Body:	**Cabinet**
Date:	**11 February 2019**
Subject:	**Treasury Management and Prudential Indicators 2019/20, Capital Strategy & Investment Strategy**
Report of:	**Homira Javadi, Chief Finance Officer**
Cabinet member:	**Councillor Bill Giles, Cabinet Member for Finance**
Ward(s):	**All**
Purpose of the report:	**To approve the Council's Annual Treasury Management Strategy together with the Treasury and Prudential Indicators for the next financial year.**
Decision type:	**Key Decision**
Recommendation:	**Cabinet is asked to recommend the following proposals to full Council :** **i) The Treasury Management Strategy and Annual Investment Strategy as set out in this report and Appendix 5.** **ii) The methodology for calculating the Minimum Revenue Provision set out at paragraph 2.3 and Appendix 2** **iii) The Prudential and Treasury Indicators as set out in this report.** **iv) Investment categories, limits & Creditworthiness Policy listed in Appendix 6** **v) Approve the Capital Strategy set out in Appendix 1.** **Cabinet is recommended to note the extended role of the Chief Financial Officer as set out in Appendix 7.**
Reasons for recommendations:	**It is a requirement of the budget setting process for the Council to review and approve the Prudential and Treasury indicators, Treasury Strategy and Capital Strategy.**
Contact:	**Homira Javadi, Chief Finance Officer.** **Email :Homira.Javadi@Lewes-Eastbourne.gov.uk**

1 Introduction

1.1 The Prudential and Treasury Indicators and Treasury Strategy covers:

- the capital prudential indicators;
- a Minimum Revenue Provision Policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed);
- Capital Strategy.

1.2 The Council has adopted CIPFA's Treasury Management Code of Practice for Treasury Management in Public Services. This requires local authorities to determine the Treasury Mangement Strategy Statement (TMSS) before the start of the financial year.

1.3 CIPFA defines treasury management as:

"The management of the local authority'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."

1.4 Revised reporting is required for the 2019/20 reporting cycle due to revisions of the Ministry of Housing, Communities and Local Government (MHCLG) Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is attached at Appendix 1.

1.5 The Capital Strategy provides the following:

- a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- an overview of how the associated risk is managed;
- the implications for future financial sustainability.

The aim of this capital strategy is to ensure that all elected members fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

2 THE CAPITAL PRUDENTIAL INDICATORS 2017/18 – 2021/22

2.1 Capital Expenditure

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators, which are designed to assist Member overview and confirm capital expenditure plans.

The table below summarises the Council's capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

The capital expenditure forecasts for the Council are:

Capital Expenditure £m	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Non-HRA	4.0	14.8	2.9	2.0	1.8
HRA	4.8	9.3	5.0	5.0	5.0
Commercial Activities/Non-financial investments	0.8	47.5	4.0	4.0	4.0
Total	9.6	71.6	11.9	11.0	10.8
Financed by:					
Capital receipts	0.4	1.7	0.1	0.1	0.1
Capital grants	0.9	1.7	1.0	1.0	1.0
Capital reserves	6.4	10.4	6.5	5.6	5.4
Revenue	1.0	1.6	0.1	0.1	0.1
Net borrowing needed for the year	0.9	56.2	4.2	4.2	4.2

The above figures include uncommitted borrowing i.e. borrowing which has been approved but schemes have not yet been identified and will only proceed if they are financially advantageous.

The net financing need for commercial activities / non-financial investments included in the above table against expenditure is shown below:

Commercial activities /non-financial investments £m	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Capital Expenditure	0.8	47.5	4.0	4.0	4.0
Financing Costs	0.2	1.2	0.1	0.1	0.1
Net Financing Need for the Year	1.0	48.7	4.1	4.1	4.1
Percentage of total net financing need %	10.4%	68.1%	35.0%	37.6%	37.6%

2.2 **The Council's Borrowing Need (the Capital Financing Requirement)**

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR includes other long term liabilities brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme already include a borrowing facility and the Council is not required to separately borrow for them.

The Council is asked to approve the CFR projections below:

£m	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Capital Financing Requirement					
CFR – non housing	7.135	38.078	37.786	37.500	37.167
CFR - housing	65.126	67.519	67.719	67.919	68.119
Commercial Activities/non-financial investments	4.949	27.482	31.482	35.482	39.532
Total CFR	77.210	133.079	136.987	140.901	144.818
Movement in CFR	0.168	55.869	3.908	3.914	3.917
Movement in CFR represented by					
Net financing needed for the year (above)	1.287	56.185	4.200	4.200	4.200
Less MRP/VRP and other financing movements	(0.119)	(0.316)	(0.292)	(0.286)	(0.283)
Movement in CFR	0.168	55.869	3.908	3.914	3.917

2.3 **MRP Policy Statement**

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).
Regulations require the Council to approve an MRP Statement in advance of each financial year. A variety of options are provided to councils, so long as there is a prudent provision. It is recommended that the following methodology is approved:

- For capital expenditure incurred before 1.4.2008 MRP is provided for at 4% of the CFR.
- For capital expenditure incurred since 1.4.2008 MRP be charged using the most appropriate of the following methods for the individual schemes as determined by the Chief Finance Officer under delegate powers
  - Asset Life method – based on the estimated life of the asset,
  - Depreciation method – based on standard depreciation accounting procedures.
  - Annuity method – based on a straight line (EIP – Equal Instalment Payment) approach.

No revenue charge is currently required for the HRA. However if the HRA is required to charge depreciation on its assets, this would have a revenue effect. In order to address any possible adverse impact, regulations allow the Major Repairs Allowance to be used as a proxy for depreciation.

Repayments included in any finance leases are applied as MRP.

A comprehensive view of the Council's MRP Policy can be found at Appendix 2.

2.4 **Affordability Prudential Indicators**

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. Indicators are required to be prepared on the gross capital spend and do not include any resulting income contributions expected from the implementation of the capital scheme. The Council is asked to approve the following indicators:

2.5 **Actual and estimates of the ratio of financing costs to net revenue stream.**

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2017/18 Actual %	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %	2021/22 Estimate %
Non-HRA	1.62	1.47	1.68	1.65	1.65
HRA	15.82	15.82	18.08	18.08	18.08

The estimates of financing costs exclude uncommitted borrowing.

