

Agenda Item No:	6	
Committee:	Corporate Governance Committee	
Date:	4 February 2020	
Report Title:	Treasury Management Strategy Statement, Capital Strategy, Minimum Revenue Provision Policy Statement and Annual Investment Strategy 2020/21	

Cover sheet:

1 Purpose / Summary

The purpose of this report is to provide Members with information on the proposed Treasury Management Strategy Statement, Capital Strategy, Minimum Revenue Provision (MRP) Policy Statement and Annual Investment Strategy for 2020/21.

2 Key issues

- The prudential and treasury indicators detailed in paragraphs 2-12, show that the Council's capital investment plans are affordable, prudent and sustainable.
- The Capital Strategy sets out the context in which capital expenditure and investment decisions are made and establishes that the Council has arrangements in place to ensure it gives due consideration to risk, reward, and impact on the achievement of priority outcomes.
- The MRP policy sets out how the Council will make prudent provision for the repayment of borrowing needs over the medium term forecast.
- The Treasury Management Strategy has been organised so that the Council will have sufficient cash resources to meet capital expenditure plans and operational cash flows.
- Due to the Council's long term PWLB debt portfolio (£4.5m at 31/03/19) currently attracting excessive premiums; it is not financially advantageous for the Council to comply with the gross borrowing and capital financing prudential indicator.
- Total external interest which includes finance lease interest payments; revised estimate for 2019/20 is £502,190 and the estimate for 2020/21 is £568,190. Additionally, in the extreme case, if the authority were to borrow £25M on 1st April 2020 to fund schemes taken forward as part of the Commercial and Investment Strategy this would attract annual interest payments of £602,500 per year from 2020/21 onwards.
- Bank rate is assumed to increase steadily but slowly over the next few years to reach 1.25% by quarter 2 2022.
- The current Medium Term Financial Strategy assumes that some external borrowing will be required over the four-year period to 31 March 2023.

- The aim of the Council’s annual investment strategy is to provide security of investments whilst managing risk appropriately; investment returns are commensurate with the Council’s historic low risk appetite although we are in the process of transition as a Council from a low risk policy to an appropriate managed risk policy. The Council achieves these objectives through differentiating between “specified” and “non-specified” investments and through the application of a creditworthiness policy.
- Total investment income is an estimated £200,000 for 2019/20 and £170,000 for 2020/2021. These are based on historic low risk investments and do not yet reflect the proposed new approach to managing risk, including potential investment in property funds.

3 Recommendations

It is recommended that:-

- Corporate Governance Committee endorses the strategy detailed in this report to be included in the final budget report for 2020/21.

Wards Affected	All
Portfolio Holder(s)	Cllr Chris Boden, Leader and Portfolio Holder, Finance
Report Originator(s)	Peter Catchpole, Corporate Director and Chief Finance Officer (S.151 Officer) Mark Saunders, Chief Accountant
Contact Officer(s)	Peter Catchpole, Corporate Director and Chief Finance Officer (S.151 Officer) Mark Saunders, Chief Accountant
Background Paper (s)	Link Asset Services template Budget working papers

Report:

1 Introduction

- 1.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's assessment of its risk appetite, providing adequate liquidity initially before considering investment return.
- 1.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.
- 1.3 The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.
- 1.4 Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure) and are separate from the day to day treasury management activities.
- 1.5 The Chartered Institute of Public Finance and Accountancy (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 pursuit of optimum performance consistent with those risks."

2 Capital Strategy Reporting Requirements

- 2.1 The CIPFA revised 2017 Prudential and Treasury Management Codes require all local authorities to prepare an additional document, a Capital Strategy (see Appendix A attached), which will provide 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; and
 - the implications for future financial sustainability.
- 2.2 The aim of the Capital Strategy is to ensure that all elected members on full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite. The Capital Strategy has been substantially revised and updated from that approved in February 2019 to reflect decisions taken by members in this financial year which have culminated in the approval of a Commercial and Investment Strategy for the Council.

- 2.3 This capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the articulation of the Council's arrangements to identify, pursue and monitor commercial investments in accordance with the approach set out in the recently-approved Commercial and Investment Strategy. The capital strategy explains:
- The corporate governance arrangements for these types of activities;
 - Any service objectives relating to the investments;
 - The expected income, costs and resulting contribution;
 - The debt related to the activity and the associated interest costs;
 - The payback period (incorporating but not restricted to the MRP policy);
 - For non-loan type investments, the cost against the current market value;
 - The risks associated with each activity.
- 2.4 Where a physical asset is being bought, details of market research, advisers used, (and their monitoring), ongoing costs and investment requirements and any credit information will be disclosed, including the ability to sell the asset and realise the investment cash.
- 2.5 Where the Council has borrowed to fund any non-treasury investment, i.e. an investment where the principal motivation for making the investment is to profit from the sums invested there should also be an explanation of why borrowing was required and why the MHCLG Investment Guidance and CIPFA Prudential Code have not been adhered to.
- 2.6 If any non-treasury investment sustains a loss during the final accounts and/or audit process, the strategy and revenue implications will be reported through the same procedure as the capital strategy.
- 2.7 The Council's Commercial and Investment Strategy was approved in January 2020. The upcoming 2020/21 financial year will be the first year in which any non-treasury investments may be undertaken in accordance with the provisions of this policy. At its meeting on 9 January 2020 Council noted the proposed intention that the newly-established Investment Board would be permitted to invest up to £25M which would be funded from a combination of borrowing and use of reserves. The allocation of £25M is expected to be formally confirmed as part of the budget-setting process.
- 2.8 The Council's Commercial and Investment Strategy provides the Council, through its Investment Board, with the flexibility to take forward a range of different types of non-treasury investments, including the facility to deliver projects through the use of a Local Authority Trading Company. At the time of preparing this report the Investment Board is yet to meet therefore no decisions regarding the Council's investment programme have been taken.
- 2.9 The Council's Minimum Revenue Provision policy has been updated so, as required by regulation, Full Council can approve its approach to charging MRP on any non-treasury investments before any transactions take place.
- 2.10 Section Four of the Council's Capital Strategy explains that, as part of the appraisal process, the S151 Officer will provide the Investment Board with details of how the proposed investment will impact on the Council's financial position. The cumulative impact of approved investments on the Council's medium-term financial position will be reflected in the information presented in future treasury management reports to Corporate Governance Committee, Cabinet and Full Council as per the reporting requirements outlined below.

3 Treasury Strategy Reporting Requirements

- 3.1 The Council is required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals. These

reports are required to be adequately scrutinised by Corporate Governance Committee and Cabinet before being recommended to the Council.

3.2 **Prudential and Treasury Indicators and Treasury Strategy** (this report), the first and most important report is forward looking and covers:

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

A Mid-Year Treasury Management Report - This will update Members with the progress of the capital position, amending prudential indicators as necessary and whether any policies require revision.

An Annual Treasury Report - This is a backward looking review document and provides details of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

3.3 The Strategy covers two main areas:

Capital issues

- the capital expenditure plans and associated prudential indicators;
- the MRP policy.

