

Capital and Investment Strategy 2018-19 to 2022-23

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 Councils need to invest in their assets, as they are the most valuable resource (termed as non-financial assets throughout the report).
- 1.3 Capital planning is about investment in assets and is, therefore, linked to asset planning. Council assets have been acquired using public money, so Councils 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.
- 1.4 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.
- 1.5 Treasury management is an important part of the overall management of the Council's finances. Councils 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.
- 1.6 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”*
- 1.7 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.
- 1.8 The Local Government Act 2003, requires local authorities to have regard to the Prudential Code. The Prudential Code, 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 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

- 1.9 Included in these regulations and codes of practice, we are required to set Prudential Indicators for assessing the prudence, affordability and sustainability of capital expenditure and treasury management decisions.
- 1.10 The revised Prudential Code sets the requirement to include non-treasury management investments in the investment strategy for the first time.
- 1.11 Due to the recommended content of the capital strategy, officers decided to prepare an integrated capital and investment strategy covering both the capital programme and treasury management, rather than separate reports as in previous years.
- 1.12 The following sections of the strategy outline the Council's balance sheet and treasury position, capital expenditure and treasury management.
- 1.13 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. Balance sheet and treasury position

Balance Sheet

- 2.1 The Council has a strong asset backed balance sheet:

Item	Balance at 31-3-16			Balance at 31-3-17		
	£000	£000		£000	£000	
Long-term Assets	790,120			872,338		
Short-term assets	8,196			7,664		
		798,316	85%	880,002		93%
Long-term investments	25,050			45,749		
Short-term investments	119,981			82,894		
		145,031	15%	128,643		14%
Total assets		943,347		1,008,645		
Current liabilities	(31,396)			(26,688)		
Long-term liabilities	(76,350)			(93,449)		
		(107,746)	31%	(120,137)		35%
Short-term borrowing	(34,991)			(35,461)		
Long-term borrowing	(203,355)			(198,125)		
		(238,346)	69%	(233,586)		67%
Total liabilities		(346,092)		(353,723)		
Net assets		597,255		654,922		

2.2 The summary balance sheets shows that investments make up only 15% of the Council's assets, and the largest proportion of our liabilities is long-term borrowing, which is predominately HRA debt.

Financial Stability/sustainability

2.3 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.

	2015-16 Actual (£000)	2016-17 Actual (£000)	2017-18 Estimate (£000)	2018-19 Estimate (£000)	2019-20 Estimate (£000)	2020-21 Estimate (£000)	2021-22 Estimate (£000)
Total debts	346,092	353,723	424,349	570,447	664,272	701,684	748,996
Total assets	943,347	1,008,645	1,098,472	1,256,777	1,365,184	1,420,566	1,467,878
Debt Ratio %	37%	35%	39%	45%	49%	49%	51%

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

2.5 Future years estimates are based on adding the budgeted cost of capital investment onto the assets, and adding the assumed debt funded expenditure to the debt figure to give an idea how the financial stability of the Council will be evolving.

- 2.6 The Local Government Association (LGA) use a number of financial indicators to assess the financial sustainability of Council's as part of their financial diagnostic tool. Amongst the indicators reviewed are:-
- (a) Total debt as a % of long term assets (this differs slightly from the Gearing ratio) - total debt can pose both short term liquidity risk and long term cash pressures, therefore the lower the relative debt the lower the risk to the authority
 - (b) Ratio of equity by net revenue expenditure - If an authority has a low level of net assets (equity) this may be because it has a low level of assets, a high level of liabilities or both. This indicator differentiates those authorities which have a relatively higher level of liabilities to fund and limited assets from which to do so, making additional financing costs likely in the years ahead
 - (c) Unringfenced reserves as a % net revenue expenditure - The higher the relative value of the unringfenced reserves the more sustainable an authority is
 - (d) Working capital as a % of the net revenue expenditure - Authorities with a strongly positive indicator would have less difficulty liquidating sufficient assets to operate in the event of a short term debt problem
 - (e) Short term liability pressure: Short term liabilities as a % of total liabilities - Short term liability poses an immediate pressure on liquidity, the lower the figure, the relatively lower exposure to short term liabilities
 - (f) Total investments as a % of net revenue expenditure - The more investments relative to the net revenue expenditure more sustainable and stable and authority's financial position.
 - (g) Investment property as a % of the net revenue - A higher total value of investment property indicates more opportunity to raise income. However, return on investment can vary depending on the type of investment and an investment strategy. The higher the relative value of investment property the more opportunity an authority has for financial stability
- 2.7 The Council proposes to monitor these indicators (as local indicators) and projections for how they will change over time during the medium term financial plan as part of the capital strategy.

