Authorities are required to prepare an Annual Statement of their policy on making MRP for each financial year. Appendix 2 to Annex 1 outlines the assessment of the Council's Annual MRP Statement for 2019/20, which is included in the Annual Strategy in paragraph 2.30.
- 2.29 Officers have reviewed the current strategy and recommend no changes to the 2019/20 strategy.

- 2.30 Consequently the following paragraphs on Borrowing Activity and Investments form part of the Council's Treasury Management Strategy with effect from 1 April 2019:
- 2.30.1 To obtain any long term borrowing requirement from the sources of finance set out in paragraph 2.9;
 - 2.30.2 To continue to fund the ex-PWLB debt via short term funds from the money markets unless circumstances dictate moving back into long term fixed rate debt. The borrowing sources mentioned in paragraph 2.9 will then be assessed as to their suitability for use;
 - 2.30.3 To repay market loans requiring renewal by realising equivalent amounts of investments. If it is not possible to realise investments then the borrowing sources in paragraph 2.9 will be assessed as to their suitability for use as replacements;
 - 2.30.4 To undertake short term temporary borrowing when necessary in order to manage cash flow to the Council's advantage;
 - 2.30.5 To reschedule market and PWLB loans, where practicable, to achieve interest rate reductions, balance the volatility profile or amend the debt profile, dependent on the level of premiums payable or discounts receivable;
 - 2.30.6 To ensure security and liquidity of the Council's investments and to then optimise investment returns commensurate to those ideals;
 - 2.30.7 To contain the type, size and duration of investments with individual institutions within the limits specified in Appendix 1 to this Annex.;
 - 2.30.8 To move further funds into the CCLA Property Fund or other externally managed funds if it is felt prudent to do so following appropriate due diligence; and in consultation with the Cabinet Member for Finance and Legal;
 - 2.30.9 To meet the requirements of the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 the Council's policy for the calculation of MRP in 2019/20 shall be that the Council will set aside an amount each year which it deems to be prudent and appropriate, having regard to statutory requirements and relevant guidance issued by DCLG. The Council will also consider the use of capital receipts to pay down any MRP incurred; and
 - 2.30.10 To ensure all borrowing and investment activities are made with due reference to any relevant Prudential Indicators.

Interest Projections 2018/19 Revised and 2019/20 Original

- 2.31 The CIPFA document Treasury Management in the Public Services: Code of Practice places a requirement on the Council to publish estimates relating to the operation of the borrowing and investment function.

2.32 The 2018/19 budget and the projected position for 2018/19 as at December 2018 and also an initial projection for 2019/20 are shown in summary format in the table below:

	Budget 2018/19	Projected 2018/19	Projection 2019/20
	£'000's	£'000's	£'000's
Interest payable on External Debt			
Debt Interest	9,301	9,303	15,213
Total internal interest	<u>96</u>	<u>96</u>	<u>51</u>
Interest payable	<u>9,397</u>	<u>9,399</u>	<u>15,264</u>
Investment Income			
Interest on Investments	<u>(22,167)</u>	<u>(23,054)</u>	<u>(38,699)</u>
Net interest credited to the General Fund	<u>(12,770)</u>	<u>(13,655)</u>	<u>(23,435)</u>
MRP- Supported/Unsupported Borrowing	<u>7,285</u>	<u>7,285</u>	<u>6,773</u>

2.33 It is noted that the figures shown above for 2019/20 include assumptions made about the level of balances available for investment, any anticipated new long term borrowing and the level of interest rates achievable. They may be liable to a significant degree of change during the year arising from variations in interest rates, other market and economic developments, and Council's response to those events.

2.34 In accordance with the requirements of the revised CIPFA Treasury Management Code, the Council will report on treasury management activity and the outturn against the treasury related Prudential Indicators at least bi-annually.

Approved Investment Counterparties:

Credit Rating	Banks/Building Societies Unsecured		Bank/Building Societies Secured		Government		Corporates		Registered Providers	
	Amount	Period	Amount	Period	Amount	Period	Amount	Period	Amount	Period
UK Govt	N/A	N/A	N/A	N/A	£unlimited	50 years	N/A	N/A	N/A	N/A
AAA	£10m	5 years	£20m	20 years	£20m	50 years	£10m	20 years	£10m	20 years
AA+	£10m	5 years	£20m	10 years	£20m	25 years	£10m	10 years	£10m	10 years
AA	£10m	4 years	£20m	5 years	£20m	15 years	£10m	5 years	£10m	10 years
AA-	£10m	3 years	£20m	4 years	£20m	10 years	£10m	4 years	£10m	10 years
A+	£10m	2 years	£20m	3 years	£10m	5 years	£10m	3 years	£10m	5 years
A	£10m	1 year	£20m	2 years	£10m	5 years	£10m	2 years	£10m	5 years
A-	£7.5m	13 months	£15m	13 months	£10m	5 years	£10m	13 months	£10m	5 years
BBB+	£5m	6 months	£10m	6 months	£5m	2 years	£5m	6 months	£5m	2 years
BBB	£5m	100 days	£10m	100 days	N/A	N/A	N/A	N/A	N/A	N/A
BBB-	£5m	100 days	£10m	100 days	N/A	N/A	N/A	N/A	N/A	N/A
None	£5m	6 months	N/A	N/A	£5m	25 years	N/A	N/A	N/A	N/A

