Capital, Treasury and Investment Strategy - detail

1. Introduction

1.1 A capital strategy is the foundation of proper long-term planning of capital investment in assets and how it is to be delivered. It needs to link into the Council's overall corporate objectives and strategic priorities.

1.2 Council's need to invest in their assets, as they are the most valuable resource (termed as non-financial assets throughout the report).

1.3 Capital expenditure is defined as:

"*Money spent on acquiring or upgrading fixed assets, to increase the life of the asset or improve its productivity or efficiency to the organisation*"

1.4 Capital planning is about investment in assets and is, therefore, linked to asset planning. Council assets have been acquired using public money, so they have an obligation to protect the value of those assets. Failure to do this means assets will gradually deteriorate and in the long-term this puts the Council's ability to fulfil its basic responsibilities at risk.

1.5 An integral part of a capital strategy is how the programme is financed. This is inexplicitly linked to treasury management and informs the resources available for treasury investments.

1.6 Treasury management is an important part of the overall management of the Council's finances. Council's may borrow or invest for any purpose related to its functions, under any enactment, or for the purpose of the prudent management of its financial affairs.

1.7 The CIPFA definition of treasury management is:

"the management of the organisations 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"

1.8 Statutory requirements, the CIPFA Code of Practice for Treasury Management in the public services (the TM Code) and the CIPFA Prudential Code regulate the Council's treasury activities.

1.9 MHCLG requires authorities to prepare an investment strategy, which comprises both treasury and non-treasury investments.

1.10 An authority invests its money for three broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (treasury management investments)

- to support local public services by lending to or buying shares in other organisations (service investments)
- to earn investment income (commercial investments where this is the main purpose)

1.11 The Local Government Act 2003, require Local Authorities to have regard to the Prudential Code. The Prudential Code, last revised in 2017, requires Local Authorities to determine a capital strategy. The strategy is to have regard to:

Capital expenditure

- an overview of the governance process for the approval and monitoring of capital expenditure
- a long-term view of capital expenditure plans
- an overview of asset management planning
- any restrictions around borrowing or funding of ongoing capital finance

Debt and borrowing and treasury management

- a projection of external debt and use of internal borrowing to support capital expenditure
- provision for the repayment of debt over the life of the underlying asset
- authorised limit and operational boundary for the following year
- the approach to treasury management including processes ,due diligence and defining the risk appetite

Commercial activity

- the Council's approach to commercial activities, including processes, ensuring effective due diligence and defining the risk appetite including proportionality in respect of overall resources

Other long-term liabilities

- an overview of the governance process for approval and monitoring and ongoing risk management of any other financial guarantees and other long-term liabilities.

Knowledge and skills

- a summary of the knowledge and skills available to the Council and confirmation that these are commensurate with the risk appetite.

1.12 Included in these regulations and codes of practice, we are required to set Prudential and Treasury Indicators for assessing the prudence, affordability and sustainability of capital expenditure and treasury management decisions. The MHCLG investment guidance also suggest some local indicators.

1.13 The following sections of the strategy outline the Council's balance sheet and treasury position, capital expenditure and treasury management strategy.

1.14 In order to understand the context of the capital and investment strategy (where we are going and how we will get there), it is important to understand where we are now.

2. External Context

Economic Background

2.1 The UK's progress negotiating its exit from the EU, together with its future trading arrangements, will continue to be a major influence on the Council's treasury management strategy for 2019-20.

2.2 UK GDP growth is slow, at an annual rate of 1.5%, which is below trend. The Bank of England, in its November Inflation Report, expects GDP growth to average around 1.75% over the forecast time horizon, providing the UKs exit from the EU is relatively smooth.

2.3 The headline rate of UK Consumer Price Inflation (CPI) rose to 2.4% year on year in October, slightly below the consensus forecast and the Bank of England November inflation report.

2.4 The labour market data is continuing to look positive. The unemployment rate fell to 4.1%, and the employment rate was 75.7% - the joint highest in record. The 3-month average annual growth rate for pay excluding bonuses was 3.3% as wages continue to steadily rise and provide some pull on general inflation. However, adjusting for inflation this means that real wages grew by 1% and likely to have little impact on household spending.

2.5 The US economy continues to perform robustly. The US Federal Reserve continued its' tightening throughout 2018, pushing interest rates to the current 2%-2.25% in September. Markets continue to expect another rise in December, but expectations are fading that further increases previously expected in 2019 will materialise as there are concerns over trade wars that are dragging on economic activity.

Credit outlook

2.6 The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ring-fencing regulation. Bank of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank are the ring-fenced 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 ring-fenced banks generally being better rated than their non ring-fenced banks.

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

Interest rate forecast

2.8 Arlingclose forecast the bank rate to increase during 2019 with two 0.25% rate rises, taking the official rate to 1.25%. The 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.

2.9 The market is assuming that a Brexit deal will be struck and some agreement will be reached on transition and future trading arrangements before the UK leaves the EU, there is a possibility of a 'no deal' Brexit hanging over the economic activity. As such, the risks to the interest rate forecasts are considered to the downside.

2.10 Gilt yields and therefore long-term borrowing rates have remained at low levels but some upward movement is expected due to the strength of the US economy and the European Central Bank's (ECB's) forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.5% to 2% respectively over the interest forecast horizon, however volatility arises from both economic and economic events that are likely to mean borrowing opportunities.