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, MHCLG MRP Guidance, the CIPFA Treasury Management Code and the MHCLG Investment Guidance.

4 Capital Prudential Indicators 2020/21 to 2022/23

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

4.2 The capital expenditure prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously and those forming part of this budget cycle. Commercial activities/non-financial investments relate to areas such as capital expenditure on investment properties, loans to third parties etc.

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

Capital Programme	2019/20 Revised Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Forecast Capital Expenditure	5,525	3,652	2,054	1,557
Commercial and Investment Strategy – Approved Allocation to Investment Board	0	25,000	0	0
TOTAL	5,525	28,652	2,054	1,557
Financed by:				
Capital Grants	1,454	1,066	950	950
Capital Receipts	467	225	0	0
Reserves used in year to fund Capital	632	401	400	0
Section 106 and Other Contributions	65	244	0	12
Total Financing	2,618	1,936	1,350	962
Net Financing Need For The Year (Borrowing)	2,907	26,716	704	595

- 4.4 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 indebtedness, its underlying borrowing need. Any capital expenditure shown above, which has not immediately been paid for will increase the CFR.
- 4.5 The CFR does not increase indefinitely, as each year the Council is required to pay off an element of the capital spend (including finance leases) through a statutory revenue charge (MRP). In the case of schemes taken forward as part of the Council's capital programme this has the effect of reducing the Council's (CFR) broadly over the asset's life.
- 4.6 In the case of capital expenditure incurred in accordance with the Council's Commercial and Investment Strategy the MRP charge cannot be determined until such time that the Investment Board approves a scheme. Where the projected Capital Financing Requirement is disclosed in this report the figures used reflect the impact of borrowing to fund the full allocation of £25M but no assumptions have been made regarding how MRP might reduce the CFR attributable to these schemes. This approach is considered reasonable until such time that any schemes are formally approved by the Investment Board.
- 4.7 In this context, it is also important to note that, as well as the statutory MRP charge, the Council is permitted to make additional voluntary payments to reduce the CFR. These voluntary payments will typically reduce the statutory charge that would have been due in future years. Voluntary payments can be funded from capital resources. This is particularly significant in the context of the Council's Commercial and Investment Strategy. As a result of investments undertaken, the Council may receive significant capital receipts and/or repayments of amounts due under the terms of loan agreements with third parties, including the proposed Local Authority Trading Company. These

amounts may be received before the maturity date of the external borrowing used to undertake the initial investment. Any assumptions regarding the anticipated use of capital resources to reduce the CFR will be reported as part of future treasury management reporting.

- 4.8 The CFR includes any other long term liabilities (finance leases). A finance lease is a commercial arrangement between the Council and a lessor (finance company), where in consideration for a series of payments the Council has the right to use an asset (e.g. refuse vehicle) for the lease duration (typically 7 years). The annual lease payment is made up of a capital and interest repayment.
- 4.9 Although legally the Council doesn't own the asset during the lease duration, International Accounting Standards require that the Council capitalise the asset and liability on its balance sheet, much like a loan. Whilst this increases the CFR, the nature of the finance lease agreement doesn't require the Council to separately borrow to fund the asset.

Capital Financing Requirement (CFR)	2019/20 Revised Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
CFR – as at 31 March				
FDC Capital Programme	3,876	5,074	5,177	5,164
Commercial and Investment Strategy – Approved Allocation to Investment Board	0	25,000	25,000	25,000
Total CFR	3,876	30,074	30,177	30,164
Movement in CFR	2,665	26,198	103	(13)
Movement in CFR represented by				
Net financing need for the year	2,907	26,716	704	595
Less MRP and other Financing Movements	(242)	(518)	(601)	(608)
Movement in CFR	2,665	26,198	103	(13)

5 Minimum Revenue Provision (MRP) Policy Statement

- 5.1 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), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision).
- 5.2 MHCLG regulations have been issued which require the Council to approve an MRP statement in advance each year. A variety of options are provided to Councils within the guidance. Councils are permitted under the guidance to establish their own approach to setting MRP and different approaches can be applied for different types of assets. The Council's principal responsibility is to ensure that they can demonstrate that whatever approach they adopt across their asset base it is prudent. Given the Council's decision to adopt a Commercial and Investment Strategy it has been necessary to revise the MRP policy which applied to previous years to take account of investments which might feasibly be taken forward in accordance with the Commercial and Investment Strategy. The policy applicable from the 2020/21 financial year onwards shall be as follows:
- (1) For unsupported borrowing (including finance leases) undertaken to fund the Council's capital programme, excluding any capital expenditure approved by the Council's Investment Board, MRP will be based on the estimated useful life of the assets to be purchased or acquired. Repayments made under the terms of finance leases shall be applied as MRP.

- (2) For Investment Properties purchased or constructed (following a decision taken by the Council's Investment Board) the MRP charge shall be based on the difference between the value of the asset and the value of any outstanding unsupported borrowing secured to fund the original purchase of the asset. A calculation shall be undertaken at the end of each financial year to identify the difference between the value of the asset and the amount borrowed. Where a difference exists MRP shall be charged over a period commensurate with the period the Council expects to hold the asset as set out in reports presented to the Investment Board.
- (3) For any loans made to third parties, including those made to the Local Authority Trading Company, no MRP shall be charged where the loan requirement requires the third party to make repayments on at least an annual basis over the life of the loan. In the unlikely event of the Council providing a maturity loan to a third party, MRP shall be charged in equal amounts over the life of the loan.
- (4) Should the Council acquire an equity stake in any third party, the MRP charge will be for the lower of twenty years or the scheduled completion date of any projects funded by the third party using the proceeds from selling an equity stake to the Council.
- (5) For investment in Property Funds which the Council, following consultation with its Treasury Advisors, assesses as meeting the definition of capital expenditure MRP shall be charged over the period the Council expects to hold the investment. The period over which MRP can be charged for this type of investment shall not be permitted to exceed 20 years.

6 The Use of Council's Resources and the Investment Position

- 6.1 The application of resources (capital receipts, reserves etc) and temporary use of 'surplus cash balances' to both finance capital expenditure and other budget decisions to support the revenue budget reduces cash investment balances held (see below). Unless resources are supplemented with new sources (asset sales, capital grants, etc) then new borrowing will be required to fulfil the objectives as set in the Council's Business Plan. Detailed below are estimates of the year end balances for each resource.

Year End Resources	2019/20 Revised Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Fund balances / reserves	8,653	7,518	6,806	6,671
Capital Grants Unapplied	396	0	0	0
Total core funds	9,049	7,518	6,806	6,671
Expected Cash investments	15,934	11,149	10,045	9,450

7 Affordability Prudential Indicators

- 7.1 The previous sections cover the overall capital and control of borrowing prudential indicators; also 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. The Council is asked to approve the following indicators.

- 7.2** 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.