3 TREASURY MANAGEMENT STRATEGY

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 **Current Portfolio Position**

The Council's treasury portfolio position at 31 March 2018, with forward projections, are summarised below. The table shows the actual external borrowing (the treasury management operations), against the capital borrowing need (the Capital Financing Requirement - CFR), highlighting any under borrowing.

£m	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
External Borrowing					
Borrowing at 1 April	56.7	56.7	111.3	117.3	121.6
Expected change in borrowing	0.9	56.3	4.3	4.3	4.2
Other long-term liabilities (OLTL)	0.4	0.4	0.4	0.4	0.4
Expected change in OLTL	**0.0**	**0.0**	**0.0**	**0.0**	**0.00**
Actual gross borrowing at 31 March	56.7	111.3	117.3	121.6	125.8
CFR – the borrowing need	77.2	133.1	137.0	140.9	144.6
Under borrowing	20.5	21.8	19.7	19.3	18.8

Within the above figures the level of debt relating to commercial actrivities/non-financial investments is:

	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Actual Debt at 31 March £m	0.8	47.3	52.3	56.3	60.3
Percentage of total external debt %	1.4%	43.4%	44.6%	46.3%	46.3%

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross borrowing does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

Whilst investment interest rates continue to be below that for borrowing, value for money can be best achieved by avoiding new borrowing and using internal cash balances to temporarily finance new capital expenditure or to replace maturing external debt, thus maximising short term savings. However this needs to be carefully considered to ensure borrowing is taken at advantageous rates, but not taken too long before the need to borrow to avoid the cost of carrying the debt.

3.2 Treasury Indicators: Limits to Borrowing Activity

3.2.1 **The Operational Boundary.** This is the limit beyond which external borrowing is not normally expected to exceed.

The Council is asked to approve the following operational boundary limits:

Operational boundary £m	**2017/18 Actual**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**
Borrowing	55.9	63.0	65.0	65.3
Other long term liabilities	0.4	0.4	0.4	0.4
Commercial activities/non-financial investments	0.8	48.3	52.3	56.3
Total	57.1	111.7	117.7	122.0

3.2.2 The Council is asked to approve the following authorised limit**:**

Authorised limit £m	**2017/18 Actual**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**
Borrowing	55.9	68.0	70.0	70.3
Other long term liabilities	0.4	0.4	0.4	0.4
Commercial activities/non-financial investments	0.8	53.3	57.3	61.3
Total	57.1	121.7	127.7	132.0

Separately, the Council was also limited to a maximum HRA CFR through the

HRA self-financing regime of £75.248m which is included in the authorised limits above.

In October 2018, Prime Minister Theresa May announced a policy change for the abolition of the HRA debt cap. Members will be updated when information becomes available as to the detail of when and how this policy change will be implemented.

3.2.3 The Council has complied with these prudential indicators in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.3 **Prospects for Interest Rates**

The Council has appointed Arlingclose as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates

Following the increase in Bank Rate to 0.75% in August 2018, the Authority's treasury management adviser Arlingclose is forecasting two more 0.25% hikes during 2019 to take official UK interest rates to 1.25%. The Bank of England's Monetary Policy Committee (MPC) has maintained expectations for slow and steady rate rises over the forecast horizon. The MPC continues to have a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose believes that MPC members consider both that ultra-low interest rates result in other economic problems, and that higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise when rate cuts will be required.

The UK economic environment remains relatively soft, despite seemingly strong labour market data. Their view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. While assumptions are that a Brexit deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" Brexit still hangs over economic activity. As such, the risks to the interest rate forecast are considered firmly to the downside.

Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected based on the Arlingclose interest rate projections, due to the strength of the US economy and the ECB's forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.7% and 2.2% respectively over the interest rate forecast horizon, however volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix 4.

3.4 **Borrowing Strategy**

The Authority currently holds £56.65 million of loans, as per the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecasts in table 1 shows that the Authority [expects to borrow up to £117.7m in 2019/20. The Authority may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £127.7 million.

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

Strategy: Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2019/20 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

Alternatively, the Authority may arrange forward starting loans during 2019/20, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the Authority may borrow short-term loans to cover.

3.5 **Treasury Management Limits on Activity**

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates.

The Council is asked to approve the following treasury indicators and limits:

	2019/20	2020/21	2021/22
Interest rate Exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	25%	25%	25%
Maturity Structure of fixed interest rate borrowing 2019/20			
		Lower	**Upper**
Under 12 months		0%	75%
12 months to 2 years		0%	75%
2 years to 5 years		0%	75%
5 years to 10 years		0%	100%
10 years and above		0%	100%

3.6 **Policy on Borrowing in Advance of Need**

The Council will not borrow more than, or in advance of, its needs, purely in order to profit from the investment of the extra sums borrowed. 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 and that the Council can ensure the security of such funds.

Risks associated with any borrowing in advance of activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.7 **Debt Rescheduling**

As short term borrowing rates are currently considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt.

Debt scheduling will only be considered under the following circumstances:

- the generation of cash savings and /or discounted cash flow to produce sufficent savings to cover the costs;
- it helps to fulfil the treasury strategy; and
- the balance of the portfolio (amend the maturity profile and/or the balance of volatility) is maintained.

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.
All rescheduling will be reported to Cabinet, at the earliest meeting following its action.

3.8 **Municipal Bond Agency**

It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. The Agency hopes that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority may make use of this new source of borrowing as and when appropriate.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment Policy

The MHCLG and CIPFA have extended t e hNon meaning of 'investments' to include both financial and non-financial investments. -financial investments are essentially the purchase of income yielding assets, are covered in the Investment Strategy see Appendix 5.

The Council's investment policy has regard to the following: -

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018

The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return).

After this main principle the Council will ensure:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in Appendix 6 and,

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

4.2 Creditworthiness Policy

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.

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,

- any existing investments that can be recalled or sold at no cost will be, and,
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a 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.

Other information on the security of investments: The Authority 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 Authority’s treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

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 Authority 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 Authority’s cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

4.3 The Chief Finance Officer will maintain a counterparty list in compliance with the criteria set out in Appendix 7 and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either Specified or Non-Specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

4.4 **Time and monetary limits applying to investments.**

The proposed criteria for time and monetary limits for institutions on the Council’s counterparty list are detailed in Appendix 6.