3. Balance sheet and treasury position

Balance Sheet

3.1 The Council has a strong asset backed balance sheet

Item	Balance at 31 Mar 17			Balance at 31 Mar 18		
	£000	£000		£000	£000	
Long-term Assets	872,338			893,702		
Short-term assets	7,664			27,189		
		880,002	87%		920,891	88%
Long-term investments	45,749			34,335		
Short-term investments	82,894			94,075		
		128,643	13%		128,410	12%
Total assets		**1,008,645**			**1,049,301**	
Current liabilities	(26,688)			(29,796)		
Long-term liabilities	(93,449)			(90,217)		
		(120,137)	34%		(120,013)	33%
Short-term borrowing	(35,461)			(48,965)		
Long-term borrowing	(198,125)			(192,895)		
		(233,586)	66%		(241,860)	67%
Total liabilities		**(353,723)**			**(361,873)**	
Net assets		**654,922**			**687,428**	

3.2 The summary balance sheet shows that cash investments make up only 12% of the Councils assets, and investment property makes up 16% of the long-term assets (being £147.412 million). The largest proportion of our liabilities is long-term borrowing, which is predominately HRA debt.

Financial Stability/Sustainability

3.3 Gearing is a measure of financial leverage, demonstrating the degree to which activities are funded by our own money or by debt. The higher the leverage, the more risky the company is considered to be because of the financial risk and that they must continue to service its debt regardless of the level of income or surplus. Gearing can be calculated by using the debt ratio (total debt / total assets), and is the proportion of our assets that are financed by debt.

	2017-18 Actual (£000)	2018-19 Estimate (£000)	2018-19 Outturn (£000)	2019-20 Estimate (£000)	2020-21 Estimate (£000)	2021-22 Estimate (£000)	2022-23 Estimate (£000)	2023-24 Estimate (£000)
Total debts	361,873	570,447	396,747	455,042	556,208	620,112	695,025	695,025
Total assets	1,049,301	1,256,777	1,120,074	1,204,257	1,325,090	1,413,870	1,512,984	1,529,604
Debt Ratio %	34%	45%	35%	38%	42%	44%	46%	45%

3.4 This shows that our gearing is low, which is because of our strong asset base.

3.5 Future years' estimates are based on adding the budgeted cost of capital investment onto the assets, and adding the assumed debt funded expenditure (not external debt as shown in the liability benchmark) to the debt figure to give an idea how the financial stability of the Council will be evolving.

Local indicators

3.6 The Local Government Association (LGA) use a number of different financial indicators to assess the financial sustainability of Council's as part of their financial diagnostic tool. We have chosen to use the following as local indicators:

- Total debt as a % of long term assets
- Ratio of equity by net revenue expenditure
- Un-ringfenced reserves as a % of net revenue expenditure
- Working capital as a % of net revenue expenditure
- Short term liability pressure (short term liabilities as a % of total liabilities)
- Total investments as a % of net revenue expenditure
- Investment property as a % of net revenue expenditure

3.7 Suggested MHCLG local indicators are:

Indicator	Description
Debt to net service expenditure (NSE) ratio	Gross debt as a percentage of net service expenditure
Commercial income to NSE ratio	Dependence on non-fees and charges income to deliver core services. Fees and Charges are to be netted off gross service expenditure to calculate the NSE
Investment cover ratio	The total net income from property investments, compared to the interest expense
Loan to value ratio	The amount of debt compared to the total asset value
Target income returns	Net revenue income compared to equity. This is a measure of achievement of the portfolio of properties
Benchmarking of returns	As a measure against other investments and against other Council's property portfolios
Gross and net income	The income received from the investment portfolio at a gross level and net level (less costs) over time
Operating costs	The trend in operating costs of the non-financial investment portfolio over time, as the portfolio of non-investments expands

Vacancy levels and tenant exposures for non-financial investments	Monitoring vacancy levels (voids) ensure the property portfolio is being managed (including marketing and tenant relations) to ensure the portfolio is as productive as possible

Treasury position

3.8 The following table shows the Council's current treasury position, which is the next step to moving forward from the balance sheet.

	March 18 Actual £'000	Nov 18 position £'000
Investments		
Managed in-house		
Call Accounts	436	1,052
Notice Accounts - UK	11,000	11,000
Money Market Funds	8,324	9,169
Temporary Fixed Deposits	35,000	11,000
Long term Fixed Deposits	16,500	21,500
Certificates of Deposit	3,000	0
Unsecured bonds	5,803	5,300
Covered Bonds	30,829	28,200
Revolving credit facility	2,500	2,500
Total investments managed in-house	**113,392**	**89,721**
Pooled Funds		
Total pooled funds investments	**20,245**	**20,287**
Total Investments	**133,637**	**110,008**
Borrowing		
Temporary borrowing	43,500	19,500
Long-term borrowing (PWLB)	193,125	193,010
Long-term borrowing (LAs)	5,000	0
Total borrowing	**241,625**	**212,510**
Net investments / (borrowing)	**(107,988)**	**(102,502)**

3.9 The table shows the position at the start of the financial year (included in the balance sheet), and the position at the end of November 2018 (the latest position).

3.10 Investment balances are lower, due to less temporary borrowing. The net borrowing position has decreased since March 2018 by £5.5 million because there is a net reduction in external borrowing.

4. Capital expenditure

4.1 To understand the movement in our balance sheet over the medium term, it is important to understand the anticipated capital expenditure and capital receipts over that time.

4.2 The Council has an ambitious Corporate Plan and medium to long-term aspirations within the Borough. There is, therefore, a number of processes in place to ensure the capital programme is approved and monitored for good governance.

