

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 we 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 requires Local Authorities to have regard to the Prudential Code. The Prudential Code, last revised in 2021, 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 See appendix 15

Credit outlook

2.2 See appendix 15.

Interest rate forecast

2.3 See appendix 15.

3. Balance sheet and treasury position**Balance Sheet**

3.1 The Council has a strong asset backed balance sheet

	Balance at 31 March 2020		Balance at 31 March 2021		
	£'000	£'000	£'000	£'000	
Long term assets	948,801		966,201		
Short term assets	28,574		92,938		
		977,375		1,059,139	89%
Long term investments	42,170		27,022		
Short term investments	59,189		100,969		
		101,359		127,991	11%
Total assets		1,078,734		1,187,130	
Current liabilities	(36,915)		(61,265)		
Long term liabilities	(113,567)		(143,258)		
		(150,482)		(204,523)	40%
Short term borrowing	(44,493)		(163,772)		
Long term borrowing	(192,435)		(147,435)		
		(236,928)		(311,207)	60%
Total liabilities		(387,410)		(515,730)	
Net assets		691,324		671,400	

3.2 The summary balance sheet shows that cash investments make up only 11% of the Councils assets. Investment property makes up 16% of the long-term assets (being £152 million). The largest proportion of our liabilities is long-term borrowing, which is all 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 riskier the organisation 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.

	2020-21 Actual ('000)	2021-22 Outturn ('£000)	2022-23 Estimate ('£000)	2023-24 Estimate ('£000)	2024-25 Estimate ('£000)	2025-26 Estimate ('£000)
Total debts	311,207	256,935	374,289	480,997	516,110	526,159
Total assets	1,187,130	1,246,866	1,394,698	1,513,852	1,557,191	1,597,574
Debt Ratio %	26%	21%	27%	32%	33%	33%

3.4 This shows that our gearing is low, but increasing and remaining steady, which is because of our strong asset base, and projecting forwards capital spend will continue to grow our 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 Councils 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

3.8 These indicators will be calculated on an actual basis and will form part of the outturn report.

Treasury position

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

	March 21 Actual £'000	Nov 21 position £'000
Investments		
<u>Managed in-house</u>		
Call Accounts	330	3,942
Notice Accounts - UK	3,000	3,000
Money Market Funds	39,220	35,438
Temporary Fixed Deposits	57,500	92,300
Long term Fixed Deposits	18,500	19,500
Cash plus	5,000	5,000
Short term bonds	2,000	5,800
Gilts	0	8,000
Covered Bonds	16,100	19,500
Total investments managed in-house	141,650	192,480
<u>Pooled Funds</u>		
CCLA	6,490	7,103
M&G	3,530	3,758
Schroders	700	714
UBS	2,220	2,185
Royal London	2,330	2,313
Fundamentum	1,980	2,049
Funding Circle	500	209
Total pooled funds investments	17,750	18,332
Total Investments	159,400	210,812
Borrowing		
Temporary borrowing	163,772	196,500
Long-term borrowing (PWLb)	147,435	147,435
Total borrowing	311,207	343,935
Net investments / (borrowing)	(151,807)	(133,123)

- 3.10 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 2021 (the latest position).
- 3.11 Investment balances are higher, due to more temporary borrowing. The net borrowing position has decreased since March 2021 due to an increase in cash investments.

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 (radar stage)
 - Approved programme (outline & final business case stage)
 - Provisional programme (strategic outline case stage)
 - Reserves funded programme
 - S106 funded programme
- 4.4 The Council splits the schemes into three types to enable 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:
- a) development for financial reasons - those schemes that are for economic growth, regeneration and redevelopment (including housing schemes) which have a neutral or positive direct financial benefit to the council
 - b) development for non-financial reasons - those schemes that are for economic growth, regeneration, redevelopment, including housing schemes and infrastructure which have no direct financial benefit to the Council and
 - c) non-development essential schemes (i.e., those that must be done to keep our fixed assets in an acceptable condition) - those schemes that need to be undertaken for statutory/compliance reasons, are required to maintain service provision at existing levels (or prevent cost escalation)
- 4.5 Type (a) 'development schemes for financial reasons' 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 or by the capital receipts generated from the scheme being sufficient to repay any debt used to finance the scheme such that there are no borrowing costs on the revenue account.
- 4.6 Type (b) 'development schemes for non-financial reasons' are required to provide regeneration in the borough to support economic growth in the borough but may not have any direct financial benefit to the Council
- 4.7 Type (c) 'essential schemes' often do not have cashable savings or efficiencies associated with them, but often prevent further cost escalation of services. Essential

schemes often have revenue costs associated with them, particularly if funded from borrowing.