Financing Costs to Net Revenue Stream	2019/20 Revised Estimate %	2020/21 Estimate %	2021/22 Estimate %	2022/23 Estimate %
General Fund (excluding Commercial and Investment Strategy Schemes)	4.99	8.11	8.46	8.49
Commercial and Investment Strategy Schemes (£25M allocation)	0	5.34	5.15	5.08
Total	4.99	13.44	13.61	13.57

8 Treasury Management Strategy

- 8.1 The capital expenditure plans set out in section 4 provide a summary of future level of spend. 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 service activity and the Council's capital strategy. This will involve both the organisation of cash flow and where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.
- 8.2 The Council's treasury portfolio as at 31 March 2019 for borrowing and investments was £8.363m and £20.2m respectively. As of 31 December 2019, investments are £21.9m (see Appendix B attached) and borrowing £8.294m.
- 8.3 The Council's forward projections for borrowings are summarised below. The next table shows the actual external debt, against the underlying capital borrowing need (the Capital Financing Requirement - CFR).

	2019/20 Revised Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Debt at 1 April	7,800	7,800	35,571	35,156
Expected change in debt to fund capital programme (excluding Commercial and Investment Strategy schemes)	0	2,771	(415)	(415)
Borrowing to fund Commercial and Investment Strategy Schemes	0	25,000	0	0
Other long term liabilities (OLTL)	563	406	243	106
Expected change in OLTL	(157)	(163)	(137)	(83)
Actual gross debt at 31 March	8,206	35,814	35,262	34,764
Capital financing requirement (CFR) at 31 March	3,876	30,074	30,177	30,164
Borrowing less CFR – 31 March	4,330	5,740	5,085	4,600

- 8.4 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 debt, 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 2020/21 and the following two financial years. This allows some flexibility for limited early borrowing for future years and ensures that long term borrowing is not undertaken for revenue or speculative purposes (in the sense of anticipating future upward movements in interest rates), other than where the borrowing fits in with the Council's approved Investment Strategy (Appendix A refers).

- 8.5 The Council notes that the Prudential Code published by CIPFA prohibits local authorities from borrowing in advance of need. This prohibition has been recently re-affirmed by MHCLG in its Statutory Guidance on Local Authority Investments which states that this prohibition extends to undertaking borrowing to fund the purchase of financial and non-financial investments, including investment properties. This is on the basis that in such circumstances local authorities would be borrowing 'purely in order to profit from investment of the extra sums borrowed'. Section 4 of the Council's Capital Strategy explains how the Council has had regard for this guidance and notes the Council's approach to determining whether the motivation behind any proposed investment is purely to profit from investment of any sums borrowed.
- 8.6 As a result of the Council's long term Public Works Loan Board (PWLB) debt portfolio of £4.5m (31/03/19) currently attracting excessive premiums (£3.152m at the time of writing this report), if it were prematurely repaid and the fixed rate market loan of £3.3m (31/03/2019), attracting a premium charge on application to prematurely repay, it is not financially advantageous for the Council to fully comply with this prudential indicator. This has been the case since the housing stock transfer in 2007 and has been acknowledged and approved by Council since then. In addition, the Council's external auditors have also acknowledged this situation and have not raised any issues with our strategy.
- 8.7 Interest repayments associated with the external debt (including finance leases) above are shown below. The figures in the third column reflect the interest which would fall due if the Investment Board were to approve schemes totalling the full allocation of £25M on 1st April 2020 and fund all of that expenditure from a maturity loan at today's rate.

YEARS	INTEREST DUE (EXISTING CAPITAL SCHEMES) £000	INTEREST DUE (FUNDING OF COMMERCIAL AND INVESTMENT STRATEGY) £000	TOTAL £000
2019/20	502	-	502
2020/21	568	603	1,171
2021/22	553	603	1,156
2022/23	540	603	1,143

- 8.8 The operational boundary is the limit beyond which external debt is not normally expected to exceed. In most cases this would be a similar figure to the CFR but may be lower or higher depending on the levels of actual debt.

Operational Boundary	2019/20 Revised Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Debt	12,000	12,000	12,000	12,000
Other long term liabilities	1,000	1,000	1,000	1,000
Commercial Activities / Non Financial Investments	25,000	25,000	25,000	25,000
Total	38,000	38,000	38,000	38,000

- 8.9 The authorised limit is a key prudential indicator, which represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited and this limit needs to be set or revised by full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term but is not sustainable in the longer term.

- 8.10 This is a statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all council's plans, or those of a specific council, although this power has not yet been exercised. The Council is asked to approve the following authorised limit.

Authorised Limit	2019/20 Revised Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Debt	17,000	17,000	17,000	17,000
Other long term liabilities	1,000	1,000	1,000	1,000
Commercial Activities / Non Financial Investments	25,000	25,000	25,000	25,000
Total	43,000	43,000	43,000	43,000

9 Prospects for Interest Rates

- 9.1 The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives Link Assets Service's central view.

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.60	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.20	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.10	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00

- 9.2 The above forecasts have been based on an assumption that there is an agreed deal on Brexit, including agreement on the terms of trade between the UK and EU, at some point in time. The result of the general election has removed much uncertainty around this major assumption. However, it does not remove uncertainty around whether agreement can be reached with the EU on a trade deal within the short time to December 2020, as the prime minister has pledged.
- 9.3 It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit and the outcome of the general election. In its meeting on 7 November, the MPC became more dovish due to increased concerns over the outlook for the domestic economy if Brexit uncertainties were to become more entrenched, and for weak global economic growth: if those uncertainties were to materialise, then the MPC were likely to cut Bank Rate. However, if they were both to dissipate, then rates would need to rise at a "gradual pace and to a limited extent". Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. There is still some residual risk that the MPC could cut Bank Rate as the UK economy is still likely to only grow weakly in 2020 due to continuing uncertainty over whether there could effectively be a no deal Brexit in December 2020 if agreement on a trade deal is not reached with the EU. Until that major uncertainty is removed, or the period for agreeing a deal is extended, it is unlikely that the MPC would raise Bank Rate.

- 9.4 There has been much speculation during 2019 that the bond market has gone into a bubble, as evidenced by high bond prices and remarkably low yields. However, given the context that there have been heightened expectations that the US was heading for a recession in 2020, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last thirty years. We have therefore seen over the last year, many bond yields up to ten years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby ten-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated, as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities. However, stock markets are also currently at high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.
- 9.5 During the first half of 2019-20 to 30 September, gilt yields plunged and caused a near halving of longer term PWLB rates to completely unprecedented historic low levels. (See paragraph 9.9 for comments on the increase in the PWLB rates margin over gilt yields of 100bps introduced on 9.10.19.) There is though, an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth. If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but also in the UK due to a correlation between US treasuries and UK gilts; at various times this correlation has been strong but at other times weak. However, forecasting the timing of this, and how strong the correlation is likely to be, is very difficult to forecast with any degree of confidence. Changes in UK Bank Rate will also impact on gilt yields.
- 9.6 One potential danger that may be lurking in investor minds is that Japan has become mired in a twenty-year bog of failing to get economic growth and inflation up off the floor, despite a combination of massive monetary and fiscal stimulus by both the central bank and government. Investors could be fretting that this condition might become contagious to other western economies.
- 9.7 Another danger is that unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), may end up doing more harm than good through prolonged use. Low interest rates have encouraged a debt-fuelled boom that now makes it harder for central banks to raise interest rates. Negative interest rates could damage the profitability of commercial banks and so impair their ability to lend and / or push them into riskier lending. Banks could also end up holding large amounts of their government's bonds and so create a potential doom loop. (A doom loop would occur where the credit rating of the debt of a nation was downgraded which would cause bond prices to fall, causing losses on debt portfolios held by banks and insurers, so reducing their capital and forcing them to sell bonds – which, in turn, would cause further falls in their prices etc.). In addition, the financial viability of pension funds could be damaged by low yields on holdings of bonds.
- 9.8 The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market

developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

- 9.9 In addition, PWLB rates are subject to ad hoc decisions by H.M. Treasury to change the margin over gilt yields charged in PWLB rates: such changes could be up or down. It is not clear that if gilt yields were to rise back up again by over 100bps within the next year or so, whether H M Treasury would remove the extra 100 bps margin implemented on 9.10.19.
- 9.10 Economic and interest rate forecasting remains difficult with so many influences weighing on UK gilt yields and PWLB rates. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

10 Borrowing Strategy

- 10.1 As noted above in paragraph 8.5 the Council recognises that statutory guidance indicates that whilst the Council has the necessary powers to borrow in advance of need the government and CIPFA state it should refrain from doing so where such borrowing takes place purely in order to profit from investment of the extra sums borrowed. None of the Council's current borrowing was undertaken in advance of need. Section 4 of the Council's Capital Strategy explains how this Council will have regard for this guidance in future. This section of the strategy explains the process to be followed should the Chief Finance Officer wish to bring forward a proposal to borrow in advance of need purely in order to profit from investment of the extra sums borrowed. Risks associated with borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.
- 10.2 As a result of the Council's decision not to repay debt of £7.8m at the time of the housing stock transfer in 2007, the Council is currently over borrowed (see paragraph 8.6 above); the Council's gross debt exceeds its CFR over the term of the treasury strategy.
- 10.3 Where the Council has insufficient internal resources to fund its capital programme the difference between available resources and funds required is met through borrowing. The Council is able to borrow internally if it identifies that it has surplus funds currently held in investments which could be used to finance its capital programme. However, any decision to borrow internally has to consider when any funds borrowed might be required to support the day-to-day cash needs of the Council. Unless the Council is able to increase the surplus funds it has available, i.e. through generating surpluses on the revenue account, internal borrowing will only provide a temporary solution to funding the capital programme.
- 10.4 When the Council borrows externally it will ordinarily do so using funds borrowed from the Public Works Loan Board. The current Medium Term Financial Strategy assumes that some external borrowing will be required over the four-year period to 31 March 2023. Assumptions about the level of external interest payable are reflected as part of the prudential indicators included in this document. Responsibility for deciding when to borrow externally, together with details of the amount to borrow and the term and type of any loan, rests with the Chief Finance Officer. The Chief Finance Officer's decision will be informed by advice from the Council's treasury management advisors and information regarding the progress of schemes set out in the capital programme. Any borrowing decisions will be reported to Cabinet through either the mid-year or annual treasury management reports.

- 10.5 Following the decision by PWLB on 9 October 2019 to increase their margin over gilt yields by 100 bps to 180 bps on loans lent to local authorities, consideration will be given to sourcing funding at cheaper rates from other sources.
- 10.6 The Chief Finance Officer will monitor capital plans and interest rates in financial markets and adopt a pragmatic approach to funding the capital programme. Any borrowing decisions and budget consequences will be reported to Cabinet through either the mid-year or annual treasury management reports.
- 10.7 Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing and are required for upper and lower limits.

Maturity structure of fixed interest rate borrowing 2020/21	Lower %	Upper %
Under 12 months	0	20
12 months to 2 years	0	50
2 years to 5 years	0	75
5 years to 10 years	0	75
10 years and above	0	100

Maturity structure of variable interest rate borrowing 2020/21	Lower %	Upper %
Under 12 months	0	100
12 months to 2 years	0	100
2 years to 5 years	0	100
5 years to 10 years	0	100
10 years and above	0	100

11 Debt Rescheduling / Repayment

- 11.1 Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100 bps increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates.
- 11.2 If rescheduling was done, it will be reported to the Cabinet at the earliest meeting following its action.

12 Annual Investment Strategy

- 12.1 The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, (a separate report).
- 12.2 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"); and
 - CIPFA Treasury Management Guidance Notes 2018.
- 12.3 The intention of the strategy is to provide security and appropriately manage risk. The Council's investment priorities are:

- the security of capital;
- the liquidity of its investments;
- return on its investments.

- 12.4 The above guidance from the MHCLG and CIPFA, place a high priority on the management of risk. The Council has adopted a prudent approach to managing risk and defines its risk appetite by the following means.
- 12.5 Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings
- 12.6 Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.
- 12.7 Investment instruments identified for use in the financial year are listed below under the ‘specified’ and ‘non-specified’ investments categories. Counterparty limits will be as set through the Council’s treasury management practices – schedules.
- 12.8 **Specified Investments** – These investments are sterling investments (meeting the minimum ‘high’ quality criteria where applicable) of not more than one year maturity, or those which could be for a longer period but where the Council has the right to repay within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. Investment instruments identified for use in the financial year are as follows:
- term deposits with part nationalised banks and local authorities;
 - term deposits with high credit criteria deposit takers (banks and building societies);
 - callable deposits with part nationalised banks and local authorities;
 - callable deposits with high credit criteria deposit takers (banks and building societies);
 - money market funds (CNAV) / (LVNAV) / (VNAV);
 - Debt Management Agency Deposit Facility (DMADF); and
 - UK Government gilts, custodial arrangement required prior to purchase.
- 12.9 **Non-Specified Investments** – These are any other type of investment (i.e. not defined as specified above). Investment instruments identified in both “specified” and “non-specified” categories are differentiated by maturity date and classed as non-specified when the investment period and right to be repaid exceeds one year. Non-specified investments are more complex instruments which require greater consideration by members and officers before being authorised for use. Investment instruments identified for use in the financial year are as follows:
- term deposits with high credit criteria deposit takers (banks and building societies);
 - term deposits with part nationalised banks and local authorities;
 - callable deposits with part nationalised banks and local authorities;
 - callable deposits with high credit criteria deposit takers (banks and building societies);
 - Debt Management Agency Deposit Facility (DMADF);

- UK Government gilts, custodial arrangement required prior to purchase; and
- Property funds.

12.10 As a result of the change in accounting standards first introduced in 2018/19 under IFRS 9, the Council will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1.4.18.

12.11 Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Short term cash flow requirements (up to 12 months) include payments such as, precepts, business rate retention, housing benefits, salaries, suppliers, interest payments on debt etc.