Treasury position

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

	March 17 Actual £'000	Nov 17 position £'000
Investments		
<u>Managed in-house</u>		
Call Accounts	475	0
Notice Accounts - UK	13,000	13,000
Money Market Funds	1,319	4,062
Temporary Fixed Deposits	34,000	42,000
Long term Fixed Deposits	16,500	16,500
Certificates of Deposit	2,000	3,000
Unsecured bonds	6,824	8,502
Covered Bonds	27,736	33,829
Revolving credit facility	2,500	2,500
Total investments managed in-house	104,354	123,393
<u>Pooled Funds</u>		
Total pooled funds investments	22,563	22,321
Total Investments	126,917	145,715
Borrowing		
Temporary borrowing	30,000	44,000
Long-term borrowing (PWLb)	193,355	193,240
Long-term borrowing (LAs)	10,000	5,000
Total borrowing	233,355	242,240
Net investments / (borrowing)	(106,438)	(96,525)

2.9 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 2017 (the latest position). Investments balances are higher, because of temporary borrowing related to expenditure on the capital programme. The net borrowing position has decreased since March 2017 by £9.9 million because investment balances have risen by more than borrowing.

3. Capital Expenditure

- 3.1 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.
- 3.2 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 with good governance.
- 3.3 The Council has the following parts to its capital programme:
- Capital vision
 - Approved programme
 - Provisional programme
 - Reserves funded programme
 - S106 funded programme

- 3.4 The Council splits the schemes into development and non-development (ie 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.
- 3.5 The capital programme covers a 5-10 year period, with more emphasis on the first five years.
- 3.6 Any projects that are expected to be delivered after the five-years, or those where the scheme has not 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.
- 3.7 Many of the bids in the capital programme are development projects, and their expenditure and income profile could 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.
- 3.8 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.
- 3.9 The proposed financing of the capital programme assumes available resources will be used in the following order
 - a) capital receipts from the sale of assets
 - b) capital grants and contributions
 - c) earmarked reserves
 - d) the general fund capital schemes reserve
 - e) revenue contributions
 - f) internal borrowing
 - g) external borrowing
- 3.10 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.
- 3.11 Capital expenditure is split between 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.

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

CAPITAL EXPENDITURE SUMMARY	2017-18 Approved £000	2017-18 Outturn £000	2018-19 Estimate £000	2019-20 Estimate £000	2020-21 Estimate £000	2021-22 Estimate £000	2022-23 Estimate £000
General Fund Capital Expenditure							
- Main Programme	45,916	30,627	35,140	23,129	5,220	5,220	0
- Provisional schemes	51,850	2,773	45,260	86,645	67,545	49,762	41,762
- Schemes funded by reserves	1,573	3,316	2,302	537	537	0	0
- S106 Projects	440	602	0	0	0	0	0
- Affordable Housing (General Fund)	220	0	0	0	0	0	0
Total Expenditure	99,999	37,318	82,702	110,311	73,302	54,982	41,762
<u>Financed by :</u>							
Capital Receipts	(330)	(324)	(4,000)	(9,200)	(9,075)	(16,000)	0
Capital Grants/Contributions	(3,982)	(3,432)	(1,221)	(2,250)	(4,750)	(1,750)	0
Capital Reserves/Revenue	(7,973)	(9,371)	(13,980)	(757)	(757)	(220)	0
Borrowing	(87,714)	(24,192)	(63,501)	(98,104)	(58,720)	(37,012)	(41,762)
Financing - Totals	(99,999)	(37,318)	(82,702)	(110,311)	(73,302)	(54,982)	(41,762)
Housing Revenue Account Capital Expenditure							
Total Expenditure	21,970	9,172	18,386	25,145	11,475	5,975	6,975
<u>Financed by :</u>							
- Capital Receipts	(4,974)	(1,623)	(4,273)	(6,151)	(2,050)	(400)	(700)
- Capital Reserves/Revenue	(16,996)	(7,548)	(14,113)	(18,994)	(9,425)	(5,575)	(6,275)
Financing - Totals	(21,970)	(9,172)	(18,386)	(25,145)	(11,475)	(5,975)	(6,975)

3.13 The programme has slipped significantly in 2017-18 – estimated expenditure on the GF of £100 million, has been reduced to £37 million. The majority of this relates to expenditure on regeneration schemes and has been moved into later years.

Housing

3.14 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.

3.15 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 preparation costs regardless of who builds the structure.

GF Housing - Affordable housing

3.16 We are continuing with our ambitious programme of directly providing new housing, and we are looking to provide housing for market sale as well as affordable housing.

3.17 Government policy has recently changed once again the HCA have confirmed that there is now grant available for Affordable Rented housing. It

has also been suggested that grant will be available for social rent, although the Government has not yet confirmed whether this would be properties let at the traditional target rent/council rent levels. Nonetheless, indications are that we could apply for higher grant levels which would allow us to keep rents at a more affordable level, particularly if Guildford is designated as an area of high demand/value. As per the policy agreed in previous years, we have designed our schemes to HCA standards to enable us to submit bids where appropriate. The Government has also announced we can apply to have the HRA borrowing cap raised for specific schemes. This presents another funding option, once we have spent all Right to Buy receipts and sums received via s106 planning obligations.