- 4.8 The capital programme covers a 5 to 10-year period, with more emphasis on the first five years.
- 4.9 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.
- 4.10 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.
- 4.11 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.
- 4.12 Under the financial regulations, schemes that are fully funded by s106 receipts or grants and contributions can be added to the capital programme under delegation.
- 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 2, 4, 7, 10 and 11 and then as part of the final accounts report. Under the PPM Governance framework, the Major Project Portfolio Board, and its sub groups, meet monthly, and they receive highlight reports on the progress of all the major projects in the capital programme.
- 4.15 The proposed financing of the capital programme assume 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 GF (incorporating non-HRA housing) and HRA housing.
- 4.18 Our current approved capital programme, revised in year for updates in the programme and for the new bids to be submitted for approval by the Executive is as follows:

CAPITAL EXPENDITURE SUMMARY	2021-22 Approved £000	2021-22 Outturn £000	2021-22 Variance £000	2022-23 Estimate £000	2023-24 Estimate £000	2024-25 Estimate £000	2025-26 Estimate £000	2026-27 Estimate £000
General Fund Capital Expenditure								
- Main Programme	92,790	49,088	(43,702)	106,198	7,738	2,705	2,000	2,000
- Provisional schemes	53,533	6,937	(46,596)	40,666	110,916	40,634	38,383	24,642
- Schemes funded by reserves	1,975	3,541	1,566	910	500	0	0	0
- S106 Projects	0	171	171	58	0	0	0	0
- New Bids (net cost)	0	0	0	4,089	1,948	2,500	5,000	3,000
Total Expenditure	148,298	59,736	(88,562)	151,921	121,102	45,839	45,383	29,642
Financed by :								
Capital Receipts	(95)	(448)	(353)	0	0	0	(21,641)	(24,642)
Capital Grants/Contributions	(51,415)	(18,138)	33,277	(48,626)	(15,315)	(2,954)	0	0
Capital Reserves/Revenue	(2,195)	(4,263)	(2,068)	(1,130)	(720)	(220)	0	0
Borrowing	(94,593)	(36,887)	57,706	(102,165)	(105,067)	(42,665)	(23,742)	(5,000)
Financing - Totals	(148,298)	(59,736)	88,562	(151,921)	(121,102)	(45,839)	(45,383)	(29,642)
Housing Revenue Account Capital Expenditure								
- Main Programme	17,988	15,761	(2,227)	8,041	9,253	1,400	400	0
- Provisional schemes	34,117	0	(34,117)	19,339	54,270	24,200	18,515	49,575
- New bids	0	0	0	32,550	950	0	0	0
Total Expenditure	52,105	15,761	(36,344)	59,930	64,473	25,600	18,915	49,575
Financed by :								
- Capital Receipts	(13,914)	(2,595)	11,319	(8,472)	(11,964)	(6,288)	(400)	(13,200)
- Capital Reserves/Revenue	(38,191)	(13,166)	25,025	(41,459)	(42,509)	(9,313)	(8,515)	(26,375)
- Borrowing	0	0	0	(10,000)	(10,000)	(10,000)	(10,000)	(10,000)
Financing - Totals	(52,105)	(15,761)	36,344	(59,930)	(64,473)	(25,600)	(18,915)	(49,575)

- 4.19 The programme has slipped in 2021-22 – estimated expenditure on the GF of £148 million, has been reduced to £60 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 accounted for in the HRA capital programme. All other housing related expenditure is accounted for in the GF capital programme. Where there are mixed use schemes, we will split the expenditure based on the proposed percentage of social/affordable housing to be developed.

New capital schemes

- 4.21 To ensure good governance, the Council has the following process for the capital programme.
- 4.22 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 radar projects for the capital vision.
- 4.23 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 9). 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.

- 4.24 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.
- 4.25 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.
- 4.26 Each project will require a business case, in line with guidance set out in the HM Treasury Green Book ('Green book'). The following applies:
- Simple non-complex projects (e.g., BAU R&M) – a simple business justification case will be required to justify the spending proposal
 - All other projects 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
- 4.27 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:
- 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

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.