4.3 The Council has the following parts to its capital programme:

- Capital vision
- Approved programme
- Provisional programme
- Reserves funded programme
- S106 funded programme

4.4 The Council splits the schemes into development and non-development (i.e. those that must be done to keep our fixed assets in an acceptable condition). This enables us to review the amount of spend on statutory items against those which we are expecting a financial return from as part of our regeneration plans.

4.5 The capital programme covers a 5-10 year period, with more emphasis on the first five years.

4.6 Any projects that are expected to be delivered after the first five years of the programme, or those where the scheme has not yet been fully identified are placed on the Council's Capital Vision. The vision enables us to model the potential financial impact of these schemes, and be aware of the potential schemes to be brought forward onto the GF capital programme in future.

4.7 Many of the bids in the capital programme are development projects, and their expenditure and income profile can span beyond the five-year timeframe. The Council's capital programme, is therefore, a prudent one. Any income arising as a result of a development project that is outside the five years or is currently only estimated is shown in the capital vision. Any development projects will be subject to a thorough business case, which will assess the delivery model, and officers will ensure that they are financially viable before they can proceed.

4.8 The Council maintains a provisional programme to be able to produce a realistic five year programme, and include the financial implications in the outline budget. It also gives Councillors an indication as to what schemes are being investigated, and an indication as to when these schemes may be progressed.

4.9 The programme is also split between:

a) 'essential schemes' – those schemes that need to be undertaken for statutory/compliance reasons, are required to maintain service provision at existing levels (or prevent cost escalation) or are infrastructure schemes; and
b) 'investment schemes' – those schemes that are for economic growth, regeneration, redevelopment and income generation purposes.

4.10 Type (a) '<u>essential schemes</u>' often do not have cashable savings or efficiencies associated with them, but often prevent further cost escalation of services, or, in the case of infrastructure will act as a catalyst for type (b) schemes. Essential schemes often have revenue costs associated with them, particularly if funded from borrowing.

4.11 Type (b) '<u>investment schemes</u>' are required to provide a positive or neutral impact on the Council's GF revenue account. It is envisaged that this is achieved by the revenue income generated by the completed scheme/project being greater than the capital financing costs on the GF revenue account.

4.12 Under the financial regulations, schemes that are fully funded by s106 receipts or grants and contributions can be added to the capital programme, where they have been approved by the relevant Lead Councillor and relevant Director in consultation with the Financial Services Manager.

4.13 During the year, the Capital Monitoring Group (CMG) meets on a quarterly basis to review the scheduling of the capital programme. The group consists of officer representatives across the Council from different departments to give a joined up approach.

4.14 The capital programme is also reviewed by CMT and Corporate Governance and Standards Committee (CGSC) as part of the regular financial monitoring for months 3, 6, 8, 10 and then as part of the final accounts report. Officers are proposing the timing of these reporting months are changed from 2019-20 to months 2, 4, 7, 10 and 11, to allow more regular reporting for Councillors.

4.15 The proposed financing of the capital programme assumed available resources will be used in the following order:

a) capital receipts from the sale of assets (after applying the flexible use of capital receipts policy if applicable)
b) capital grants and contributions
c) earmarked reserves
d) the general fund capital schemes reserve
e) revenue contributions
f) internal borrowing
g) external borrowing

4.16 The actual financing of each years' capital programme is determined in the year in question, as part of the preparation of the Council's statutory accounts.

4.17 Capital expenditure is split between the General Fund (GF) (incorporating non-HRA housing) and HRA housing. This strategy focusses on the GF capital programme. The HRA produces its 30-year business plan that is approved by Council in February each year, shown in a separate report.

4.18 Our current approved capital programme, revised in year for updates in the programme, for the period is as follows:

CAPITAL EXPENDITURE SUMMARY	2018-19 Approved £000	2018-19 Outturn £000	2018-19 variance £000	2019-20 Estimate £000	2020-21 Estimate £000	2021-22 Estimate £000	2022-23 Estimate £000	2023-24 Estimate £000
General Fund Capital Expenditure								
- Main Programme	44,437	47,350	2,913	42,249	17,484	8,641	5,825	5,825
- Provisional schemes	50,953	2,985	(47,968)	30,171	88,402	64,983	85,788	4,820
- Schemes funded by reserves	4,351	5,540	1,189	3,849	687	500	500	0
- S106 Projects	0	350	350	0	0	0	0	0
Total Expenditure	**99,741**	**56,225**	**(43,516)**	**76,269**	**106,573**	**74,124**	**92,113**	**10,645**
Financed by :								
Capital Receipts	(5,290)	(5,726)	(436)	0	0	(4,000)	(11,200)	(10,645)
Capital Grants/Contributions	(5,465)	(2,466)	2,999	(7,145)	(4,500)	(5,500)	(5,500)	0
Capital Reserves/Revenue	(17,832)	(13,158)	4,674	(10,829)	(907)	(720)	(500)	0
Borrowing	(71,154)	(34,874)	36,280	(58,295)	(101,166)	(63,904)	(74,913)	0
Financing - Totals	**(99,741)**	**(56,225)**	**43,516**	**(76,269)**	**(106,573)**	**(74,124)**	**(92,113)**	**(10,645)**
Housing Revenue Account Capital Expenditure								
Total Expenditure	**21,970**	**14,548**	**(7,422)**	**7,915**	**14,260**	**14,656**	**7,001**	**5,975**
Financed by :								
- Capital Receipts	(4,974)	(2,984)	1,990	(982)	(2,886)	(3,004)	(400)	(400)
- Capital Reserves/Revenue	(16,996)	(11,563)	5,433	(6,933)	(11,375)	(11,652)	(6,601)	(5,575)
Financing - Totals	**(21,970)**	**(14,548)**	**7,422**	**(7,915)**	**(14,260)**	**(14,656)**	**(7,001)**	**(5,975)**

4.19 The programme has slipped significantly in 2018-19 – estimated expenditure on the GF of £99.7 million, has been reduced to £56.2 million. The majority of this relates to expenditure on regeneration schemes and has been moved into later years.