4.5 **Property Funds**

The use of these instruments can be deemed capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using. Appropriate due diligence will also be undertaken before investment of this type is undertaken.

4.6 **Non treasury management investments**

This Council invests in non treasury management (policy) investments. These do not form part of the treasury management strategy. However, Members are advised that £20,000,000 in total has been earmarked for the Lewes Housing Investment Company & Aspiration Homes for 2018/19.

4.7 **Investment Strategy**

The Authority held £26.6m in invested funds at 31st December 2018, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £8 and £31 million, and similar levels are expected to be maintained in the forthcoming year.

Objectives: The CIPFA Code requires the Authority 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 Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

4.8 **Investment treasury indicator and limit** - Total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The Council is asked to approve the treasury indicator and limit:

Upper limit for principal sums invested for longer than 365 days			
£m	**2018/19**	**2019/20**	**2020/21**
Principal sums invested for longer than 365 days	£2.0m	£2.0m	£2.0m

For its cash flow generated balances, the Council will seek to utilise its current account, call accounts and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

4.9 **End of year investment report**

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

4.10 **Policy on the use of external service providers**

The Council uses Arlingclose as its external treasury management advisors.
The Council recognises that responsibility for treasury management decisions remains with the organisation at all times.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

5 Outcome expected and performance management

5.1 Loans, Investments and Prudential Indicators will be monitored regularly during 2019/20 and performance will be reported to members quarterly.

6 Financial appraisal

6.1 These are included in the main body of the report.

7 Legal implications

7.1 This report covers the requirements of the Local Government Act 2003, the CIFPA Prudential Code, the MHCLG MRP Guidance, the CIPFA Treasury Management Code and the MHCLG Investment Guidance.

8 Equality analysis

8.1 The equality implications of decisions relating to Treasury Management covered in this report are addressed within other relevant Council reports or as part of programmed equality analysis.

9 Conclusion

9.1 Capital prudential indicators have to be set to demonstrate plans for borrowing are affordable. The movement in the Capital Financing Requirement (CFR) forecasts for 2019/20 & 2020/21 have been set as £137m and £149m. This borrowing has been reflected in the Capital Financing Requirement, which sets out the Council's outlining requirement for borrowing, and includes both the use of internal resources and external borrowing.

9.2 The proposed Minimum Revenue Provision Policy is updated in accordance with Appendix 2 and ensures that prudent provision is made for the repayment of borrowing.

9.3 All Treasury indicators have been set to reflect the treasury strategy and funding requirements of the capital programme.

9.3 The Council's treasury management advisors are predicting a gradual rise in interest rates of 0.25% going forward to reach 1.25% by December 2021. Investment returns are therefore likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.

9.4 The investment strategy has been set to maintain the Councils main priorities in the order of Security, Liquidity and Yield.

9.5 The proposed criteria for Investments is shown in Appendix 6 for approval and remains unchanged from 2018/19.

9.6 CIPFA issued a revised Treasury Management Code of Practice in December 2017 which expanded the role of the Chief Finance Officer's responsibility for treasury management activities, as set out in Appendix 7. These revisions have particularly focused on non-treasury investments and introduce the requirement to produce a detailed Capital Strategy, which will be prepared in 2018/19 in partnership with other services.

10 Appendices

- 1 - Capital Strategy
- 2 - Minimum Revenue Provision (MRP) Policy Statement
- 3 – Economic Background
- 4 – Economic Forecast
- 5 – Investment Strategy
- 6 – Investment categories, limits & Creditworthiness Policy
- 7 – The Treasury Management Role of the Section 151 Officer

11 Background papers

11.1 The background papers used in compiling this report were as follows:

- CIPFA Treasury Management in the Public Services code of Practice (the Code)
- Cross-sectorial Guidance Notes
- CIPFA Prudential Code
- Council Budget 11 February 2019
- Finance Matters and Performance Monitoring Reports 2018.

To inspect or obtain copies of background papers please refer to the contact officer listed above.

APPENDIX 1 Capital Strategy

1. Introduction

1.1 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 in Lewes District Council (LDC), along with an overview of how associated risk is managed and the implications for future financial sustainability. It has purposely been written in an accessible style to enhance understanding of what can be very technical areas.

2. Capital Expenditure and Financing

2.1. Expenditure

2.1.2. Capital expenditure occurs when the Council spends money on assets such as property or vehicles, which will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. The Council has some limited discretion on what counts as capital expenditure, for example assets costing below a de minimis level are not capitalised and are charged to revenue in year.

2.1.3. Further details on the Council's capitalisation policy can be found in the 2018/19 Statement of Accounts.

2.1.4. In 2019/20, LDC is planning capital expenditure of £11.9 million (and £21.8 million over the next two years) as summarised in Table 1 below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure

	2017/18 actual £m	**2018/19 forecast £m**	**2019/20 budget £m**	**2020/21 budget £m**	**2021/22 budget £m**
General Fund Services	4.0	14.8	2.9	2.0	1.8
Council Housing (HRA)	4.8	9.3	5.0	5.0	5.0
Commercial Activities/ non-financial investments	0.8	47.5	4.0	4.0	4.0
TOTAL	**9.6**	**71.6**	**11.9**	**11.0**	**10.8**

2.1.5. The main General Fund capital projects scheduled for 2019/20 are as follows:

Commercial Property Acquisition	£4.0m
Waste Vehicle Replacement	£1.0m

2.1.6. The Housing Revenue Account (HRA) is a ring-fenced account which ensures that the Council's housing does not subsidise, or is itself subsidised, by other local services. HRA capital expenditure is therefore recorded separately.

2.2. Governance

2.2.2. The evaluation, prioritisation and acceptance of capital schemes onto the Capital Programme is carried out in accordance with strict criteria that ensures that added schemes reflect Council priorities and can be delivered within available resources (e.g. due priority is given to schemes yielding savings and/or generating income as well as meeting a Council priority).

2.2.3. The draft Capital Programme is then subject to formal Scrutiny prior to setting the budget (followed by Cabinet and full Council approval).