- 3.18 The focus is currently on council direct development because housing association partners are having difficulty finding sites in the Borough which are viable to develop entirely for affordable housing.
- 3.19 The Council will require some resources to enable scheme preparation for development of some Council owned sites. These costs include:
- valuations
 - decommissioning costs
 - home loss and disturbance payments
 - other costs relating to the rehousing of tenants
 - architectural services
 - planning fees
 - legal fees
 - survey fees
- 3.20 We may also provide grant funding to housing associations to assist development viability or fund enabling works. We have been asked to consider two schemes, and we are waiting for further details from the housing associations to demonstrate that the funding is required to make the schemes viable. We are in the process of agreeing a loan towards the purchase of a shared ownership property via the HOLD (Home Ownership for people with Long term Disability) which is run by Advance UK housing association. This will be an equity investment, repayable when the shared owner sells the property. We may also wish to pursue opportunities to bring empty homes back into use via refurbishment or redevelopment. Estimates for grant funding and enabling of both Council and housing association developments are included in the overall figures outlined in Appendix 4.

GF Housing - Private sector housing

- 3.21 The Council's housing strategy and the GF capital programme seek to integrate national and local policies to deliver improvements to the quality of housing accommodation in the private section through:
- an appropriate housing renewal policy
 - appropriate use of housing enforcement legislation
 - continued development of partnership working

- 3.22 The principal responsibility for maintenance and improvement of privately owned dwelling rests with the owners; however, the Council will intervene where it is necessary to:
- exercise statutory powers in respect of hazardous conditions in dwellings
 - bring long-term empty homes back into occupation
 - licence houses in multi occupation
 - improve conditions in privately rented accommodation
 - offer financial assistance for the repair, improvement or adaptation of private dwellings in appropriate circumstances
 - promote energy efficiency measures and take up of renewable energy sources
 - provide assistance to elderly people and other vulnerable households through the care and repair service
 - administer Disabled Facilities Grants (DFG)
- 3.23 The funding in the capital programme provides the financial resource to meet the demand for mandatory DFGs and a discretionary scheme of assistance for homeowners, which has regard to local housing conditions.
- 3.24 The emphasis in the discretionary policy is to direct support to residents on low income living in poor housing conditions or promoting a more sustainable environment. More specifically the current discretionary targets assistance towards:
- assisting lower income households needing to make homes decent
 - bring empty homes back into use
 - installing energy efficient measures particularly solid wall insulation for park homes
 - domestic renewable energy such as solar heating
- 3.25 There are specific conditions attached to the approvals of grants or loans that will ensure a substantial proportion of the funds provided will be repaid in future years.
- 3.26 Alongside the grant scheme, we offer a range of loans in partnership with Parity Trust, a social lender. These loans may be interest only or repayment.

New capital schemes

- 3.27 As the implementation of a capital strategy is a new requirement, we have taken the opportunity to update our processes, recommended for approval as part of this report.
- 3.28 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.

- 3.29 Each project will require a business case, in line with guidance set out in the HM Treasury Green book ('Green book'). Officers are proposing this is followed for projects and spending proposals as follows:-
- Projects up to £200,000 – a simple business justification case will be required to justify the spending proposal
 - Projects over £200,000 - will require a 3-stage business case consisting of:
 - a strategic outline case (ie, 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
- 3.30 The Council only 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 proposed criteria is:
- a) Each project must meet one of the five spending objectives:
 - a. Economy (Invest to Save, ie to reduce cost of services)
 - b. Efficiency (ie to improve throughput and unit costs)
 - c. Effectiveness (improving outcomes for the community)
 - d. Retendering to replace elements of existing service and
 - e. statutory or regulatory compliance (ie H&S)
 - b) Each scheme must be scored 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 cashflows and quantifiable economic benefits, payback period, 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 of 3.5%
 - f) The Revenue impact must be neutral or positive on the general fund for all projects except those carried out for statutory or regulatory compliance schemes
 - g) All projects should assess and score the qualitative benefits
- 3.31 The Council may set an affordability limit based on what the general fund can afford for the implications of the capital programme (primarily MRP and interest). The idea being 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.

- 3.32 It is proposed to set a scoring criteria, which will prioritise the bids before being presented to the Capital Monitoring Group (CMG), CMT and Councillors for review.
- 3.33 Bids will be submitted for initial review by the officer led Capital Monitoring Group in September. Their role will be to scrutinise the bids, and review them in line with the overall capital programme. CMT will then review the updated bids and evaluation proposed by officers, along with the financial impacts and NPV scores. Once CMT are fully supportive of the bids, they will be presented to Councillors in the JEABBTG for review and scrutiny in early December before being passed through the Committee Cycle and ultimately being approved at Full Council in February.
- 3.34 A summary of the new bids and their proposed funding is shown below. The detail can be seen in Appendix 2.