4.20 We split expenditure on housing services between the HRA and GF housing. Any expenditure that relates to the Council's' own stock, or its role as a landlord, is accounts for in the HRA capital programme. All other housing related expenditure is accounted for in the GR capital programme.

4.21 Where direct development is concerned, we normally account for site preparation and feasibility costs in the GF programme, but construction costs, most enabling works and other costs incurred after planning approval are accounted for in the HRA capital programme. This is because we bear the preparation costs regardless of who builds the structure.

New capital schemes

4.22 To ensure good governance, the Council has the following process for the capital programme.

4.23 Each year, as part of the budget cycle, officers are asked to submit bids for capital funding covering at least a five-year period, and also for the capital vision.

4.24 Any projects that are expected to be delivered after the five-year period, of those where a scheme has not yet been fully identified are placed on the Council's Capital Vision [1](see Appendix 8). This allows us to model the potential financial impact of these schemes, and be aware of schemes that are likely to be brought forward onto the GF capital programme in future, and start planning potential funding streams for those schemes.

[1] Long-term schemes identified in documents such as the Corporate Plan SCC Local Transport Plan, the Councils' Regeneration Strategy, Local Plan and the emerging Infrastructure Delivery Plan.

4.25 Many of the bids in the programme are development projects, and their expenditure and income profile could span beyond the five-year timeframe in this report. This report, therefore, shows a prudent capital programme and any income arising as a result of a development project (either revenue or capital) that is outside of the five years or is currently only estimates, is shown on the capital vision.

4.26 Some capital receipts or revenue streams may arise as a result of investment in particular schemes, but in most cases are currently uncertain and it is too early to make assumptions. Some information has been included in the capital vision highlighting the potential income. It is likely there are cash-flow implications of the development schemes, where income will come in after the five-year time horizon and the expenditure will be incurred earlier in the programme.

4.27 Each project will require a business case, in line with guidance set out in the HM Treasury Green Book ('Green book'). The following applies:

- Projects up to £200,000 – a simple business justification case will be required to justify the spending proposal
- Projects £200,000 and over – will require a 3-stage business case consisting of:
    - a strategic outline case (i.e. the capital bid)
    - a detailed outline business case evaluating the strategic case, economic case (including options appraisal), commercial viability, financial affordability and management case for change – this will be reported to the Executive at the point a project is asking for approval to be moved from the provisional to the approved capital programme
    - a final business case – setting out the procurement process and evaluation of tenders prior to the contractual commitment of expenditure

4.28 The Council has a limited amount of resources and needs to have regard to the overall affordability of the capital programme in future years. Each scheme, therefore, needs to be evaluated to ensure it meets the Council's objectives. The criteria is as follows:

a) Each project must meet one of the five spending objectives:
    a. Economy (invest to save, i.e. to reduce cost of services)
    b. Efficiency (i.e. to improve throughput and unit costs)
    c. Effectiveness (improving outcomes for the community)
    d. Retendering to replace elements of the existing service
    e. Statutory or regulatory compliance (i.e. H&S)

b) Each scheme must be assessed against the fundamental themes within the Council's Corporate Plan to show how well it contributes towards achieving the strategic objectives of the Council

c) Each scheme must have a cost benefit analysis, detailing the Net Present Value calculation (NPV) of both cash-flows and quantifiable economic benefits, payback period, Internal Rate of Return (IRR), Peak Debt and the assessment of its Revenue impact.

d) NPV is to be the most important criteria and must remain positive over a range of sensitivities for the Council to invest

e) NPV calculation must use the recommended treasury discount rate in the Green Book, currently at 3.5%

f) The revenue impact must be neutral or positive on the GF for all investment projects

g) All projects should assess the qualitative benefits

4.29 Bids are submitted for initial review by the officer led CMG in September. Their role is to scrutinise the bids, and review them in line with the overall capital programme. CMT will then review the updated bids, along with the financial impacts and NPV scores. Once CMT are fully supportive of the bids the relevant Lead Councillor will be given a copy, and they will be presented to Councillors in the JEABBWG for review and scrutiny in November/December before being passed through the Committee Cycle and ultimately being approved at Full Council in February.

4.30 The Council may set an affordability limit based on what the GF can afford for implications of the capital programme (primarily MRP and borrowing interest). The idea is that where there are some essential schemes that will not generate income there is an allowance in the revenue account to accommodate the revenue impact of those.

4.31 This local limit is based on the maximum increase in financing costs on the GF revenue account each year to £5 per Band D property, which is the maximum amount by which the Council can raise its Band D council tax.

4.32 The impact is that there will be a limit to the number of Essential capital schemes (ie those that need to be undertaken for statutory/compliance reasons, are required to maintain service provision at existing levels or prevent cost escalation, or are infrastructure schemes). Based on an average asset life of 25 years for MRP purposes, the limit for new essential schemes to be funded by borrowing for each financial year in the capital programme will be:

	2019-20 Projection	2020-21 Projection	2021-22 Projection	2022-23 Projection	2023-24 Projection
Affordable increase in financing costs	283,977	191,681	197,895	204,719	206,882
Maximum limit on type A essential capital schemes	7,099,419	4,792,027	4,947,382	5,117,980	5,172,051

4.33 This limit does not apply to investment capital schemes (i.e. those that will be undertaken for economic growth, regeneration, redevelopment or income generation purposes) as these schemes are defined as those which are anticipated to have a neutral or positive impact on the GF revenue account. This means that annual savings or additional income achieved from an investment capital schemes is greater than its financing costs over a range of scenarios will generate a positive benefit to the financial sustainability of the Council. The approval of these schemes will be made on a case-by-case basis following submission of an outline business case.