12.12 On the assumptions that the UK and EU agree a Brexit deal including the terms of trade by the end of the 2020 or soon after, then Bank rate is forecast to increase only slowly over the next few years to reach 1.25% by quarter 2 2022. Bank rate forecasts for financial year ends (March) are:

- 2020/21 – 1.00%
- 2021/22 – 1.00%
- 2022/23 – 1.25%

12.13 Forecast average investment interest rates for returns on investments placed for periods up to about three months during each financial year are as follows:

- 2019/20 - 0.75%
- 2020/21 - 0.75%
- 2021/22 - 1.00%
- 2022/23 - 1.25%

12.14 Estimated investment income is shown below. These figures assume that none of the existing cash balances held by the Authority will be utilised to fund schemes approved by the Investment Board.

YEARS	INTEREST RECEIVED £
2019/20	200,000
2020/21	170,000
2021/22	165,000
2022/23	140,000

12.15 **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.

	2020/21 £000	2021/22 £000	2022/23 £000
Maximum principal sums invested > 365 days	8,000	8,000	8,000

12.16 For its cash flow generated balances, the Council will seek to utilise its call accounts and short dated deposits (overnight to 180 days) in order to benefit from the compounding interest.

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

13 Creditworthiness Policy

13.1 The Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard & Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- "watches" and "outlooks" from credit rating agencies;
- Credit Default Swaps spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

13.2 This modelling approach combines credit ratings, Watches and Outlooks in a weighted scoring system, which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- yellow 5 years;
- dark pink 5 years for ultra-short dated bond funds with a credit score of 1.25;
- light pink 5 years for ultra-short dated bonds funds with a credit score of 1.5;
- purple 2 years;
- blue 1 year (only applies to nationalised or semi nationalised UK banks);
- orange 1 year;
- red 6 months;
- green 100 days
- no colour not to be used.

13.3 The Link Asset Services creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system does not give undue preponderance to just one agency's ratings.

13.4 Typically the minimum credit ratings criteria the Council will use will be short term rating (Fitch or equivalents) of F1 and a long term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use

13.5 The Council's own bank currently meets the creditworthiness policy. However, should they fall below Link Asset Services creditworthiness policy the Council will retain the bank on its counterparty list for transactional purposes, though would restrict cash balances to a minimum.

- 13.6 All credit ratings are monitored weekly and prior to any new investment decision. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services creditworthiness service.
- If a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
 - In addition to the use of credit ratings the Council will be advised of information in movements in credit default swaps against the iTraxx European Financials benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.
- 13.7 Sole reliance will not be placed on the use of Link Asset Services Creditworthiness policy. In addition, this Council will also use market data and market information, information on any external support for banks to justify its decision making process.
- 13.8 To further mitigate risk the Council has decided that where counterparties form part of a larger group, group limits should be used in addition to single institutional limits. Group limits will be as set through the Council's Treasury Management Practices – schedules.
- 13.9 In relation to financial institutions, the Council currently only invests in UK banks and building societies, which provides sufficient high credit quality counterparties to meet investment objectives. It should be noted that in some cases these banks are subsidiaries of foreign banks but these are of the highest credit quality.

14 External Service Providers

- 14.1 The Council uses Link Asset Services, Treasury Solutions as its external treasury management advisors. The Council recognises that responsibility for treasury management decisions remains with the authority at all times and will ensure that undue reliance is not placed upon our external service providers. All decisions will be undertaken with regards to available information, including, but not solely, our treasury advisors.
- 14.2 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.
- 14.3 The scope of investments within the Council's operations now includes both conventional treasury investments, (the placing of residual cash from the Council's functions), and more commercial type investments, such as investment properties. The Council will engage specialist advisers for commercial-type investments.

FENLAND DISTRICT COUNCIL
CAPITAL STRATEGY 2020/21-2022/23

1. OVERVIEW AND CONTEXT

- 1.1 The Council has established statutory and regulatory responsibilities for the management of its financial affairs. These responsibilities encompass revenue and capital expenditure. The specific responsibilities of full Council, the Cabinet, the Investment Board, Corporate Management Team (CMT) and the Council's appointed Section 151 Officer are defined within the Council's constitution.
- 1.2 The Council regularly updates its Medium Term Financial Strategy (MTFS). The MTFS provides a framework for setting the Council's annual revenue budget and updating the Council's three-year capital programme. The MTFS sets out the primary assumptions underpinning the assessment of the resources available to the Council and anticipated service budgets over the coming five financial years.
- 1.3 Whilst local authorities are required to set a balanced revenue budget, legislation permits local authorities to obtain credit and therefore fund their capital programmes from borrowing. Individual authorities are required to have regard for the Prudential Code published by the Chartered Institute of Public Finance and Accountancy. The Prudential Code requires authorities to ensure:
- all capital expenditure and investment plans are affordable;
 - all external borrowing and long-term liabilities are within prudent and sustainable levels;
 - treasury management and other investment decisions are taken in accordance with professional good practice; and
 - authorities can demonstrate themselves to be accountable by providing a clear and transparent framework.
- 1.4 Historically, this Council has discharged its responsibilities under the Prudential Code by ensuring that the Treasury Management Strategy, which is approved annually by full Council, is prepared with reference to the latest capital programme. The Capital Programme is itself developed with explicit consideration of the extent to which proposed capital investment is affordable, prudent and sustainable given the resources available to the Council as set out in the MTFS.

- 1.5 Following an update to the Prudential Code in December 2017, local authorities are now required to have a Capital Strategy. The introduction of this requirement acknowledges that individual authorities will each have their own approach to assessing priorities for capital investment, the amount the Authority can afford to borrow and the Authority's appetite to risk.
- 1.6 This strategy sets out in a single document the long term context in which capital expenditure and investment decisions are made and establishes that the Council has arrangements in place to ensure it gives due consideration to risk, reward, and impact on the achievement of priority outcomes. The Strategy is updated annually and reviewed by the Council's Corporate Governance Committee prior to being approved by Full Council alongside the annual budget.

2. CAPITAL EXPENDITURE

- 2.1 Capital expenditure incorporates a range of different types of financial transaction which the Council might enter into. What these transactions have in common is that they relate to investments decisions which impact on the Council and its stakeholders over a period which extends beyond the financial year in which the transaction is entered into. The Council's appointed S151 Officer ultimately has responsibility for determining whether expenditure is capital in nature in accordance with relevant regulation and statute.

Role and Purpose of the Asset Management Plan

- 2.2 The Council has developed an Asset Management Plan in accordance with acknowledged best practice. This document provides a strategic framework for managing the Council's current portfolio of land and buildings ensuring that officers and elected members can have confidence, in the long-term, that the Council has the land and property needed to fulfil the pledges set out in the Council's Business Plan.
- 2.3 The Asset Management Plan incorporates oversight of operational and non-operational property owned by the Council. Operational assets are those assets held by the Council to enable the Council, or its partners, to deliver those services which are either statutory in nature or provided on a discretionary basis to the extent that providing those services is consistent with the strategic objectives of the Council. Non-operational assets are those assets which are not directly used for the purposes of service delivery but are held to either provide the Council with a return on investment, either through rental income, appreciation in the value of the asset or the potential contribution that holding the asset makes to the Council's wider corporate objectives, e.g. taking forward opportunities to regenerate and develop the local economy.
- 2.4 Responsibility for the Asset Management Plan rests with the Council's Assets and Projects team which reports to the Council's Corporate Director (Growth and Infrastructure). The Assets and Projects team regularly appraise the condition of the Council's property portfolio to determine the revenue and capital resources required to ensure the portfolio continues to meet the needs of Service Managers. When the needs of services managers change the Assets and Projects team will assist in determining the impact on the property portfolio, including the resources required to meet those needs. The Assets and Projects team recognise that the Council's property needs are unlikely to remain static and the past cost of maintaining a Council asset is not necessarily a reliable indicator of future costs. Forward projections

regarding the resources to be allocated to asset management recognise the interaction between revenue and capital expenditure in determining the Council's cost base.