2.3. Financing

2.3.1 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 and leasing). The planned financing of the above expenditure is presented in Table 2 below.

Table 2: Capital Financing

	2017/18 actual £m	**2018/19 forecast £m**	**2019/20 budget £m**	**2020/21 budget £m**	**2021/22 budget £m**
External sources	2.3	5.0	1.2	1.2	1.2
Own resources	6.4	10.4	6.5	5.6	5.4
Debt	0.9	56.2	4.2	4.2	4.2
TOTAL	**9.6**	**71.6**	**11.9**	**11.0**	**10.8**

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

2.3.3 The Council's annual MRP statement can be found at Appendix 2..

2.3.4 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 £3.9 million in 2019/20. Based on the above figures for expenditure and financing, the Council's estimated CFR is presented in Table 4 below.

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement (CFR)

	2017/18 actual £m	**2018/19 forecast £m**	**2019/20 budget £m**	**2020/21 budget £m**	**2021/22 budget £m**
General Fund services	7.1	38.1	37.8	37.5	37.1
Council housing (HRA)	65.1	67.5	67.7	68.0	68.1
Capital investments	5.0	27.5	31.4	35.4	39.6
TOTAL CFR	**77.2**	**133.1**	**136.9**	**140.9**	**144.8**

3. Asset Management

3.1 Asset Management Strategy

3.1.1 The Council recognises the importance of ensuring that capital assets continue to be of long-term use especially in a rapidly changing operational and technological backdrop. Consequently, at the time of preparing this Capital Strategy, a new Asset Management Strategy (AMS) is under development. Led by the Asset Management team and backed by a comprehensive review of Council assets, the AMS will take a longer-term view comprising:

- 'Good' information about existing assets;
- The optimal asset base for the efficient delivery of Council objectives;
- The gap between existing assets and optimal assets;
- Strategies for purchasing and constructing new assets, investment in existing assets, transferring of assets to other organisations and the disposal of surplus assets; and
- Plans for individual assets.

3.2 Asset Disposals

3.2.1 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 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 takes a prudent approach of assuming future capital receipts only when there is a high probability of realisation.

4. Treasury Management

4.1 Introduction

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

4.1.2 As at 31 December the Council had borrowing of £56.7 million at an average interest rate of 3.1% and investments of £26.60 million held in Money Market Funds and Deposit Accounts returning approximately 0.75%.

4.2 Borrowing

4.2.1 The Council's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in the 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%).

4.2.2 Projected levels of the Council's total outstanding debt (which comprises borrowing and leases) are shown below in Table 6, compared with the Capital Financing Requirement (Table 4 above).

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

	2017/18 actual £m	**2018/19 forecast £m**	**2019/20 budget £m**	**2020/21 budget**	**2021/22 budget £m**
Debt (incl. leases)	56.7	111.3	117.3	121.6	125.9
Capital Financing Requirement	77.2	133.10	137.0	140.9	144.6

4.2.3 Statutory guidance is that debt should remain below the Capital Financing Requirement, except in the short-term. As can be seen from Table 6, the Council expects to comply with this in the medium term.

Affordable Borrowing Limit

4.2.4 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

	2018/19 limit	**2019/20 limit**	**2020/21 limit**	**2021/22 limit**
	£m	**£m**	**£m**	**£m**
Authorised limit – total external debt	111.7	117.7	122.0	122.0
Operational boundary – total external debt	121.7	127.7	132.0	132.0

4.2.5 Further details on borrowing are contained in the Treasury Management Strategy.

4.3 Investments

4.3.1 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.

(Treasury Management) Investment Strategy

4.3.2 The Council's Investment Strategy is to prioritise security and liquidity over yield; focussing on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely in selected high-quality banks, to minimise the risk of loss.

4.4 Governance

4.4.1 Treasury management decisions are made on a daily basis and are therefore delegated to the CFO, who must act in line with the Treasury Management Strategy approved by the Council. Annual outturn reports on treasury management are also approved by the Council (following recommendation from Audit and Governance Committee), whereas mid-year updates are reported exclusively to the Audit and Governance Committee. Quarterly performance reports are also submitted to Cabinet.

5. Investments for Service Purposes

5.1 The Council will sometimes make investments for service delivery purposes where there is a strategic case for doing so.

Governance

5.2 Decisions on service investments are made by the Council's Cabinet and require the support of a full business case.

6. Commercial Investments

6.1 Current Investments

6.1.1 In recent years, the Council has invested in commercial property in the District on a selective basis, usually where there is a fit with corporate priorities and a positive financial return that can be used to contribute towards the protection of local services. As at 31st March 2018, the commercial property portfolio had an estimated Fair Value of £9.48million. Estimated gross income for 2018/19 is £0.67m.

6.2 Commercial Investment Strategy

6.2.1 However, in recognition of the continued shortfall in local government funding and commitments made in the, the Council will be preparing a Commercial Investment Strategy in the next financial year with a view to achieving a step change increase in commercial investment and trading by the Council.

6.2.2 CIPFA's guidance on borrowing to invest follows MHCLG's concern at what they perceive to be, the increasing risk taken on by local authorities following a sharp increase in Public Works Loan Board (PWLB) borrowing by councils to invest in commercial property. CIPFA has made it clear that Councils should not borrow to invest commercially and their Capital Investment Strategy must make it clear as to where they depart from this principle and why. However, it has been recognised that local investments that are primarily designed for regeneration or service delivery purposes and which have a knock-on positive impact to the revenue budgets are not intended to covered by this principle.

6.2.3 Councils have to demonstrate that such investments are "proportionate" to their resources. The Council's approach will incorporate the CIPFA guidance when it is published; this will enhance the other risk management features that are being developed; this includes a strict governance framework, the use of real estate investment experts and diversified portfolios. The aim is to offset principle risks such as falling capital values and 'voids'. However, (within a tightly controlled framework) the Council ultimately accepts a higher risk on commercial investments compared to its prudent treasury investment that have primarily focused to date on protecting the principal

2.3.2. The Council considers investing in housing properties and commercial investments within the District to be related to its temporary accommodation strategy and local regeneration. It will invest commercially but in relation to the services it provides or to build and strengthen the local economy, with the related benefit of increased business rates..