4.34 A summary of the new bids can be seen in Appendix 2

4.35 Once Councillors have approved the new bids, they will be added to the provisional capital programme, unless the business case specifically recommends the scheme be implemented immediately, explaining in detail why.

4.36 Most projects over £200,000 require a further outline business case to be approved by the Executive before a project can be moved from the provisional to the approved programme, and authority is provided for officers to start implementing the project. Any project under £200,000 can be moved under delegation.

4.37 The table below highlights the current approved programme with the new bids submitted as part of this report

CAPITAL EXPENDITURE SUMMARY	2018-19 Approved £000	2018-19 Outturn £000	2018-19 variance £000	2019-20 Estimate £000	2020-21 Estimate £000	2021-22 Estimate £000	2022-23 Estimate £000	2023-24 Estimate £000
General Fund Capital Expenditure								
- Main Programme	44,437	47,350	2,913	42,249	17,484	8,641	5,825	5,825
- Provisional schemes	50,953	2,985	(47,968)	30,171	88,402	64,983	85,788	4,820
- Schemes funded by reserves	4,351	5,540	1,189	3,849	687	500	500	0
- S106 Projects	0	350	350	0	0	0	0	0
- New Bids (net cost)	0	0	0	1,323	131	0	0	5,000
Total Expenditure	**99,741**	**56,225**	**(43,516)**	**77,592**	**106,704**	**74,124**	**92,113**	**15,645**
Financed by :								
Capital Receipts	(5,290)	(5,726)	(436)	0	0	(4,000)	(11,200)	(10,645)
Capital Grants/Contributions	(5,465)	(2,466)	2,999	(7,145)	(4,500)	(5,500)	(5,500)	0
Capital Reserves/Revenue	(17,832)	(13,158)	4,674	(10,829)	(907)	(720)	(500)	0
Borrowing	(71,154)	(34,874)	36,280	(59,618)	(101,297)	(63,904)	(74,913)	(5,000)
Financing - Totals	**(99,741)**	**(56,225)**	**43,516**	**(77,592)**	**(106,704)**	**(74,124)**	**(92,113)**	**(15,645)**
Housing Revenue Account Capital Expenditure								
- Existing programme	21,970	14,548	(7,422)	7,915	14,260	14,656	7,001	5,975
- New Bids (net cost)	0	0	0	733	5,197	7,861	1,666	0
Total Expenditure	**21,970**	**14,548**	**(7,422)**	**8,648**	**19,457**	**22,517**	**8,667**	**5,975**
Financed by :								
- Capital Receipts	(4,974)	(2,984)	1,990	(1,226)	(4,618)	(5,625)	(955)	(400)
- Borrowing	0	0	0	(244)	(1,732)	(2,620)	(555)	0
- Capital Reserves/Revenue	(16,996)	(11,563)	5,433	(7,177)	(13,107)	(14,272)	(7,156)	(5,575)
Financing - Totals	**(21,970)**	**(14,548)**	**7,422**	**(8,648)**	**(19,457)**	**(22,517)**	**(8,667)**	**(5,975)**

4.38 The net addition of the new bids for the GF is assumed to be funded by borrowing. The HRA new bids are assumed to be funded 1/3 capital receipts, 1/3 borrowing and 1/3 capital reserves.

5. Treasury management, borrowing and investment strategy

5.1 Treasury management is the management of the Council's cash flows, borrowing and investments and the associated risks. The Council both borrows and invests substantial amounts of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

5.2 Treasury risk management at the Council is conducted within the framework of the CIPFA Treasury Management in the Public Services: Code of Practice 2017 ('TM Code') which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the TM Code.

Capital Financing Requirement (CFR)

5.3 With the current treasury position, and future capital expenditure plans known, we can prepare a table of the extent of our need to borrow for capital purposes (the CFR), and what we have borrowed, compared to our level (and projected level) of reserves. We split this between the HRA and the GF.

5.4 The CFR is derived from unfinanced capital expenditure, which arises when there are no capital receipts or reserves available to fund the capital programme.

5.5 The Council's investments consist of usable reserves and working capital and are the underlying resources available for investment. In the table below, we are also showing a minimum investment balance of £45 million. This represents the minimum level of cash / investments we will always maintain at any point in time, to maintain sufficient liquidity.

5.6 The liability benchmark assumes:

- an allowance for currently known capital expenditure, until 2023-24, and then an assumed level of £10 million per annum for general capital bids, plus anticipated capital programme and capital vision items where the costs and timings can be estimated
- MRP has been allowed for based on the underlying need to borrow for the GF capital programme until 2023-24, and then projected forward based on the assumed level of capital expenditure with MRP over 25 years' repayment period
- income, expenditure and reserves are updated until 2029-30, based on estimated income and expenditure and then projected forward by using 1% inflation adjustment each year to allow for transfers to reserves each year.