Pooled Funds ,External Fund Managers and any other investment vehicle approved by the Section 151 Officer – Decisions are based on each individual case following appropriate due diligence work being undertaken.

The above limits are the maximum that the Council would expect to have in place at any time. However, in practice the actual duration limits in place are continually assessed and are often much shorter than the limits in the above table.

Credit ratings: Investment decisions are made by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.

Banks and Building Societies Unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds. 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 and Building Societies Secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements. These investments are secured on the bank's assets, which limits the potential loss 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 multi development banks. These investments are not subject to bail-in and there is an insignificant risk of insolvency. 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.

Other Organisations – The Council may also invest cash with other organisations, for example making loans to small businesses as part of a diversified pool in order to spread the risk widely. Because of the higher perceived risk of unrated businesses such investments may provide considerably higher rates of return. The Council will also undertake appropriate due diligence to assist in all investment decisions.

Registered providers: Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Community Agency and as providers of public services they retain a high likelihood of receiving Government support if needed.

Pooled Funds: Shares in diversified investment vehicles consisting of any of the above investment types plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks coupled with the services of a professional fund manager in return for a fee. Money market funds that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to instant access bank accounts while pooled funds whose value changes

with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but, are more volatile in the short term. These allow authorities to diversify into asset classes other than cash without the need to own and manage the underlying investments. These funds have no defined maturity date but are available for withdrawal after a notice period. As a result their performance and continued suitability in meeting the authority's investment objectives will be monitored regularly and decisions made on entering such funds will be made on an individual basis.

Risk assessment and credit ratings: Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- No new investments will be made
- Any existing investment 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 investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade 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.

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 and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but, can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the authorities cash balances then the surplus will be deposited with the UK Government via the Debt Management Office or invested in treasury bills for example or with other local authorities. This will cause a reduction in the level of investment income earned, but, will protect the principal sum.

Specified Investments

Specified investments will be those that meet the criteria in the CLG Guidance, i.e. the investment:

- is sterling denominated;
- has a maximum maturity of one year;
- meets the “high credit quality” as determined by the Council or is made with the UK government or is made with a local authority in England, Wales, Scotland or Northern Ireland or a parish or community council; and
- The making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

The Council defines ‘high credit quality’ organisations and securities as those having a credit rating of BBB- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds ‘high credit quality’ is defined as those having a credit rating of A- or higher

Non-specified Investments

Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares

Non-Specified Investment Limits

	Cash Limit
Total Long Term Treasury Investments	£450m
Total Investments without credit ratings or rated below A- with appropriate due diligence having been performed	£70m
Total Investments in foreign countries rated below AA+	£30m
Maximum total non-specified investments	£550m

Investment Limits

The maximum that will be lent to any one organisation in the Approved Investment Counter Party list (except the UK Government) is £20m. For other investments approved by the Section 151 Officer the amount to be invested will be determined by the Section 151 Officer, taking into account the relevant merits of the transaction such as, for example, duration and risk following due diligence work undertaken. A group of banks under the same ownership, a group of funds under the same management, brokers nominee accounts, foreign countries and industry sectors will all have limits placed on them as in the table below:

	Cash Limit
Any single organisation, except the UK Central Government	£20m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£40m
Any group of pooled funds under the same management	£50m
Any external Fund Manager	£750m
Negotiable instruments held in a brokers nominee account	£20m
Foreign countries (total per country)	£30m
Registered Providers in total	£30m
Building Societies in total (excluding overnight investments)	£40m
Loans to small businesses	£20m
Money Market Funds	£40m
Investments approved by the Section 151 Officer	Reviewed for each case

Liquidity Management

The Council maintains a cash flow spreadsheet that forecasts the Council's cash flows into the future. This is used to determine the maximum period for which funds may be prudently committed. The forecast is compiled on a pessimistic basis, with receipts under estimated and payments over estimated to minimise the risk of the Council having to borrow on unfavourable terms to meet its financial commitments.