6.3 Governance

6.3.1 At the time of preparing this Strategy, the Governance arrangements are being developed as part of the Commercial Investment Strategy.

7. Other Liabilities

7.1 Outstanding Commitments

7.1.1 The Council also has the following outstanding commitments:

- The Council has also set aside £1.2 million (as at 31st March 2018) to cover the financial risk associated with Business Rates appeals lodged with the Valuation Office Agency (VOA); and

7.2 Guarantees

7.2.1 A 30-year Business Plan for the Council's HRA has been developed, which is currently generating sufficient rental income each year to run an efficient and effective housing management service, whilst at the same time servicing the outstanding debt. However, if the HRA is unable to repay the outstanding debt at any point in the future, the Council (through its General Fund) is liable to repay any remaining balance. The remaining balance on HRA debt as at 31st March 2018 was £65.125 million.

7.3 Governance

7.3.1 Decisions on incurring new discretionary liabilities are taken by Directors and Heads of Service in consultation with the CFO. For example, in accordance with the Financial Procedure Rules credit arrangements, such as leasing agreements, cannot be entered into without the prior approval of the CFO.

8. Revenue Implications

8.1 Financing Cost

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

Table 8: Prudential Indicator: Proportion of Financing Costs to Net Revenue Stream (General Fund)

	2017/18 actual £m	2018/19 forecast £m	2019/20 budget £m	2020/21 budget £m	2020/21 budget £m
Financing Costs	0.3	0.2	0.3	0.3	0.3
Proportion of Net Revenue Stream	1.62%	1.47%	1.68%	1.65%	1.65%

Table 9: Prudential Indicator: Proportion of Financing Costs to Net Revenue Stream (HRA)

	2017/18 actual £m	2018/19 forecast £m	2019/20 budget £m	2020/21 budget £m	2021/22 budget £m
Financing Costs	2.6	2.6	3.0	3.0	3.0
Proportion of Net Revenue Stream	15.82%	15.82%	18.08%	18.08%	18.08%

8.1.2 Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for many [occasionally up to 50] years into the future.

8.2 "Prudence, Affordability and Sustainability"

8.2.1 The CFO is satisfied that the proposed Capital Programme (Section 2) is prudent, affordable and sustainable based on the following:

<u>Prudence</u>

- Prudential indicators 8 and 9 presented above (Paragraph 8.1.1) are within expected and controllable parameters. Thus:
  - *Prudential Indicator 8 (General Fund) - Proportion of Financing Costs to Net Revenue Stream* – the growth in financing costs reflects the Council's ambitions for capital investment in its strategic priorities over the medium-term.
  - *Prudential Indicator 9 (HRA) - Proportion of Financing Costs to Net Revenue Stream* – the indicator profile mirrors the HRA 30-Year Business Plan.
- *Underlying Prudent Assumptions* – a prudent set of assumptions have been used in formulating the Capital Programme. This is illustrated in the approach to capital receipts whereby the proceeds are not assumed within projections until the associated sale is completed and the money received by the Council; and
- *Repairs and Maintenance* – the approach to asset maintenance is professionally guided with assets maintained in a condition commensurate with usage and expected life, addressing those items that could affect ongoing and future maintenance, in the most appropriate and cost effective manner.

<u>Affordability</u>

- The estimated 'revenue consequences' of the Capital Programme have been included in the 2019/20 Budget and Medium-Term Financial Strategy (MTFS), extending to 2021/22; and
- The MTFS includes a reserves strategy, which includes contingency funds in the event that projections are not as expected (further supported by CFO report to Council under Section 25 of the Local Government Act 2003 on the robustness of estimates and the adequacy of financial reserves and balances).

<u>Sustainability</u>

- Capital schemes that are expected to deliver long-term revenue savings/generate income are given due priority.
- As explained in Section 3.1 above, the Asset Management Strategy will represent an enhancement to the Council approach to asset planning through (especially) taking a longer-term view. This includes providing for future operational need, balancing the requirement to achieve optimal performance, whilst taking account of technological change and managing the risk of obsolescence.

9. Knowledge and Skills

9.1 Officers

9.1.1 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. Most notably:

- *Finance* - the Chief Finance Officer (CFO) is a qualified (ACCA/ CIPFA) accountant with many years of public and private sector experience. The Council sponsors junior staff to study for relevant professional qualifications including AAT, CIPFA and ACCA. The Council also supports training courses and conferences across all aspects of accounting.
- *Property* – the Head of Property and Facilities Shared Service (PFSS) – a qualified property expert - is responsible for Asset Management within the Council. PFSS comprises the Asset Development, Building and Maintenance, Corporate Landlord and development functions of the Council. Each area has appropriately qualified professionals within their individual specialism. The Head of PFSS plays a key role in the Council's approach to commercial investment and trading (highlighted above in Section 6).

9.1.2 The Council also has a separate Housing team that is responsible for overseeing social housing developments within the District.

9.2 External Advisors

9.2.1 Where the Council does not have the relevant knowledge and skills required, judicious use is made of external advisers and consultants that are experts/specialists in their field. The Council currently employs Arlingclose as Treasury Management advisers, and the Asset Management team will commission property advisors as appropriate (e.g. development managers, valuers etc.) to support their work where required to ensure that the Council has access to knowledge and skills commensurate with risk.

9.3 Councillors

9.3.1 May 2019 will see the election for some new councillors. Duly elected councillors will therefore all receive training appropriate to their role in the new Council.

9.3.2 Specifically with regard to Treasury Management, the Council acknowledges the importance of ensuring that members have appropriate capacity, skills and information to effectively undertake their role. To this end, newly elected Lewes councillors with Treasury Management responsibilities will receive tailored training sessions from the Council's Treasury Management advisors (Arlingclose).

10. CFO Statement on the Capital Strategy

10.1 Prudential Code

10.1.1 Paragraph 24 of the recently updated Prudential Code determines that…."the Chief Finance Officer should report explicitly on the affordability and risk associated with the Capital Strategy".

10.1.2 Accordingly, it is the opinion of the CFO that the Capital Strategy as presented is affordable, and associated risk has been identified and is being adequately managed.

10.2 Affordability

10.2.1 The Capital Strategy is affordable and there is a range of evidence to support this assertion, including:

- *Capital Programme* – the Programme as presented above (in Section 2.1) is supported by a robust and resilient MTFS extending through until 2021/22 that contains adequate revenue provision, including sufficient reserves in the event that plans and assumptions do not materialise as expected.