Guildford BC Balance Sheet Summary and Projections in £000 - last updated 12 Dec 2018						
31st March:	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
Loans Capital Financing Req.	271,443	305,522	362,851	461,889	522,635	593,203
Less: External Borrowing	(241,625)	(192,895)	(192,665)	(192,435)	(147,435)	(147,435)
Internal (Over) Borrowing	**29,818**	**112,627**	**170,186**	**269,454**	**375,200**	**445,768**
Less: Usable Reserves	(156,150)	(150,755)	(156,473)	(162,156)	(170,882)	(181,281)
Less: Working Capital Surplus	(7,761)	(7,761)	(7,761)	(7,761)	(7,761)	(7,761)
(Investments) / New Borrowing	**(134,093)**	**(45,889)**	**5,952**	**99,537**	**196,557**	**256,726**
Net Borrowing Requirement	107,532	147,006	198,617	291,972	343,992	404,161
Preferred Year-end Position	45,000	45,000	45,000	45,000	45,000	45,000
Liability Benchmark	**152,532**	**192,006**	**243,617**	**336,972**	**388,992**	**449,161**
Housing Revenue Account - Summary and Projections in £000						
HRA Loans CFR	197,024	197,024	197,024	197,024	197,024	197,024
HRA Reserves	(110,378)	(108,301)	(113,561)	(119,473)	(127,070)	(140,589)
HRA Working Capital	0	0	0	0	0	0
HRA Borrowing	(193,125)	(192,895)	(192,665)	(192,435)	(147,435)	(147,435)
HRA Cash Balance	**(106,479)**	**(104,172)**	**(109,202)**	**(114,884)**	**(77,481)**	**(91,000)**

General Fund - Summary and Projections in £000						
GF Loans CFR	74,419	108,498	165,827	264,865	325,611	396,179
GF Reserves	(45,772)	(42,454)	(42,912)	(42,683)	(43,812)	(40,692)
GF Working Capital	(7,761)	(7,761)	(7,761)	(7,761)	(7,761)	(7,761)
GF Borrowing	(48,500)	0	0	0	0	0
GF Cash Balance	**(27,614)**	**58,283**	**115,154**	**214,421**	**274,038**	**347,726**

5.7 The liability benchmark shows the lowest risk level of borrowing – i.e. using the Council's overall cash to fund the capital programme, and only externalising the borrowing when our minimum liquidity requirement is reached.

5.8 The differential between the CFR and the level of reserves is the Council's overall external borrowing need. Where the external borrowing amount is lower than the CFR, it means we have internally borrowed and used non-capital receipts and reserves to initially finance capital expenditure (i.e. the Council's overall cash). Items on the capital vision are currently excluded, mainly because the cost and/or timings of the schemes are unknown.

5.9 The Prudential Code recommends that the Council's total debt (external borrowing) should be lower than its forecast CFR over the next three years – in other words, not over borrowing. The table shows the Council's internal / (over) borrowing position and shows that we are expecting to comply with this recommendation.

5.10 The table shows our gross debt position against our CFR. This is one of the Prudential Indicators, and is a key indicator of prudence. This indicator aims to ensure that, over the medium-term, debt will only be for a capital purpose. We monitor this position and demonstrate prudence by ensuring that medium to long-term debt does not exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years (2017-18 to 2020-21). The liability benchmark is expected to increase to £449 million by March 2024.

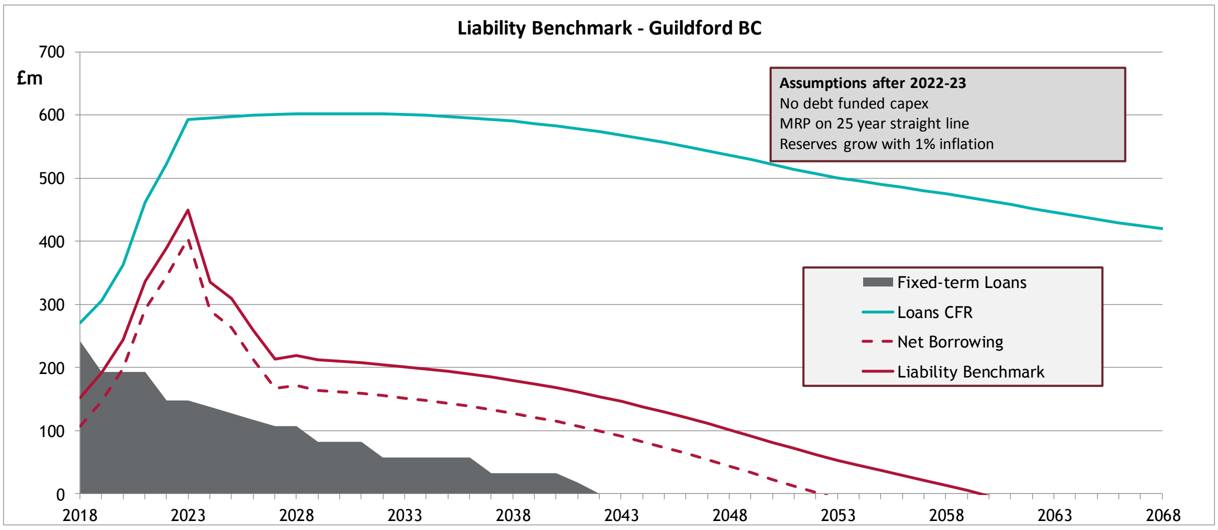
5.11 The Council has an increasing CFR due to the increasing need to borrow for the GF capital programme. The increase in estimated capital spend is more than the annual MRP. We are projecting the cash balance of the Council to reduce, whilst maintaining a good level of (core) reserves over the period shown in the table.