Bid number	Project title	GROSS ESTIMATES					TOTAL COST £000
		2018-19 £000	2019-20 £000	2020-21 £000	2021-22 £000	2022-23 £000	
	General fund						
1	97 Tyting Farm Land - removal of barns and concrete hardstanding	250	0	0	0	0	250
2	111 A331 hotspots	300	2,230	1,400	0	0	3,930
3	129 Rodboro buildings - electric theatre through road and parking	450	0	0	0	0	450
4	130 Castle grounds cottage	60	0	0	0	0	60
5	139 Guildford bike share	530	0	0	0	0	530
6	145 48 Quarry St, Museum - structural works	30	220	0	0	0	250
7	151 Guildford West (Park Barn) station	150	50	0	0	0	200
8	169 Bus station relocation	300	200	0	0	0	500
9	197 Shawfield DC	83	0	0	0	0	83
10	198 SMP - electrical works	39	0	0	0	0	39
11	201 Millmead House - M&E plant renewal	33	0	0	0	0	33
12	205 Hydro private wire	85	0	0	0	0	85
13	210 Stoke Park Masterplan enabling costs	100	100	150	0	150	500
14	211 Roads & footpaths	300	400	400	400	400	1,900
15	213 Sports pavilions - replace water heaters	154	0	0	0	0	154
16	229 Millmead fish pass	0	60	0	0	0	60
17	261 Land to the rear of 39-42 castle street	10	0	0	0	0	10
18	264 Old Manor House - replacement windows	193	0	0	0	0	193
19	Crematorium VAT	1,023	669	0	0	0	1,692
20	Student Housing	3,000	45,000	33,000	0	0	81,000
21	Museum additional funding	185	180	855	0	0	1,220
22	Capital Contingency fund (annual budget)	5,000	5,000	5,000	5,000	5,000	25,000
	Total	12,275	54,109	40,805	5,400	5,550	118,139
	For reserves programme (approved prog)						
23	140 ICT renewals	2,284	527	500	500	500	4,311
24	177 Deck Millbrook Car Park	0	2,000	0	0	0	2,000
25	181 New POF equipment	15	585	0	0	0	600
26	194 Structural works to MSCP	200	100	0	0	0	300
27	200 PBDC - air source heat pump	143	0	0	0	0	143
28	207 SMP - air source heat pump	28	0	0	0	0	28
29	212 Stoke Park nursery - air source heat pump	17	0	0	0	0	17
	Total funded from reserves	2,687	3,212	500	500	500	7,399
	Gross total	14,962	57,321	41,305	5,900	6,050	125,538

Approved capital schemes

- 3.35 The Council's capital programme, has been split into two sections – the approved capital programme and the provisional capital programme. The capital bids are equivalent to the Strategic Outline Case (SOC) described in the HM Treasury Green Book.
- 3.36 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.
- 3.37 Most projects over £200,000 require a further outline business case to be prepared and approved by the Executive before a project can be moved from the provisional to the approved capital programme and authority is provided

for officers to spend on implementation of the project. Any project under £200,000 can be moved under officer delegation.

- 3.38 Capital bids are ranked against the priorities in the Corporate Plan as part of the capital bidding process before they are placed on the provisional capital programme.
- 3.39 In addition, since 2016-17 we have also split the capital programme 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.
- 3.40 Type (a) 'essential schemes' 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.
- 3.41 Type (b) 'investment schemes' are required to provide a positive or neutral impact on the Council's general fund 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 general fund revenue account.
- 3.42 Under the financial regulations, schemes that are fully financed 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 Head of Financial Services.
- 3.43 During the year, the 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.
- 3.44 The capital programme is also reviewed by CMT and the Corporate Governance and Standards Committee as part of the budget monitoring reports for months 3, 6, 8 and 10, and then as part of the final accounts report.
- 3.45 The table below highlights the currently approved capital programme and the proposed new bids highlighted in the report and appendices.