- *Asset Management* – as presented above (in Section 3.1) a new Asset Management Strategy is under development, which is taking a strategic longer-term (i.e. beyond 2021/22) view of the Council's asset base. A fundamental aim of the Strategy is to achieve the optimum balance between future operational need and affordability, which will be reflected in its component parts including strategies for purchasing and constructing new assets, investment in existing assets, transferring of assets to other organisations and the disposal of surplus assets.

- *Commercial Investment* – as presented above (in Section 6.2) the Commercial Investment Strategy is also under development. The primary aim of the Strategy long-term is income generation to replace the shortfall in Government funding. The Strategy is progressing positively towards the delivery stage and its success will be critical to the long-term affordability of the Capital Strategy.

10.3 Risk

10.3.1 The risk associated with the Capital Strategy has been identified and is being adequately managed. Evidence to support this assertion includes:

- *Treasury Management Strategy* – the Council will formally approve a Treasury Management Strategy for 2019/20, at the Council meeting on 20 February 2019, in accordance with CIPFA's "Treasury Management in the Public Services: Code of Practice 2017". That Strategy was developed by the Council's (professionally qualified and experienced) Finance team and informed by specialist advisors Arlingclose and other relevant and extant professional guidance.

- *Investment Strategy* – the Council will also formally approve an Investment Strategy for 2019/20, at the Council meeting on 25 February 2019, in accordance with MHCLG's "Statutory Guidance on Local Government Investments (3rd Edition) 2017". As with the Treasury Management Strategy, the Investment Strategy was developed by the Finance team and informed by specialist advisors Arlingclose and other relevant and extant professional guidance.

- *Commercial Activities* – as noted above (in Paragraph 6.2) the Council is committed to significantly expanding the scale of its commercial activities in the medium-term as part of its Commercial Investment Strategy. It is recognised and accepted that increased commercial activity brings with it additional risk. The Strategy is therefore being developed in accordance with contemporary best practice. This includes the engagement of professional advisors on the commercial, financial and legal aspects of the project and the preparation of full supporting business cases prior to the commencement of both in-house and arms-length trading activities, strictly in accordance with HM Treasury's 'five case model' ("The Green Book: Central Government Guidance on Appraisal and Evaluation").

11. Capital Strategy Updates

11.1 The Capital Strategy is a 'living document' and will be periodically, usually annually, updated to reflect changing local circumstances and other significant developments. However, the development of the Asset Management Strategy and the Commercial Investment Strategy (explained above in Sections 3 and 6) are both major initiatives that could have a material impact on the Strategy as early as 2019/20, once full details are known. In the event that this happens, the Capital Strategy will be updated and re-presented to full Council.

Appendix 2 Minimum Revenue Provision (MRP) Policy Statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the Capital Financing Requirement - CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

MRP represents the minimum amount that must be charged to an authority's revenue account each year for financing capital expenditure, which will have initially been funded by borrowing. This is to ensure an authority can pay off the debts it has from investing in capital assets. Where there are opportunities to reduce the borrowing requirements from more certain and guaranteed capital receipts, the Council's MRP is appropriately reduced.

MHCLG regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. There are four primary options:

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP options are:

Either

- Existing practice - MRP will follow the existing practice outlined in former MHCLG regulations (option 1); or
- Based on CFR – MRP will be based on the CFR (option 2);

These options provide for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy options are:

- Asset life method – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3);
- Depreciation method – MRP will follow standard depreciation accounting procedures (option 4);

These options provide for a reduction in the borrowing need over approximately the asset's life. There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place). Repayments included in annual PFI or finance leases are applied as MRP. It is important to note that changes in the Local Government Financial Regulations means that in the future operating leases will be treated in a manner consistent with financial leases.

Recommendations

The Council is recommended to approve the following MRP Statement:

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be based on the CFR and use the 4% reducing balance method.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be the Asset life method – MRP will be based on the estimated life of the assets, in accordance with the regulations (commonly referred to as option 3).

Furthermore, the Council intends to use the default position of an annuity model for all capital projects except for transformation and ICT projects, which will use a straight line (EIP – Equal Instalment Payment) approach, as the benefit is more immediate and where an annuity method would not be appropriate.

The Council reserves the right to make voluntary MRP contributions, those charges over and above the statutory minimum levels, where it deems appropriate or to use capital receipts to reduce the Capital Financing Requirement. This is intended to reflect the situation, but not limited to, if the asset is significantly impaired or the asset life is now viewed as likely to be shorter than was originally anticipated.

A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2019, there were no VRP overpayments.

The Council does not charge MRP till the year following the Capital scheme is complete and the first year in which the asset is in full operation.

Appendix 3 Arlingclose Economic Background

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 Authority's treasury management strategy for 2019/20.

UK Consumer Price Inflation (CPI) for October was up 2.4% year/year, slightly below the consensus forecast and broadly in line with the Bank of England's November Inflation Report. The most recent labour market data for October 2018 showed the unemployment rate edged up slightly to 4.1% while the employment rate of 75.7% was the joint highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.3% as wages continue to rise steadily and provide some pull on general inflation. Adjusted for inflation, real wages grew by 1.0%, a level still likely to have little effect on consumer spending.

The rise in quarterly GDP growth to 0.6% in Q3 from 0.4% in the previous quarter was due to weather-related factors boosting overall household consumption and construction activity over the summer following the weather-related weakness in Q1. At 1.5%, annual GDP growth continues to remain below trend. Looking ahead, the BoE, in its November Inflation Report, expects GDP growth to average around 1.75% over the forecast horizon, providing the UK's exit from the EU is relatively smooth.

Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy has been made since. However, the Bank expects that should the economy continue to evolve in line with its November forecast, further increases in Bank Rate will be required to return inflation to the 2% target. The Monetary Policy Committee continues to reiterate that any further increases will be at a gradual pace and limited in extent.

While US growth has slowed over 2018, the economy continues to perform robustly. The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the current 2%-2.25% in September. Markets continue to expect one more rate rise in December, but expectations are fading that the further hikes previously expected in 2019 will materialise as concerns over trade wars drag on economic activity.