5.12 HRA reserves are decreasing over the early part of the period because of the HRA plans to build new social housing. Our priority is to build new homes rather than reduce debt, although moving forward the table does not include any new borrowing, to show the true cash position of the HRA, and, therefore, the requirement to refinance borrowing.

5.13 GF reserves are projected to remain stable (our core cash). The CFR is increasing sharply due to the proposed capital programme. We are projecting a small need to borrow for the Council as a whole from 2019-20, based on the current profile of the capital programme. We have taken out short-term loans in the year to cover cash flow.

5.14 Working capital is the net of debtors and creditors we have at the end of the financial year, and will vary during the year. If we owe more money to creditors than we are owed by debtors, the working capital is a negative figure (as in the table above).

5.15 The liability benchmark can also be presented graphically:



5.16 The red solid line is the liability benchmark (the lowest risk strategy). If the liability benchmark line rises above the amount of loans we have (shaded area), we need to borrow externally and no longer have any internal borrowing capacity.

Borrowing strategy

5.17 The Council's chief objective when borrowing money is to strike an appropriately low risk 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 Council's long term plans change is a secondary objective.

5.18 Given the significant cuts to public expenditure and in particular local government funding, our borrowing strategy continues to focus on 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 instead.

5.19 We will not automatically externally borrow for the GF when the cash balance is negative, although we will review the position in line with our borrowing strategy and the cash position for the Council as a whole.

5.20 When making decisions about longer-term borrowing, we will review the liability benchmark, as opposed to just the CFR, to assess the length of time we need to borrow for, according to our projections on the level of reserves we may have, as well as other factors detailed in our borrowing strategy. This helps to limit a number of treasury risks of holding large amounts of debt and investments. We will also assess borrowing based on individual projects.

5.21 By doing this, we are able to reduce net borrowing costs (despite forgone investment income) and reduce overall treasury risk.

5.22 We will undertake some modelling taking into account the projects listed in the Corporate Plan and capital vision, for example, which will tell us the potential impact on our borrowing requirement.

5.23 We will continue to monitor our internal borrowing position against the potential of incurring additional interest costs if we defer externalising borrowing into the future when long-term borrowing costs are forecast to rise modestly. Arlingclose will assist us with this 'cost of carry' and breakdown analysis in line with our capital spending plans. Its output may determine whether the Council 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.

5.24 The Council may decide to externalise our current internal borrowing, or to pre-fund future years' requirement, providing this does not exceed the authorised borrowing limit and the highest level of the CFR in the next three years (to ensure we do not over borrow).

5.25 Its output may determine whether we arrange forward stating loans during 2019-20, where the interest is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

5.26 We may continue to borrow short-term for cash flow shortages.

Sources of borrowing

5.27 We will consider, but are not limited to, the following long and short term borrowing sources:

- Public Works Loans Board (PWLB) and any successor body
- any institution approved for investments
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except the local pension fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

5.28 We may also raise capital finance by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- sale and leaseback

5.29 The Council has previously raised the majority of its long-term loans from the PWLB, but we will continue to investigate other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates.

Municipal Bond Agency (MBA)

5.30 UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to uses bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB because

a) borrowing authorities will be required to provide bonds investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason and

b) there will be a lead time of several months between committing to borrow and knowing the interest rate payable.

Short-term and variable rate loans

5.31 These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the following interest rate exposure limits indicator, which is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be £200,000.

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

5.33 We are also required to present the maturity structure of borrowing. This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits of on the maturity structure of borrowing will be:

Maturity Structure of borrowing		
	2019-20	
	Lower	Upper
Under 12 months	0%	30.00%
1 year to 2 years	0%	20.00%
3 years to 5 years	0%	35.00%
6 years to 10 years	0%	50.00%
11 years and above	0%	100.00%

5.34 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.

Debt Rescheduling

5.35 The PWLB allows local authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk and where we have enough money in reserves to fund the repayment.

Investment strategy

5.36 The CIPFA TM code requires the Council to invest its funds prudently, and to have regard to the security (protecting capital sums from loss) and liquidity (keeping money readily available for expenditure when needed or having access to cash) of investments before seeking the highest rate of return, or yield. The Council's objective when investment 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.

5.37 Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal to or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

5.38 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. The 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.

5.39 Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to continue to diversify into more secure and, where possible, higher yielding asset classes during 2019-20. This is especially the case for our longer-term investments. This diversification will represent a continuation of the new strategy adopted in 2015-16.

5.40 Diversification is key. All investments can earn extra interest, but not all investments will default. Also, to highlight the need for security and diversification it takes a long time of earning an extra 1% of interest cover to cover the 20% to 50% loss from a default. It is unlikely we will be able to move away from unsecured deposits entirely, but the less in this category and the more diversified the portfolio is the better the spread of risk.

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

Counterparty limits

5.42 Limits per counterparty on investments are shown in the table below:

Credit Rating	Banks - unsecured	Banks - secured	Government (incl LAs)	Corporates	Asset backed securities
Specified investments					
UK Government	n/a	n/a	£unlimited, 50 yrs	n/a	n/a
AAA	£6m, 5 yrs	£10m, 20 yrs	£10m, 50 yrs	£6m, 20 yrs	£6m, 20 yrs
AA+	£6m, 5 yrs	£10m, 10 yrs	£10m, 25 yrs	£6m, 10 yrs	£6m, 10 yrs
AA	£6m, 4 yrs	£10m, 5 yrs	£10m, 15 yrs	£6m, 5 yrs	£6m, 10 yrs
AA-	£6m, 3 yrs	£10m, 4 yrs	£10m, 10 yrs	£6m, 4 yrs	£6m, 10 yrs
A+	£6m, 2 yrs	£10m, 3 yrs	£6m, 5 yrs	£6m, 3 yrs	£6m, 5 yrs
A	£6m, 2 yrs	£10m, 3 yrs	£6m, 5 yrs	£6m, 2 yrs	£6m, 5 yrs
A-	£6m, 18 mths	£10m, 2 yrs	£6m, 5 yrs	£6m, 18 mths	£6m, 5 yrs
Non Specified investments					
BBB+	£4m, 1 yr	£5m, 1 yr	£4m, 2 yrs	£3m 2 yr	£3m, 2 yrs
None	£1m, 12 mths	n/a	£4m, 25 yrs	£6m, 5yrs	£6m, 5 yrs
Money Market Funds	£20m per fund				
Pooled funds	£10m per fund				