THE MINIMUM REVENUE PROVISION STATEMENT

Introduction:

The rules for Minimum Revenue Provision (MRP) were set out in the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003. These rules have now been revised by the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008.

Authorities are required to submit to a meeting of their Council an annual statement of their policy on making MRP.

Background:

Each year the Council borrows money in order to finance some of its capital expenditure. The loans taken out for this purpose, unlike a mortgage which is repaid in part each month, are fully repayable at a future point in time. The repayment date is chosen to secure the best financial result for the Council.

The concept of Minimum Revenue Provision was introduced in 1989 to prescribe a minimum amount which must be charged to the revenue account each year in order to make provision to meet the cost of repaying that borrowing.

The detailed rules and formulae to be used in the more recent method of calculation were laid down in the Regulations mentioned in the introduction section.

This system has now been radically revised and requires an annual statement to full Council setting out the method the Council intends to adopt for the calculation of MRP.

Considerations:

Under the old regulations Local Authorities were required to set aside each year, from their revenue account an amount that, in simple terms equalled approximately 4% of the amount of capital expenditure financed by borrowing. Local Authorities had no freedom to exercise any discretion over this requirement.

The amendment regulations introduce a simple duty for an authority each year to set aside an amount of MRP which it considers to be 'prudent'. The regulation does not define a 'prudent provision' but the MRP guidance makes recommendations to authorities on the interpretation of that term.

The MRP guidance document is a statutory document and authorities are obliged by section 21 of the Local Government Act 2003 to have regard to such guidance. The guidance aims to provide more flexibility and in particular for development schemes it is possible to have an MRP "holiday" for assets or infrastructure under construction.

In addition, it is accepted that where there is capital expenditure that will give rise to a capital receipts, either through the disposal of the asset or loan repayments, then

there is no need to set aside MRP on an annual basis but the capital receipt or loan repayments should be set aside on receipt for that purpose.

The operative date of the change was 31 March 2008, which means the new rules have applied since the financial year 2007/08.

The Annual MRP Statement

As stated above, Local Authorities are required to prepare an annual statement of their policy on making MRP for submission to their full Council. This mirrors the existing requirements to report to the Council on the Prudential borrowing limits and Treasury Management strategy. The aim is to give elected Members the opportunity to scrutinise the proposed use of the additional freedoms conferred under the new arrangements. The statement must be made before the start of each financial year.

The statement should indicate how it is proposed to discharge the duty to make prudent MRP in the financial year in question for the borrowing that is to take place in that financial year. If it is ever proposed to vary the terms of the original statement during any year, a revised statement should be put to Council at that time.

The guidance includes specific examples of options for making a prudent provision. The aim of this is to ensure that the provision to repay the borrowing is made over a period that bears some relation to the useful life of the assets in question or where a capital receipt will be received to repay the debt in part or in full.

Proposals

The Minimum Revenue Provision Policy Statement for 2019/20:

- In accordance with the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 the Council's policy for the calculation of MRP in 2019/20 shall be that the Council will set aside an amount each year which it deems to be prudent and appropriate, having regard to statutory requirements and relevant guidance issued by DCLG; and
- The Council will also consider the use of capital receipts to pay down any MRP incurred.

The policy will be reviewed on an annual basis.

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Amendment to Capital Strategy
(Pages 65 and 66 of Council Agenda)

There are 2 changes to note in Tables 1 and 2 of the Capital Strategy. Both relate to the column setting out the 2019/20 figures.

Table 1 on Page 65 is now replaced by the version set out below ensuring the 2019/20 column is summed correctly:

Table 1: Prudential Indicator: Estimates of Capital Expenditure in £m

	2017/18 actual	2018/19 forecast	2019/20 forecast	2020/21 forecast	2021/22 forecast
General Fund services	39.630	80.189	119.003	38.959	24.524
Council housing (HRA)	13.125	19.667	33.950	10.000	10.000
Capital investments	339.503	308.997	275.637	305.000	250.000
TOTAL	392.258	408.853	428.590	353.959	284.524

Table 2 on Page 66 is now replaced by the version set out below ensuring the 2019/20 column has been amended and summed correctly:

Table 2: Capital financing in £m

	2017/18 actual	2018/19 forecast	2019/20 forecast	2020/21 forecast	2021/22 forecast
External sources	26.794	46.374	66.575	16.257	16.309
Own resources	13.690	14.362	22.310	10.000	10.000
Debt	351.774	348.117	339.705	327.702	258.215
TOTAL	392.258	408.853	428.590	353.959	284.524

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