- c) Each scheme must have some or all of a cost benefit analysis, including but not limited to 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 development schemes for financial reasons
- g) All projects should assess the qualitative benefits

- 4.28 The Council has 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.
- 4.29 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.
- 4.30 The impact is that there will be a limit to the number of Essential capital schemes (i.e., 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) and the number of development schemes that are undertaken for non-financial reasons. Based on an average asset life of 25 years for MRP purposes, the limit for new essential and non-financial development schemes to be funded by borrowing for each financial year in the capital programme will be:

	2022-23 £000	2023-24 £000	2024-25 £000	2025-26 £000	2026-27 £000	2027-28 to 2030-31 £000
New Bids - net addition	4,089	1,948	2,500	5,000	3,000	10,600
Net non income generating approved prog	1,933	71	0	0	0	0
Net non income generating provisional prog	2,673	2,250	7,599	3,402	250	(500)
	8,695	4,198	10,099	8,402	3,250	10,100
						0
Affordability level	7,292	5,318	5,494	5,663	5,827	25,063
Less additional MRP over 21/22 base re historical exp	(94)	(159)	(33)	(34)	(35)	(130)
amount of additional cap exp the Council can afford	7,198	5,159	5,462	5,629	5,791	24,933
over / (under) affordable level	1,497	(961)	4,637	2,773	(2,541)	(14,833)

- 4.31 This limit does not apply to development capital schemes (i.e., those that will be undertaken for economic growth, regeneration, redevelopment or income generation purposes, titled development/infrastructure – nonfinancial benefit and development – financial benefit) as these schemes are defined as those which are anticipated to have a neutral or positive impact on the GF revenue account or on the town. 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.

- 4.32 The bids submitted by officers for both the GF and HRA can be found in appendices 2 and 3.
- 4.33 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.
- 4.34 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.
- 4.35 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 (RTB 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 2021 ('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 showing 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 hold at any point in time, to maintain sufficient liquidity.
- 5.6 The liability benchmark assumes:

- an allowance for currently known capital expenditure is included, with no future allowance for unknown schemes
- MRP has been allowed for based on the underlying need to borrow for the GF capital programme until 2032-33
- 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 11 Jan 2022							
31st March:	2021	2022	2023	2024	2025	2026	2027
Loans Capital Financing Req.	327,847	363,915	462,955	573,692	612,735	622,046	645,652
Less: External Borrowing	(310,935)	(192,435)	(192,435)	(182,435)	(172,435)	(162,435)	(152,435)
Internal (Over) Borrowing	16,912	171,480	270,520	391,257	440,300	459,611	493,217
Less: Usable Reserves	(191,043)	(155,204)	(159,888)	(119,621)	(117,936)	(123,267)	(98,278)
Plus: Working Capital Required	15,558	15,558	15,558	15,558	15,558	15,558	15,714
(Investments) / New Borrowing	(158,573)	31,834	126,190	287,194	337,923	351,903	410,653
Net Borrowing Requirement	152,362	224,269	318,625	469,629	510,358	514,338	563,088
Preferred Year-end Position	45,000	45,000	45,000	45,000	45,000	45,000	45,450
Liability Benchmark (year-end)	197,362	269,269	363,625	514,629	555,358	559,338	608,538