CAPITAL EXPENDITURE SUMMARY	2017-18 Approved £000	2017-18 Outturn £000	2018-19 Estimate £000	2019-20 Estimate £000	2020-21 Estimate £000	2021-22 Estimate £000	2022-23 Estimate £000
General Fund Capital Expenditure							
- Main Programme	45,916	30,627	35,140	23,129	5,220	5,220	0
- Provisional schemes	51,850	2,773	45,260	86,645	67,545	49,762	41,762
- Schemes funded by reserves	1,573	3,316	2,302	537	537	0	0
- S106 Projects	440	602	0	0	0	0	0
- Affordable Housing (General Fund)	220	0	0	0	0	0	0
- New Bids (net cost)	0	0	6,940	47,814	34,250	400	5,550
Total Expenditure	99,999	37,318	89,642	158,125	107,552	55,382	47,312
Financed by :							
Capital Receipts	(330)	(324)	(4,000)	(9,200)	(9,075)	(16,000)	0
Capital Grants/Contributions	(3,982)	(3,432)	(1,221)	(2,250)	(4,750)	(1,750)	0
Capital Reserves/Revenue	(7,973)	(9,371)	(13,980)	(757)	(757)	(220)	0
Borrowing	(87,714)	(24,192)	(70,441)	#####	(92,970)	(37,412)	(47,312)
Financing - Totals	(99,999)	(37,318)	(89,642)	#####	#####	(55,382)	(47,312)
Housing Revenue Account Capital Expenditure							
Total Expenditure	21,970	9,172	18,386	25,145	11,475	5,975	6,975
Financed by :							
- Capital Receipts	(4,974)	(1,623)	(4,273)	(6,151)	(2,050)	(400)	(700)
- Capital Reserves/Revenue	(16,996)	(7,548)	(14,113)	(18,994)	(9,425)	(5,575)	(6,275)
Financing - Totals	(21,970)	(9,172)	(18,386)	(25,145)	(11,475)	(5,975)	(6,975)

Borrowing strategy

- 3.46 Our primary objective when borrowing is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should our long-term plans change is a secondary option, but is still a consideration.
- 3.47 The Council can borrow short-term for cash flow purposes and long-term for funding the capital programme, which is linked to the Capital Financing Requirement (CFR)
- Capital financing requirement (CFR)*
- 3.48 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, and what we have borrowed, compared to our level (and projected level) of reserves. We split this between the GF and the HRA.
- 3.49 The CFR measures the Council's underlying need to borrow for a capital purpose. This is derived from unfinanced capital expenditure which arises when there are no capital receipts or reserves available to fund the capital programme. This then increases the CFR.
- 3.50 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 £25 million. It represents

the minimum level of cash / investments we will always maintain to cover the Council's cash movements, at any point in time.

- 3.51 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 cash). The reserves currently exclude the items on the capital vision, mainly because the cost of the schemes are unknown.
- 3.52 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 during 2018-19.

Guildford Borough Council							
Balance Sheet Summary and Projections in £000 - last updated 16 Dec 2017							
31st March:	2017	2018	2019	2020	2021	2022	2023
Loans Capital Financing Req.	266,839	290,457	359,883	504,151	594,693	625,464	665,297
Less: External Borrowing	(233,355)	(225,125)	(192,895)	(192,665)	(192,435)	(147,435)	(147,435)
Internal (Over) Borrowing	33,484	65,332	166,988	311,486	402,258	478,029	517,862
Less: Usable Reserves	(141,824)	(131,385)	(118,258)	(110,742)	(114,089)	(120,542)	(123,430)
Less: Working Capital Surplus	(18,646)	(18,646)	(18,646)	(18,646)	(18,646)	(18,646)	(18,646)
(Investments) / New Borrowing	(126,986)	(84,699)	30,084	182,098	269,523	338,841	375,786
Net Borrowing Requirement	106,369	140,426	222,979	374,763	461,958	486,276	523,221
Preferred Year-end Position	20,000	25,000	25,000	25,000	25,000	25,000	25,000
Liability Benchmark	126,369	165,426	247,979	399,763	486,958	511,276	548,221

Housing Revenue Account - Summary and Projections in £000							
HRA Loans CFR	196,664	196,664	197,024	197,024	197,024	197,024	197,024
HRA Reserves	(102,019)	(96,033)	(84,571)	(76,623)	(80,187)	(85,499)	(90,495)
HRA Working Capital	0	0	0	0	0	0	0
HRA Borrowing	(193,355)	(193,125)	(192,895)	(192,665)	(192,435)	(147,435)	(147,435)
HRA Cash Balance	(98,710)	(92,494)	(80,442)	(72,264)	(75,598)	(35,910)	(40,906)