- 2.5 The capital resources required to meet investment needs identified as part of the Asset Management Plan are routinely assessed and anticipated capital expenditure is profiled over the financial years when it is expected to be incurred. On at least an annual basis capital schemes identified as part of the Asset Management Plan are presented to a meeting of the Council's Corporate Asset Team to determine when and if they should be incorporated into the Council's Capital Programme.

Investment in Vehicles, Plant, Equipment and IT

- 2.8 The Council has nominated service managers who are responsible for the vehicles, plant and information technology assets in use within the Council. These assets all have an expected useful economic life informed by an assessment by the nominated manager. The need to allocate capital resources to fund the replacement of these assets at the end of their useful life is assessed annually by the Council's Corporate Asset Team. There is also an annual appraisal of business cases relating to proposals to invest in additional equipment not reflected in the programme of rolling replacements.

Role and Function of the Corporate Asset Team

- 2.9 The Corporate Asset Team is an officer-led group which meets bi-monthly under the Chairmanship of the Corporate Director (Growth and Infrastructure). On behalf of the Council's Corporate Management Team, the Corporate Asset Team assumes responsibility for providing a strategic oversight in respect of all matters pertaining to asset management.
- 2.10 All proposed changes to the Council's three-year capital programme are subject to review by the Corporate Asset Team prior to being considered by Corporate Management Team, the Cabinet and Full Council. Any scheme which is not already incorporated into the Council's Asset Management Plan will only be considered for inclusion in the Capital Programme if the Officer proposing the scheme can demonstrate, with appropriate evidence, one or more of the following:
- there is a statutory obligation for the Council to incur the capital expenditure proposed;
 - the proposed capital expenditure relates to works deemed necessary on the grounds of health and safety;

- capital expenditure is proposed to protect a Council asset and reduce the risk of excessive revenue expenditure being incurred in upcoming financial years;
- the proposed capital expenditure will generate income, either of a revenue or capital nature, in excess of the capital expenditure which is expected to be incurred including any financing costs; and/or
- the proposed capital expenditure will (after including financing costs) reduce revenue expenditure incurred by one or more of services in future financial years.

2.11 The capital financing regulations permit the Council to treat as capital expenditure certain types of transaction which do not result in the acquisition of a physical asset by the Council. These transactions can be high-volume, small value transactions such as the awarding of Disabled Facilities Grants which are currently funded from monies received as part of Cambridgeshire County Council's Better Care Fund allocation. Such transactions do not require specific approval providing the nature and purpose of the expenditure has been approved as part of the Capital Programme.

2.12 Any proposals to incur capital expenditure which do not lead to the recognition of a physical asset where the expenditure proposed exceeds £10,000 but does not fall within the scope of the Council's Commercial and Investment Strategy will be considered at a meeting of CMT. If approved by Cabinet, approval will be sought at a meeting of Cabinet before being considered at full Council if necessary. Possible examples include, but are not restricted to:

- granting loans to third parties (for reasons not linked to the objectives of the Commercial and Investment Strategy);
- providing grant-funding to a third party which enables that third party to undertake expenditure which would have been capital in nature had it been undertaken by the Council.

Role and Function of the Investment Board

2.13 During the 2019-20 financial year the Council initiated the development of a Commercial and Investment Strategy for the Council. The current version of the Strategy was approved by full Council on 9 January 2020.

2.14 The Commercial and Investment Strategy was developed in recognition of the investment opportunities available to the Council acknowledging that utilising the Council's powers to invest could bring substantial benefits not only to the Council but also to the wider District and its residents. The Capital Strategy has been updated to take account of the changes in the

Council's arrangements for determining its capital priorities which arise from the implementation of the Commercial and Investment Strategy. This is explained in more detail in section four of this document.

- 2.15 Following the approval of the Commercial and Investment Strategy Cabinet approved the establishment of a sub-committee known as the Investment Board. The Investment Board has initially been allocated a maximum budget of £25M to take forward capital schemes which facilitate the achievement of the objectives set out in the Strategy.
- 2.16 The Investment Board undertakes its own appraisals of proposed capital schemes. The appraisal of such schemes will be separate from and in addition to the proposals for new capital schemes considered at meetings of Corporate Asset Team which follow the process outlined in paragraph 2.10 of this strategy. The Investment Board has delegated powers to approve schemes providing the maximum budget is not exceeded.
- 2.17 Capital schemes which fall within the remit of the Investment Board include the acquisition of share capital or the granting of loan funding to companies and/or partnerships in which the Council has an interest. The decision about whether to establish a company or enter into a partnership rests with Cabinet. The Investment Board is responsible for the approval of the business plans of any entities created as a result of a decision taken by Cabinet. Approval of the relevant business plan will precede the allocation of capital funds.

3 DEBT AND BORROWING AND TREASURY MANAGEMENT

3.1 Day-to-day responsibility for the Treasury Management function rests with the Chief Finance Officer. This section of the strategy reproduces key information taken from the Treasury Management Strategy Statement. For reasons outlined in that document, no assumptions have been made regarding the timing of any borrowing (internal and/or external) arising from the implementation of the Commercial and Investment Strategy. However, the operational boundary and authorised limits shown in Tables 3 and 4 have been determined with reference to the budget allocated to the newly-established Investment Board referred to in paragraph 2.15 above.

Key Considerations relating to Treasury Management

3.2 The tables below set out the Council's Investment and Debt positions with forward projections.

Year End Investments	2019/20 Revised Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Fund balances / reserves	8,653	7,518	6,806	6,671
Capital Grants Unapplied	396	0	0	0
Total core funds	9,049	7,518	6,806	6,671
Expected investments	15,934	11,149	10,045	9,450

Table 1: Year End Investment Balances projected over the period 1 April 2019 – 31 March 2023

Year-End Debt	2019/20 Revised Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Debt at 1 April	7,800	7,800	35,571	35,156
Expected change in debt to fund capital programme (excluding Commercial and Investment Strategy schemes)	0	2,771	(415)	(415)
Borrowing to fund Commercial and Investment Strategy schemes	0	25,000	0	0
Other long term liabilities (OLTL)	563	406	243	106
Expected change in OLTL	(157)	(163)	(137)	(83)
Actual debt at 31 March	8,206	35,814	35,262	34,764

Table 2: Year End Debt and Net Investment projected over the period 1 April 2019– 31 March 2023

3.3 At 1 April 2019 the Council's Debt position comprised other long-term liabilities relating to finance leases of £563k and external borrowing of £7.8m. These loans were taken out at prevailing market rates between 1994 and 2004. The term of these loans is between 25 and 50 years. Following the transfer of the Council's Housing Stock in 2007, which generated a significant capital receipt for the Council, the Council has retained investment balances which exceed the amounts borrowed. However, changes in prevailing interest rates since the loans were taken out mean that a high premium would be payable by the Council if it were to seek to repay any of the loans early. The premiums to be applied are considered to be prohibitively high for early redemption to be regarded as a reasonable treasury management decision. The Council continues to keep this situation under review with the support of its appointed treasury management advisors. However, for the purposes of this strategy, it has been assumed that external borrowing of £7.8m brought forward, as at 1 April 2019, will continue to be carried forward due to the current historically low interest rates.