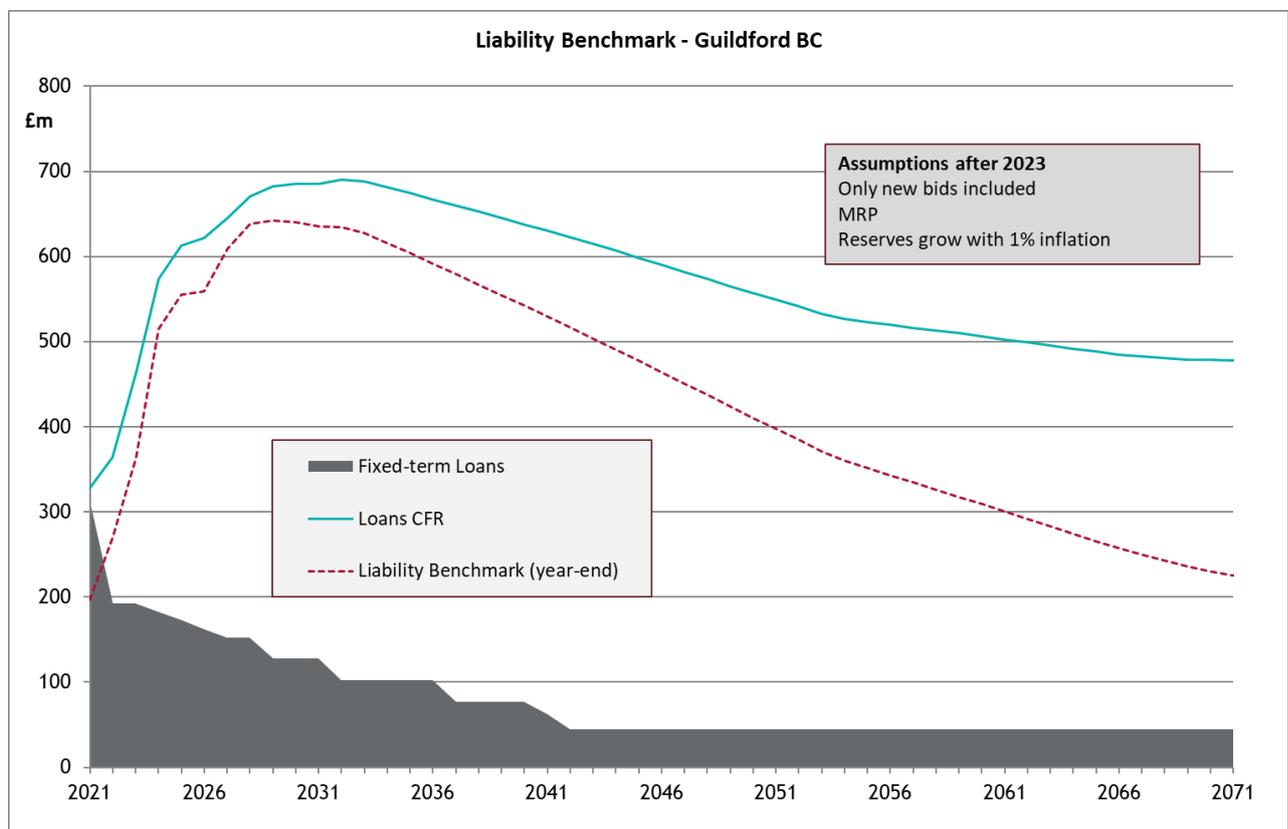
Housing Revenue Account - Summary and Projections in £000							
31st March:	2021	2022	2023	2024	2025	2026	2027
HRA Loans CFR	199,204	207,024	217,024	227,024	237,024	237,024	237,024
HRA Reserves	(120,991)	(85,023)	(90,827)	(51,367)	(49,649)	(54,947)	(29,925)
HRA Working Capital	0	0	0	0	0	0	0
HRA Borrowing	(192,435)	(192,665)	(192,665)	(182,665)	(172,665)	(162,665)	(152,665)
HRA Cash Balance	(114,222)	(70,664)	(66,468)	(7,008)	14,710	19,412	54,434

General Fund - Summary and Projections in £000							
31st March:	2021	2022	2023	2024	2025	2026	2027
GF Loans CFR	128,643	156,891	245,931	346,668	375,711	385,022	408,628
GF Reserves	(70,052)	(70,181)	(69,061)	(68,254)	(68,287)	(68,320)	(68,353)
GF Working Capital	15,558	15,558	15,558	15,558	15,558	15,558	15,714
GF Borrowing	(118,500)	230	230	230	230	230	230
GF Cash Balance	(44,351)	102,498	192,658	294,202	323,212	332,490	356,219

- 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 (2021-22 to 2023-24). The liability benchmark is expected to increase to £460 million by March 2026.

- 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 2021-22, 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 primary 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 2022-23 with a view to keeping future interest costs low, even if this causes additional cost in the short term.
- 5.24 PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Council needs to avoid this activity in order to retain access to PWLB funding.
- 5.25 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).
- 5.26 Its output may determine whether we arrange forward starting loans during 2022-23, 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.

- 5.27 We may continue to borrow short-term for cash flow shortages.
- 5.28 We have an agreement with Homes England on the WUV project, whereby we have been successful in being granted a loan at the local infrastructure rate. Borrowing will be taken out from the PWLB in line with the agreed timetable.

Sources of borrowing

- 5.29 We have previously borrowed our long-term HRA borrowing from the PWLB. We will review all borrowing sources moving forwards and may explore the possibility of issuing bonds and similar instruments in order to lower interest costs and reduce over reliance on one source of funding, in line with the CIPFA Code.
- 5.30 We will consider, but are not limited to, the following long- and short-term borrowing sources:
- HM Treasury's PWLB lending facility
 - 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
- 5.31 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

Municipal Bond Agency (MBA)

- 5.32 UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB because:
- a) borrowing authorities will be required to provide bonds investors with a 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

- 5.33 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. Financial derivatives may be used to manage this interest rate risk (see below).