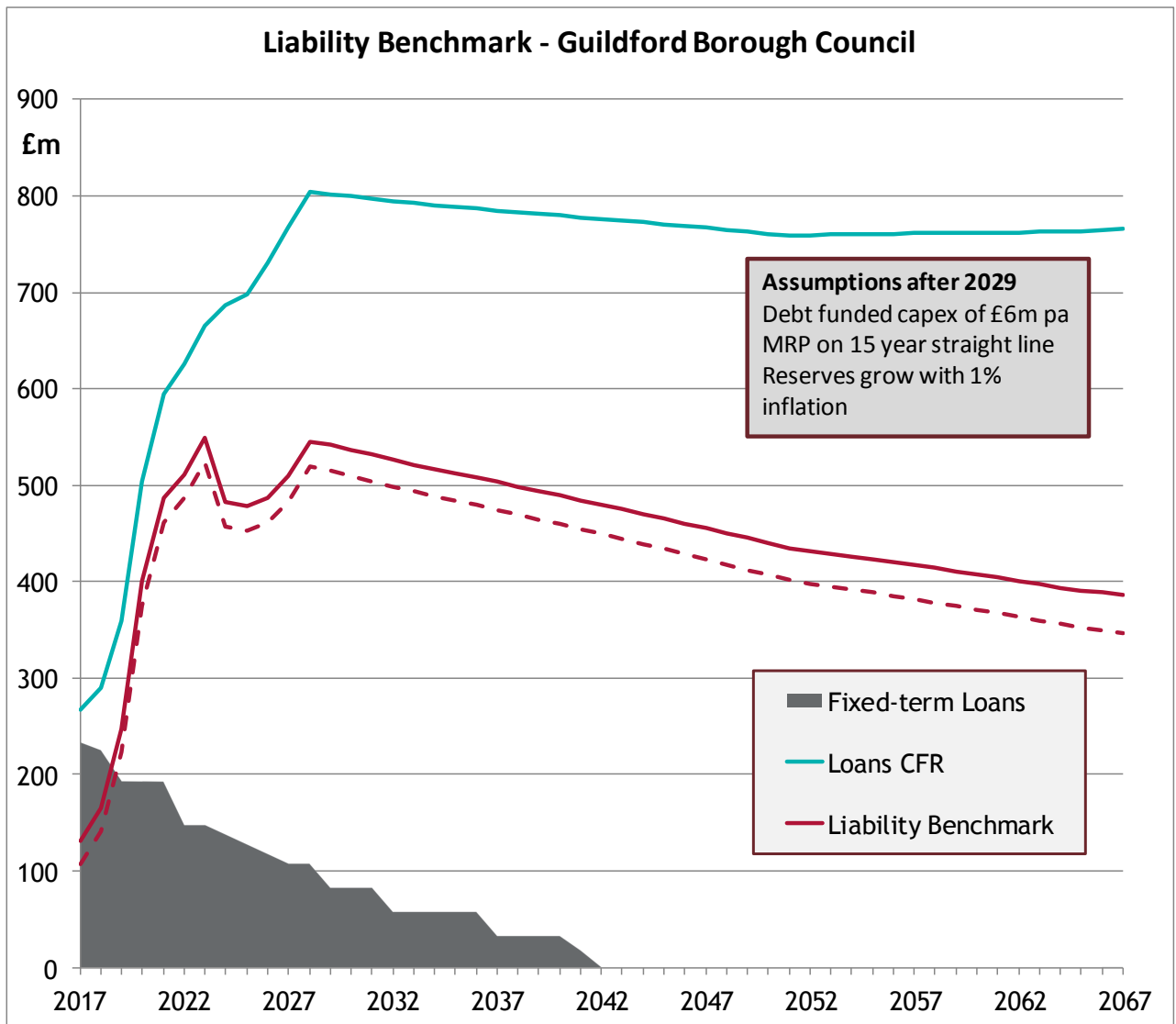
General Fund - Summary and Projections in £000							
31st March:	2016	2017	2018	2019	2020	2021	2022
GF Loans CFR	70,175	93,793	162,859	307,127	397,669	428,440	468,273
GF Reserves	(39,805)	(35,352)	(33,687)	(34,119)	(33,902)	(35,043)	(32,935)
GF Working Capital	(18,646)	(18,646)	(18,646)	(18,646)	(18,646)	(18,646)	(18,646)
GF Borrowing	(40,000)	(32,000)	0	0	0	0	0
GF Cash Balance	(28,276)	7,795	110,526	254,362	345,121	374,751	416,692

- 3.53 This 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 (2016-17 to 2019-20). The table above shows the liability benchmark is expected to be £548 million by March 2023.

- 3.54 The Council has an increasing CFR due to the increasing underlying 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.
- 3.55 HRA reserves are decreasing over the early part of the period because of the HRAs plan to build new social housing, whilst the HRA CFR remains the same because we are operating at our debt cap. Our priority is to build homes rather than reduce the level of debt, although moving forward the table does not include any new borrowing, which is to show the true cash position of the HRA, and, therefore, the requirement to refinance borrowing.
- 3.56 In March 2012, the HRA subsidy system changed, and we took on £194 million of debt to effectively buy ourselves out of the subsidy system. This meant that instead of paying money over to the government every year we took control of the liability and could fund the settlement how we wished. HRA debt is reducing slightly due to the Equal Instalments of Principal (EIP) loan we hold. The remaining debt is on a maturity repayment profile (principal repayment at the end of the term).
- 3.57 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 GF in 2017-18, and indeed for the Council as a whole for 2018-19, based on the profile of the capital programme. We have taken out short-term loans in the year to cover cash flow.
- 3.58 Working capital is the net 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).
- 3.59 We will not automatically borrow externally 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 of the Council as a whole.
- 3.60 We can consider a number of options, alongside externalising our internal borrowing, including internally borrowing from the HRA or transferring loans from the HRA (both of which depend on HRA reserve availability, which is directly related to the HRA capital programme, level of external borrowing and annual revenue surplus).
- 3.61 To assist with the long-term treasury management strategy, the Council and its advisors, have created a liability benchmark. This forecasts our need to borrow over the longer term. Following on from the medium term forecasts in the table above, the benchmark assumes:
- an allowance for currently known capital expenditure, until 2022-23 and then an assumed level of additional annual capital expenditure