3.4 Regulation requires the Council to determine, as part of the Treasury Management Strategy, the maximum external debt position for the upcoming three financial years. This is known as the Council's authorised limit. Additionally, the Council is required to set an operational boundary. The purpose of the operational boundary is to set a threshold for external borrowing which the Council would not expect to exceed in the ordinary management of its affairs. Sustained breaches of the operational boundary would be indicative that the Council could be at risk of exceeding its authorised limit.

3.5 The current authorised limits and operational boundaries for the period covered by this strategy are set out in the table below

Operational Boundary	2019/20 Revised Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Debt	12,000	12,000	12,000	12,000
Other long term liabilities	1,000	1,000	1,000	1,000
Commercial Activities/ Non-Financial Investments	25,000	25,000	25,000	25,000
Total	38,000	38,000	38,000	38,000

Table 3: Operational Boundary over the period 1 April 2019 – 31 March 2023

Authorised Limit	2019/20 Revised Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Debt	17,000	17,000	17,000	17,000
Other long term liabilities	1,000	1,000	1,000	1,000
Commercial Activities / Non-Financial Investments	25,000	25,000	25,000	25,000
Total	43,000	43,000	43,000	43,000

Table 4: Authorised Limit over the period 1 April 2019 – 31 March 2023

3.6 Table 2 above indicates that the Council's Actual Debt position is expected to increase over the period covered by this strategy. This reflects an anticipated decision to undertake external borrowing to fund the expenditure commitment set out in the capital programme. In accordance with the Council's constitution, any decision about when, how much and from where to borrow will be made by the appointed S151 Officer.

3.7 Regulations prevent the Council from borrowing in advance of need. However, there is no requirement for the Council to draw on investment balances to fund its capital commitments prior to undertaking external borrowing. To manage interest rate effectively, the Council will continue to consider medium and long-term forecasts of interest rates provided by its Treasury Management advisors to project likely returns from the investment of surplus funds and the financing costs associated with external borrowing. This approach recognises that postponing long-term borrowing to future years could be more expensive over the life of the loan if interest rates were to increase.

3.8 The Council is required by statute to make arrangements to ensure that there is provision to repay as part of the Council's revenue budget any borrowing undertaken to finance the capital programme. This is known as the Minimum Revenue Provision (MRP) and the Council is required to approve its MRP policy on an annual basis:

	Projected Minimum Revenue Provision £000
2019/20	242
2020/21	518
2021/22	601
2022/23	608

Table 5: Projected Minimum Revenue Provision over the period 1 April 2019 – 31 March 2023

3.9 Regulation requires the Council to ensure that its MRP policy results in prudent levels of MRP. The Council's MRP policies are explained in full as

part of the Treasury Management Strategy Statement which is approved by Full Council annually. Specific provisions are in place to explain the approach taken to determine MRP for schemes taken forward as part of the Commercial and Investment Strategy.

- 3.10 At the present time no assumptions have been made regarding the MRP which would be due on schemes taken forward as part of the implementation of the Commercial and Investment Strategy. These assumptions will be updated as schemes are taken forward.
- 3.11 In recognition of the inherent volatility of commercial investment the Council has established an Investment Strategy reserve. One of the purposes of that reserve is that it should hold surpluses in respect of those years where actual income generated from commercial investments exceeds budget estimates. This can help reduce the impact on the General Fund of any unanticipated shortfall which might arise in future years.

4. COMMERCIAL ACTIVITY

- 4.1 The Council has a long-standing portfolio of non-operational assets which it manages to secure a rental income and income from fees and charges earned from providing facilities for conferences and meetings. The main non-operational assets held by the Council are:
- Boathouse Business Centre, Wisbech – Office Units, Conference and Meeting Space
 - South Fens Business Centre, Chatteris - Office Units, Conference and Meeting Space
 - South Fens Enterprise Park, Chatteris – Light Industrial Units for Small Business Use
- 4.2 Rents generated from the lease to third parties of areas of land, buildings and/or infrastructure held by the Council principally for the purposes of service delivery, i.e. premises at Fenland Hall, the Base and Wisbech Port have been assessed by officers to fall outside the scope of commercial activity in the context of this section of the Council Strategy. This reflects the fact that the motive for holding these assets is not principally commercial in nature.
- 4.3 Responsibility for assessing the need for capital investment in the current portfolio of non-operational assets, reflecting those non-operational assets held as at 31 March 2020 currently rests with the Corporate Asset Team in accordance with the arrangements set out in paragraph 2.10 above.
- 4.4 During the 2019-20 financial year the Council approved a Commercial and Investment Strategy. The Council has established an Investment Board to take forward capital schemes which deliver against objectives set out in part two (commercial property investment) and part three of the Strategy (commercial investment and regeneration).
- 4.5 The Commercial and Investment Strategy sets out the assessment criteria to be used for investments undertaken in accordance with part two of the strategy. This requires the Council to determine the net yield associated with each proposed acquisition, after taking account of financing costs, including MRP, and to assess the particular circumstances relating to each acquisition to understand the risks the Council is subject to and possible sources of mitigation.
- 4.6 The Investment Board is a sub-committee of the Cabinet. The Council's constitution requires that the committee's membership includes the Leader (who Chairs the Investment Board), the Portfolio Holder for Finance, as well as one other member of Cabinet appointed by the Leader or two members of Cabinet if the Leader also has the Finance Portfolio. The constitution

requires the Chair of the Investment Board to ensure the Investment Board meets a minimum of three times each year. The Chair of the Overview and Scrutiny Panel will attend the Investment Board's meetings in an observational capacity.

- 4.7 The Investment Board is a decision-making body and its functions include the determination of investment appraisals and business cases submitted for its consideration. A report on the discharge of these functions is provided to the Cabinet twice a year.
- 4.8 The Investment Board also has responsibility for monitoring the performance and financial delivery of those appraisals and business cases it agrees to fund. The Section 151 Officer ensures that reports on the activities of the Investment Board prepared for consideration by Cabinet include details about the impact of the Board's activities on the overall financial position of the Council.
- 4.9 Statutory guidance published by MHCLG requires the Council to:
- assess and disclose publically the extent to which it is dependent on profit-generating investments to deliver a balanced revenue budget over the life of the medium-term financial strategy; and
 - to set limits for gross debt and commercial income as a proportion of the Council's budgeted net service expenditure over the life of the medium-term financial strategy.