- 5.34 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.
- 5.35 We are also required to present the maturity structure of borrowing. This indicator is set to control the Council's exposure to refinancing risk, in terms of loans being unavailable. The upper and lower limits of on the maturity structure of borrowing will be:

Maturity Structure of borrowing		
	2021-22	
	Lower	Upper
Under 12 months	0%	50.00%
1 year to 2 years	0%	50.00%
3 years to 5 years	0%	60.00%
6 years to 10 years	0%	75.00%
11 years and above	0%	100.00%

- 5.36 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

- 5.37 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

- 5.38 The CIPFA TM code requires the Council to invest its treasury 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 investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.
- 5.39 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.
- 5.40 The Covid-19 pandemic has increased the chance that the Bank of England will 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. Since investments cannot pay negative income, negative rates will be applied by reducing the value of the investment. 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.

- 5.41 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 2021-22. This is especially the case for our longer-term investments. This diversification will represent a continuation of the strategy adopted in 2015-16.
- 5.42 The Council has had a review undertaken, and as such, linked to the profile of the capital programme, the optimum asset allocation is:

Overnight liquidity	5%
Long-term fixed deposits (1-3years)	21%
Unsecured bonds (1-4years)	21%
Covered bonds (1-5 years)	23%
External funds	5%
Revolving credit facility	2%
Asset backed securities	10%
Private bonds	13%

This will be reviewed annually.

- 5.43 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.
- 5.44 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

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

Sector	Time limit	Counterparty limit	Sector limit
UK Government	50 yrs	unlimited	n/a
Local authorities and other Government entities	25 yrs	£10 million	unlimited
Secured investments	25 yrs	£10 million	unlimited
Banks (unsecured)	13 mths	£6 million	unlimited
Building Societies (unsecured)	13 mths	£6 million	£15 million
Registered providers (unsecured)	5 yrs	£6 million	£20 million
Money Market Funds	n/a	£20 million	unlimited
Strategic pooled funds	n/a	£10 million	£50 million
Real estate investment trusts	n/a	£10 million	£20 million
Other investments	5 yrs	£10 million	£20 million

- 5.46 The time limits shown are the maximum from the start of an investment, and operationally we could have a shorter duration.
- 5.47 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.
- 5.48 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.
- 5.49 Secured investments: investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies 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. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.
- 5.50 Banks and building societies (unsecured): Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.
- 5.51 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 Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years. Local Authorities are statutory bodies and have access to the PWLB for borrowing, and any of these loans would be transferred to a successor body. There has not been a Local authority default, despite some s114 notices being put in place, instead Government has stepped in so the risk of a local authority defaulting is very low.
- 5.52 Registered providers (unsecured): 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 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.
- 5.53 Money market funds: Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment

risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

- 5.54 Pooled funds: Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.
- 5.55 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.
- 5.56 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. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.
- 5.57 Other investments: This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Authority's investment at risk.
- 5.58 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.
- 5.59 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.
- 5.60 In addition, we may make an investment that is defined as capital expenditure by legislation, such as company shares.
- 5.61 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

- 5.62 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
- 5.63 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.
- 5.64 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.
- 5.65 We will not make investments with any organisation if there are substantive doubts about its credit quality, even if it meets the above criteria.
- 5.66 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, 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 investment returns to fall but will protect the principal sum invested.
- 5.67 We will measure and manage our exposure to treasury management risk by using the following indicators:
- Security: 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 2022-23.

- **Liquidity:** we monitor our liquidity for a given financial year using an online 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 £45 million as our minimum liquidity requirement. We also have a high-level cash flow projection over four years.

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

	2021-22 Approved	2022-23 Estimate	2023-24 Estimate	2024-25 Estimate
Upper limit for total principal sums invested for longer than a year	£50m	£50m	£50m	£50m

5.69 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, assessed using the appropriate credit rating for derivative exposures. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

- 6.6 In line with the CIPFA Code, the Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

Markets in Financial Instruments Derivative

- 6.7 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

- 6.8 The Council operates a two-pooled approach to its loan's portfolio, which means we separate long-term HRA and GF loans.
- 6.9 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.
- 6.10 We will charge long-term loan interest on an actual basis, as incurred.
- 6.11 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.