moving forward of £6 million per annum for general capital bids, plus anticipated capital programme and capital vision items where the costs and timings can be estimated

- minimum revenue provision (MRP) has been allowed for based on the underlying need to borrow for the GF capital programme until 2022-23, and then projected forward based on the assumed level of capital expenditure with MRP over 15 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



3.62 The liability benchmark (the solid red line in the graph) shows our net debt position (the minimum amount of borrowing we would need to have zero investments). If the liability benchmark line rises above the amount of loans

we have (the shaded area), we need to borrow externally and no longer have any internal borrowing capacity. Within the liability benchmark figure, we are assuming we will hold a minimum level of cash investments of £25 million at any point in time moving forward, to cover our cash flows.

- 3.63 The loans CFR (the blue line in the graph) is continuing to increase in line with the assumptions made around capital expenditure being financed from borrowing.
- 3.64 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 use internal borrowing or to borrow short-term loans instead. We will, however, continuously review all borrowing options available to us and assess their suitability.
- 3.65 The assessment of affordability relates to the revenue impact (MRP and interest) of the capital programme on the GF and HRA revenue accounts. The ratio of financing costs to net revenue stream is therefore a key indicator of affordability. The Council proposes to set a local limit 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. The impact will be that there will be a limit on the number of Essential capital schemes (ie, 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) which the Council can support each year from internal or external borrowing. Based on an average asset life of 25 years for MRP purposes, the limit for Essential capital scheme expenditure to be funded by borrowing for each financial year in the capital programme will be as follows:-

Year	2018-19	2019-20	2020-21	2021-22	2022-23
Affordable increase in GF revenue financing costs	£285,400	£286,800	£290,200	£293,700	£296,800
Maximum Essential GF capital scheme expenditure to be funded by borrowing	£7.1 million	£7.2 million	£7.3 million	£7.3 million	£7.4 million

- 3.66 The above limit does not apply to Investment capital schemes (ie, those which will be undertaken for economic growth, regeneration, redevelopment and income generation purposes) as the schemes are defined as those which are anticipated to have a neutral or positive impact on the GF revenue

account. This means that the annual savings or additional income achieved from a Investment capital scheme is greater than its financing costs over a range of scenarios and the scheme 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.

- 3.67 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.
- 3.68 By doing this, we are able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.
- 3.69 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.
- 3.70 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 breakeven analysis in line with our capital spending plans. Its output may determine whether we borrow additional sums at long-term fixed rates in 2018-19 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.
- 3.71 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).
- 3.72 We may also arrange forward starting loans during 2018-19, where the interest rate is fixed in advance, but the cash is received in later years. This would enable cost certainty to be achieved without suffering a cost of carry in the intervening period.
- 3.73 We may continue to borrow short-term for cash flow purposes.

Sources of borrowing

- 3.74 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 (see section 4.22)
 - UK local authorities
 - any other bank or building societies authorised to operate in the UK

- UK public and private sector pension funds (other than the local pension fund)
- capital market bond investors
- UK Municipal Bond Agency plc and other special purpose companies created to enable local authority bond issues (see paragraph xx)
- European Investment Bank (EIB)

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

- operating and finance leases
- hire purchase
- private finance initiative
- sale and leaseback

3.76 The Council has previously raised the majority of 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)

3.77 UK Municipal Bond Agency Plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons.

- (1) borrowing authorities will be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason
- (2) there will be a lead in time of several months between committing to borrow and knowing the interest rate payable

3.78 Any decision to borrow from the agency will, therefore, be subject to a further report to Councillors.

Debt rescheduling

3.79 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 could 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.

Operational Boundary for external debt

3.80 This is a monitoring indicator that shows the most likely (prudent by not worst case) scenario for external debt. It directly links to our capital expenditure plans, the CFR and cash-flow requirements. It is a key management tool for in-year monitoring. Other long-term liabilities include finance leases, private

finance initiatives and other long-term liabilities that are not borrowing but form part of the Council's debt.