Commercial Income as a proportion of net service expenditure

- 4.10 The current limit for budgeted commercial income as a proportion of net service expenditure has been set at 20% (equivalent to commercial income of £2.313M per year based on 2019/20 budgeted net service expenditure).
- 4.11 The Investment Board was established in January 2020 and it is yet to approve any capital schemes. Consequently the Council currently only has a very limited reliance on its non-operational assets to generate income to balance the Council's budget. This is shown in the table 6 below:

Budgeted Income from pre-2019/2020 non-operational assets (Economic Estates - Revised Budget 2019/20)	£842,000
Net Service Expenditure	£11,565,000
Commercial Income as a proportion of Net Service Expenditure	7.3%
Approved Limit	20%

Table 6: Commercial Income as a proportion of Net Service Expenditure

Gross Debt as a proportion of net service expenditure

4.12 The current limit for gross debt as a proportion of net service expenditure has been set at 375% (equivalent to gross debt of £43.370M per year based on 2019/20 budgeted net service expenditure).

4.13 As explained in paragraph 3.3 above whilst the Council has not undertaken external borrowing in recent years it does have £7.8M of external debt which was taken out at prevailing market rates between 1994 and 2004. This impacts on the calculation of gross debt as a proportion of net service expenditure as follows:

Gross Debt expected as at 31 March 2020	£7,800,000
Net Service Expenditure	£11,565,000
Gross Debt as a proportion of Net Service Expenditure	67%
Approved Limit	375%

Table 7: Gross Debt as a proportion of Net Service Expenditure

Commercial Property Investment – Loan to Value Assessment

4.14 An important consideration when appraising the impact of the Council's commercial and investment strategy on the Council is to consider the extent to which borrowing undertaken by the Council to fund investment in property is matched by the underlying value of the assets purchased.

4.15 When assets are first purchased it is common for the directly attributable costs associated with acquiring the asset, including applicable stamp duty, to exceed the realisable value of the asset. Consequently, if a property purchase is funded from borrowing this may mean in the early years of the Council's ownership the fair value of property owned by the Council may be less than the borrowing undertaken by the Council to fund the acquisition. Over time, if property prices appreciate this will have a positive impact on the Council's loan to value ratio.

4.16 The Council will obtain valuations of all its commercial investment properties annually and disclose the Loan to Value ratio as part of each year's capital strategy. Currently the Council does not hold any investment properties which have been funded from borrowing.

Borrowing in Advance of Need

- 4.17 Statutory guidance on Local Authority Investments and the Prudential Code published by CIPFA requires that authorities must not borrow in advance of their needs purely in order to profit from the investment of the extra sums borrowed. Government has clarified that this requirement extends to the use of external borrowing to fund the purchase of non-financial investments, including investment properties.
- 4.19 As noted in paragraph 2.15 above the Council's Investment Board has been allocated a budget of £25M to take forward the Council's Commercial and Investment Strategy. The Council's Commercial and Investment Strategy provides for two types of investments to be taken forward: part two of the strategy sets out the process to be followed for commercial property investment and part three is concerned with investments for regeneration and place-shaping.
- 4.20 The Council will need to undertake external borrowing if it is to utilise the full budget of £25M which has been allocated by Full Council. Part two of the Council's Commercial and Investment Strategy states that any investments made in accordance with this part of the strategy will be 'for pure financial benefit'. Consequently any borrowing undertaken to enable such investments to take place will be in breach of the statutory guidance published by MHCLG.
- 4.21 The statutory guidance recognises that the Council can disregard the provisions of the Prudential Code and the statutory guidance providing it explains its reasons for doing so and its policies for investing the extra amounts borrowed and the arrangements in place to manage the associated risks.
- 4.22 The launch of the Council's Commercial and Investment Strategy represents a key element of the Council's 20/21 Business Plan. This Council believes that investment in property is an appropriate and proportionate response to the Council's current financial position. Exploiting opportunities presented by commercial property could provide this Council with a reliable long-term source of revenue income to fund the provision of Council services. Securing such an income stream could therefore help achieve the reduction in net expenditure necessary to meet the financial gap identified in the Council's Medium Financial Strategy. This approach also further diversifies the Council's sources of income recognising that upcoming reforms to the business rates system and the implementation of the fair funding review could adversely impact on the Council's financial position.
- 4.23 The Commercial and Investment Strategy sets out in detail the appraisal and decision-making approach the Investment Board is required to follow before any investment in commercial property is undertaken. This ensures that appropriate governance arrangements are in place and the Council has due regard to the risks associated with investments both individually and in the context of the overall level of risk presented by the Council's

current portfolio. The extent to which the Council needs to borrow in advance of need to undertake investment in commercial property will be fully disclosed to the Investment Board by the Chief Finance Officer before any investment is undertaken.

- 4.24 Active monitoring of the portfolio will take place throughout the year with reference to the indicators included in this strategy together with appropriate commentary relevant to the particular investments held by this Council.

5. KNOWLEDGE AND SKILLS

- 5.1 The Council has professionally qualified staff across a range of disciplines including finance, legal and property that follow continuous professional development (CPD) and attend courses on an ongoing basis to keep abreast of new developments and skills.
- 5.2 Appropriate external advice will be engaged from suitably qualified professionals as and when required. This will apply particularly in those circumstances when the Council needs to undertake independent due diligence prior to making a decision regarding a proposed investment. Additionally, the Council will continue to enlist the year-round support of external Treasury Management advisors. This support is currently provided by Link Asset Services.
- 5.3 Internal and external training will be offered to members to ensure they have up to date knowledge and expertise to understand and challenge capital proposals brought forward for approval and interpret the treasury management policies developed by officers in conjunction with relevant professional advisors.

TEMPORARY INVESTMENTS AS AT 31/12/2019

BORROWER	AMOUNT £000	START DATE	MATURITY DATE	PERIOD IN DAYS	CURRENT INTEREST RATE %
Barclays Bank*	2,100	16/06/14		Flexible Interest	0.50
Santander UK	5,000	15/12/15		180 Day Notice A/C	1.00
Lloyds Bank	1,800	16/12/19		32 Day Notice A/C	0.90
Bank of Scotland	1,000	17/06/19	08/06/20	357	1.25
Lloyds Bank	1,500	18/09/19	27/02/20	162	0.84
Bank of Scotland	2,000	01/11/19	27/02/20	118	0.81
Yorkshire BS	3,000	15/11/19	23/01/20	69	0.70
Yorkshire BS	1,000	20/11/19	23/01/20	64	0.70
Coventry BS	2,500	02/12/19	20/01/20	49	0.58
Wirral Metropolitan BC	2,000	20/12/19	19/03/20	90	0.75
Total Investments at 31/12/2019	21,900				

* Barclays Bank Call Account is operated on the basis of meeting more immediate/very short term needs of the Council eg. payment of salaries, suppliers, benefits etc. Therefore a level of balance is maintained dependent on the immediate and very short-term requirements of the Council.