Appendix 4 – Economic Forecast

Credit outlook: The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ringfencing legislation. Bank of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank are the ringfenced banks that now only conduct lower risk retail banking activities. Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and NatWest Markets are the investment banks. Credit rating agencies have adjusted the ratings of some of these banks with the ringfenced banks generally being better rated than their non-ringfenced counterparts.

The Bank of England released its latest report on bank stress testing, illustrating that all entities included in the analysis were deemed to have passed the test once the levels of capital and potential mitigating actions presumed to be taken by management were factored in. The BoE did not require any bank to raise additional capital.

European banks are considering their approach to Brexit, with some looking to create new UK subsidiaries to ensure they can continue trading here. The credit strength of these new banks remains unknown, although the chance of parental support is assumed to be very high if ever needed. The uncertainty caused by protracted negotiations between the UK and EU is weighing on the creditworthiness of both UK and European banks with substantial operations in both jurisdictions.

Interest rate forecast: Following the increase in Bank Rate to 0.75% in August 2018, the Authority's treasury management adviser Arlingclose is forecasting two more 0.25% hikes during 2019 to take official UK interest rates to 1.25%. The Bank of England's MPC has maintained expectations for slow and steady rate rises over the forecast horizon. The MPC continues to have a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose believes that MPC members consider both that ultra-low interest rates result in other economic problems, and that higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise when rate cuts will be required.

The UK economic environment remains relatively soft, despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. While assumptions are that a Brexit deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" Brexit still hangs over economic activity. As such, the risks to the interest rate forecast are considered firmly to the downside.

Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected based on Arlingclose's interest rate projections, due to the strength of the US economy and the ECB's forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.7% and 2.2% respectively over the interest rate forecast horizon, however volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.

Underlying assumptions:

- Our central interest rate forecasts are predicated on there being a transitionary period following the UK's official exit from the EU.

- The MPC has a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. We believe that MPC members consider that: 1) tight labour markets will prompt inflationary pressure in the future, 2) ultra-low interest rates result in other economic problems, and 3) higher Bank Rate will be a more effective policy weapon if downside risks to growth crystallise.

- Both our projected outlook and the increase in the magnitude of political and economic risks facing the UK economy means we maintain the significant downside risks to our forecasts, despite the potential for slightly stronger growth next year as business investment rebounds should the EU Withdrawal Agreement be approved. The potential for severe economic outcomes has increased following the poor reception of the Withdrawal Agreement by MPs. We expect the Bank of England to hold at or reduce interest rates from current levels if Brexit risks materialise.

- The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in the middle quarters of 2018, but more recent data suggests the economy slowed markedly in Q4. Our view is that the UK economy still faces a challenging outlook as the country exits the European Union and Eurozone economic growth softens.

- Cost pressures are easing but inflation is forecast to remain above the Bank's 2% target through most of the forecast period. Lower oil prices have reduced inflationary pressure, but the tight labour market and decline in the value of sterling means inflation may remain above target for longer than expected.

- Global economic growth is slowing. Despite slower growth, the European Central Bank is conditioning markets for the end of QE, the timing of the first rate hike (2019) and their path thereafter. More recent US data has placed pressure on the Federal Reserve to reduce the pace of monetary tightening – previous hikes and heightened expectations will, however, slow economic growth.

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

Forecast:

- The MPC has maintained expectations of a slow rise in interest rates over the forecast horizon, but recent events around Brexit have dampened interest rate expectations. Our central case is for Bank Rate to rise twice in 2019, after the UK exits the EU. The risks are weighted to the downside.

- Gilt yields have remained at low levels. We expect some upward movement from current levels based on our central case that the UK will enter a transitionary period following its EU exit in March 2019. However, our projected weak economic outlook and volatility arising from both economic and political events will continue to offer borrowing opportunities.

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.17**
Arlingclose Central Case	**0.75**	**0.75**	**1.00**	**1.00**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.13**
Downside risk	0.00	-0.50	-0.75	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	**-0.85**
3-mth money market rate														
Upside risk	0.10	0.10	0.10	0.10	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	**0.17**
Arlingclose Central Case	**0.90**	**0.95**	**1.10**	**1.30**	**1.40**	**1.40**	**1.40**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	**1.27**
Downside risk	-0.20	-0.45	-0.60	-0.80	-0.90	-0.90	-0.90	-0.85	-0.85	-0.85	-0.85	-0.85	-0.85	**-0.76**
1-yr money market rate														
Upside risk	0.20	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.33**
Arlingclose Central Case	**1.15**	**1.25**	**1.35**	**1.50**	**1.70**	**1.60**	**1.50**	**1.40**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	**1.40**
Downside risk	-0.35	-0.50	-0.60	-0.80	-0.90	-0.90	-0.90	-0.85	-0.85	-0.85	-0.85	-0.85	-0.85	**-0.77**
5-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**1.15**	**1.25**	**1.35**	**1.50**	**1.50**	**1.40**	**1.35**	**1.35**	**1.30**	**1.30**	**1.30**	**1.30**	**1.30**	**1.33**
Downside risk	-0.50	-0.60	-0.65	-0.80	-0.80	-0.70	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	**-0.66**
10-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**1.50**	**1.65**	**1.70**	**1.80**	**1.80**	**1.75**	**1.75**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**
Downside risk	-0.55	-0.70	-0.70	-0.80	-0.80	-0.75	-0.75	-0.70	-0.70	-0.70	-0.70	-0.70	-0.70	**-0.71**
20-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**2.00**	**2.10**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.18**
Downside risk	-0.60	-0.70	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**
50-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**1.90**	**1.95**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**1.99**
Downside risk	-0.60	-0.70	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**

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

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

APPENDIX 5 - Investments Strategy

Introduction

The Council invests its money for two 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), and
- to earn investment income (known as commercial investments where this is the main purpose).

This investment strategy is a new report for 2019/20, meeting the requirements of statutory guidance issued by the government in January 2018, and focuses on the second of these categories.

Treasury Management Investments

The Council typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and Central Government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy. The balance of treasury management investments is expected to fluctuate between £8m and £30m during the 2019/20 financial year.

Contribution: The contribution that these investments make to the objectives of the Council is to support effective treasury management activities.