5.43 These limits are per counterparty and the higher level is the maximum. For example, we will not invest more than £10 million with a bank or group of banks, which can all be secured or a maximum of £6 million unsecured. The time limits shown are the maximum from the start of an investment, and operationally we could have a shorter duration.

5.44 We have set limits to try and avoid default on our investments, although this may not always be successful. By setting realistic, but prudent limits we are forcing diversification which aims to help reduce the value of a default if we are exposed to one.

5.45 To mitigate the risk of default, we will ensure that no more than £10 million will be invested in any one institution or institutions within the same group (other than the UK Government). A group of banks under the same ownership will be treated as a single organisation for limit purposes. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign currency, since the risk is diversified over many countries.

5.46 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.

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

5.48 Banks secured: covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the banks' assets, which limited 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 or secured investments.

5.49 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.

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

5.51 Registered providers: loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formally 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.

5.52 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.

5.53 Bond, equity and property funds offer enhanced returns over the longer-term, but are more volatile in the short-term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting our investment objectives will be monitored regularly.

5.54 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 the 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.

5.55 Operational bank accounts: the Council may incur operational exposures, for example, through 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. 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 change of the Council maintaining operational continuity.

5.56 HSBC are our bankers. We may place investments with them, and on occasions we may be in a position where we have received some unexpected cash, and we may, therefore, breach the unsecured limit. We would aim for this to be for as short a duration as possible.

5.57 In addition, we may make an investment that is defined as capital expenditure by legislation, such as company shares.

5.58 We may invest in investments that are termed ‘alternative investments’. These include, by way of example, but are not limited to, things such as renewable energy bonds (solar farms) and regeneration bonds. These are asset backed bonds, offering good returns, and will enable the Council to enter new markets, thus furthering the diversification of our investment portfolio with secured investments and enhancing yield. Any investments entered into of this type will be subject to a full due diligence review.

Risk and credit ratings

5.59 Arlingclose obtain and monitor credit ratings and they notify us with any changed 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

5.60 Where credit rating agencies announce that a credit rating is on review for possible downgrade ("rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, we will limit new investments with that organisation to overnight 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.

5.61 The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the institutions in which we invest, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management and investment advisors.

5.62 We will not make investments with any organisation if there are substantive doubts about its credit quality, even though it may meet the above criteria.

5.63 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of our 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 meet the Council'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.

5.64 We will measure and manage our exposure to treasury management risk by using the following indicators:

- <u>Security:</u> we have adopted a voluntary measure of our exposure to credit risk by monitoring the value-weighted average credit rating of our investment portfolio. This is calculated by applying a score to each investment based on credit ratings (AAA=1, AA+=2 etc) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk. The average portfolio credit rating target is set for A for 2019-20.
- <u>Liquidity</u>: we monitor our liquidity using a cash-flow system. We project forward for the financial year, and enter all known cash transactions at the beginning of the financial year and then update the position on a daily basis. This forms the basis of our investment decisions in terms of duration and value of investments made. We have set £40 million as our minimum liquidity requirement. We also have a high-level cash flow projection over four years.

5.65 <u>Principal sums invested for periods longer than a year</u>: the purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

	2019-20 Approved	2020-21 Estimate	2022-23 Estimate	2023-24 Estimate
Upper limit for total principal sums invested for longer than a year	£50m	£50m	£40m	£30m

5.66 Where we invest longer-term we strike a balance between tradeable and fixed term investments. Whilst we do not enter into the tradeable deposits with the intention of selling, we are helping mitigate the risk exposure by using these types of investments so if we have a liquidity problem we can liquidate these investments prior to maturity at nil or minimal cost.

6. Other items

6.1 There are a number of additional items the Council is obliged by CIPFA and/or MHCLG to include in our strategy.

Policy on the use of Financial Derivatives

6.2 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).

6.3 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).

6.4 The Council will only use standalone derivatives (such as swaps, forwards, futures, and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. 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.

6.5 We may arrange financial derivative transactions 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.

Markets in Financial Instruments Derivative

6.6 The Council has opted up to professional client status with its providers of financial services, allowing it to access a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of our treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

Policy on apportioning interest to the HRA

6.7 The Council operates a two-pooled approach to its loans portfolio, which means we separate long-term HRA and GF loans.

6.8 Interest payable and other costs or income arising from long-term loans (for example premiums and discounts on early redemption) will be charged or credited to the respective account. Differences between the value of the HRA loans pool and the HRAs 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.

6.9 We will charge long-term loan interest on an actual basis, as incurred.

6.10 For notional cash balances we will apply the average DMO rate for the year. This rate is the lowest credit risk investment. We apply this because if there are any investment defaults it will be a charge to the GF, regardless of whether it was HRA cash that was lost.