Further details: Full details of the Council's policies and its plan for 2019/20 for treasury management investments are covered within the body of this report.

Commercial Investments: Property

Contribution: The Council invests in local commercial property with the intention of making a profit that will be spent on local public services.

Table 1: Property held for investment purposes in £ millions

Property type	Purchase cost £m	Gains/ (Losses) At 31 March 2018 £m	Value in Accounts At 31 March 2018 £m
Various properties acquired pre 31/3/14	3.497	1.445	4.942
Retail Units	4.347	(0.247)	4.100
Mixed Commercial	0.390	0.040	0.430
Office block purchased 2018/19	2.787	to be valued	

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.

Risk assessment: The Council assesses the risk of loss before entering into and whilst holding property investments by assessing the viability of the cost of financing the investment against the return on investment in terms of receivable income. Investments that are subject to short leases are unlikely to be considered due to the high risk of potential voids.

Liquidity: Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed; the Council ensures that borrowing is on an equal instalment basis and that revenue budgets cover the cost of the loan repayment.

Loan Commitments and Financial Guarantees

Loan commitments and financial guarantees carry similar risks to the Council and are included here for completeness. Members are advised that £20,000,000 in total has been earmarked for the Lewes Housing Investment Company Ltd & Aspiration Homes LLP for 2018/19 subject to individual scheme appraisals. Loans are provided on a secured basis with interest charged at a commercial rate.

Capacity, Skills and Culture

Elected members and statutory officers: It is important that the members and officers involved in the Treasury Management function have appropriate capacity, skills and information to enable them to take informed decisions on specific investments, to assess the risk and strategic objectives and to ensure that the Council's risk exposure is managed. Periodically the Council's external Treasury advisors, Arlingclose will hold member training sessions which will provide members with a raft of technical advice specifically designed for the Council's environment. Additionally, Officers have a wide range of information available to them from various sources such as the Charted Institute of Public Finance and Accountancy (CIPFA), Arlingclose and Room 151. Officers will also attend a number of courses/seminars throughout the year and have periodical strategic meetings with the Council's treasury advisors.

Commercial deals: Officers negotiating commercial deals are aware of the core principles of the prudential framework and of the regulatory regime within which local Authorities operate and have access to a number of external bodies who can provide specific advice and direction.

Corporate governance: All of the Council's procedures provide a corporate governance arrangement that ensure accountability and for decision making on investment activities and ensure that the Council's Chief Finance Officer/Section 151 Officer is fully briefed on the Council's investment position at any one time.

APPENDIX 6 - Investment Categories, Limits & Creditworthiness Policy

The Authority held £26.6m in invested funds as at 31 December 2018, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £8 and £31 million, and similar levels are expected to be maintained in the forthcoming year.

Objectives: The CIPFA Code requires the Authority 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 Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

Negative interest rates: If the UK enters into a recession in 2019/20, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Strategy: Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to diversify into more secure and/or higher yielding asset classes during 2019/20. The majority of the Authority's surplus cash remains invested in short-term unsecured bank deposits, and money market funds. This diversification will represent a continuation of the new strategy adopted in 2016/17.

Business models: Under the new IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

Approved counterparties: The Authority may invest its surplus funds with any of the counterparty types in table below, subject to the cash limits (per counterparty) and the time limits shown.

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£2m 5 years	£2m 20 years	£2m 50 years	£2m 20 years	£2m 20 years
AA+	£2m 5 years	£2m 10 years	£2m 25 years	£2m 10 years	£2m 10 years
AA	£2m 4 years	£2m 5 years	£2m 15 years	£2m 5 years	£2m 10 years
AA-	£2m 3 years	£2m 4 years	£2m 10 years	£2m 4 years	£2m 10 years
A+	£2m 2 years	£2m 3 years	£2m 5 years	£2m 3 years	£2m 5 years
A	£2m 13 months	£2m 2 years	£2m 5 years	£2m 2 years	£2m 5 years
A-	£2m 6 months	£2m 13 months	£2m 5 years	£2m 13 months	£2m 5 years
Pooled Funds		£3m per fund or trust			

This table must be read in conjunction with the notes below

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.

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

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 higher 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.

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

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. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority 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 Authority's investment objectives will be monitored regularly.

Real estate investment trusts: Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

Operational bank accounts: The Authority may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £2,000,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

Investment limits: The maximum that will be lent to any one organisation (other than the UK Government) will be £2 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.

	Cash limit
Any single organisation, except the UK Central Government	£2m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£2m per group
Any group of pooled funds under the same management	£3m per manager
Negotiable instruments held in a broker's nominee account	£10m per broker
Foreign countries	£3m per country
Registered providers and registered social landlords	£4m in total
Unsecured investments with building societies	£5m in total
Money market funds	£15m in total
Real estate investment trusts	£4m in total

Liquidity management: The Authority uses cash flow forecasting software developed in house 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 Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium-term financial plan and cash flow forecast.

Treasury Management Indicators

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

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average 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.

Credit risk indicator	Target
Portfolio average credit AA-	A+

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

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

Interest rate exposures: This indicator is set to control the Authority'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	£40,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	£20,000

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

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.

Principal sums invested for periods longer than a year: The purpose of this indicator is to control the Authority'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:

Price risk indicator	2019/20	2020/21	2021/22
Limit on principal invested beyond year end	£2m	£2m	£2m

Related Matters

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

Financial Derivatives: Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Authority 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 Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

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.

Housing Revenue Account: On 1st April 2012, the Authority was debt free for the General Fund. All loans financed the HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured each month and interest transferred between the General Fund and HRA at the Authority's average interest rate on investments, adjusted for credit risk

Markets in Financial Instruments Directive: The Authority has opted up to professional client status with its providers of financial services, including advisers, banks and brokers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

Financial Implications

The budget for investment income in 2019/20 is £0.1 million, based on an average investment portfolio of £20 million at an interest rate of 0.50%. The budget for debt interest paid in 2019/20 is £1.7 million. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

Other Options Considered

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

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 7 – The Treasury Management Role of the Section 151 Officer

The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.

Role extended by the revised CIPFA Treasury Management and Prudential Codes 2017 as set out below.

- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe;
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money;
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority;
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing;
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees;
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority;
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above.