Operational Boundary of External Debt	2017-18 Approved £000	2017-18 Revised £000	2018-19 Estimate £000	2019-20 Estimate £000	2020-21 Estimate £000	2021-22 Estimate £000	2022-23 Estimate £000
Borrowing - General Fund	252,616	167,856	312,126	402,666	433,436	473,276	494,456
Borrowing - HRA	197,024	197,024	197,024	197,024	197,024	197,024	197,024
Other Long Term Liabilities	26,000	26,000	26,000	26,000	26,000	26,000	26,000
Total	475,640	390,880	535,150	625,690	656,460	696,300	717,480

3.81 The total represents the current debt portfolio and a maximum amount of temporary borrowing that may be required in the year. It is not a limit of total borrowing for the Council. It is calculated by taking the estimated CFR plus an allowance of headroom for cash movements. The HRA operational boundary is limited to the HRA debt cap set by the Government.

Authorised limit for external debt

3.82 The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003, and is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for any unusual cash movements.

Authorised Limit for External Debt	2017-18 Approved £000	2017-18 Revised £000	2018-19 Estimate £000	2019-20 Estimate £000	2020-21 Estimate £000	2021-22 Estimate £000	2022-23 Estimate £000
Borrowing - General Fund	302,816	212,456	368,526	463,166	499,536	530,376	566,556
Borrowing - HRA	197,024	197,024	197,024	197,024	197,024	197,024	197,024
Other Long Term Liabilities	26,000	26,000	26,000	26,000	26,000	26,000	26,000
Total	525,840	435,480	591,550	686,190	722,560	753,400	789,580

3.83 The GF authorised debt level gives headroom for significant cash-flow movements, over the operational boundary, for example if we do not receive Council Tax on the correct day. The HRA limit is set at the debt cap imposed by the Government.

3.84 We are required to set a limit for other long-term liabilities, for example finance leases. We have included an allowance for capital expenditure that could be classed as finance leases.

3.85 Officers monitor the authorised limit on a daily basis against all external debt items on the balance sheet (long and short-term borrowing, overdrawn bank balances and long-term liabilities).

Capital financing requirement

3.86 To ensure we ultimately finance the GF CFR, we are required to make a Minimum Revenue Provision (MRP) charge to the revenue account each year. This is a real charge to the revenue account and generates the cash required to pay for capital expenditure (either by replacing the internal

borrowing or repaying physical loans). There is no requirement to make an MRP charge on the HRA CFR.

- 3.87 The Government has set a debt cap for the HRA CFR. This stands at £197.025 million. As can be seen above we are operating at our debt cap so are unable to take out any more external borrowing for the HRA.

Asset Management

- 3.88 The Council has an approved comprehensive Asset Strategy and Asset Management Framework that was approved by the Executive on 20 January 2015.

4. Investment Strategy

Economic background – a summary from Arlingclose (detail in Appendix 13)

- 4.1 The Council has borrowed and invested large sums of money and is therefore exposed to financial risks, including the loss of invested funds (credit risk), the revenue effect of changing interest rates (market risk) and the risk that investment returns on investments are not keeping up with inflation (inflation risk). These risks are affected by external events. The Council's investment strategy is set in the context of the probabilities of certain events occurring, such as the likelihood of central banks raising interest rates, or of commercial banks failing.
- 4.2 Interest rates in 2018-19 will directly impact on the Council's revenue budget through interest payable on variable rates loans and new loans borrowed and the interest received on investments. The rates the Council pays on borrowing are closely linked to gilt yields, which the rate earned on investments is linked to bank lending rates, such as LIBOR.
- 4.3 The following paragraphs outline some of the external context to the investment strategy.
- 4.4 The major external influence on the Council's treasury management strategy for 2018-19 will be the UK's progress in negotiating its exit from the European Union and agreeing future trade arrangements. There are indications that uncertainty over the future is impacting on growth. Economic growth is therefore forecast to remain sluggish throughout 2018-19.
- 4.5 High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector.
- 4.6 Bail-in legislation has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. In addition, the largest UK banks will ring-fence their retail banking functions into separate legal entities during 2018. There remains

some uncertainty over how these changes will impact upon the credit strength of the residual legal entities.

- 4.7 The credit risk of making unsecured deposits has therefore increased relative to the risk of other investment options available to the Council and returns from cash deposits remain very low.
- 4.8 Arlingclose's central case is for the UK Bank Rate to remain at 0.50% during 2018-19. The Monetary Policy Committee re-emphasised that any prospective increases in the bank rate would be expected to be at a gradual pace and to a limited extent.
- 4.9 Future expectations for higher short-term interest rates are subdued and on-going decisions remain data dependent and negotiations on exiting the EU cast a shadow over monetary policy decisions. Arlingclose's central case is for gilt yields to remain broadly stable across the medium-term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

Objectives

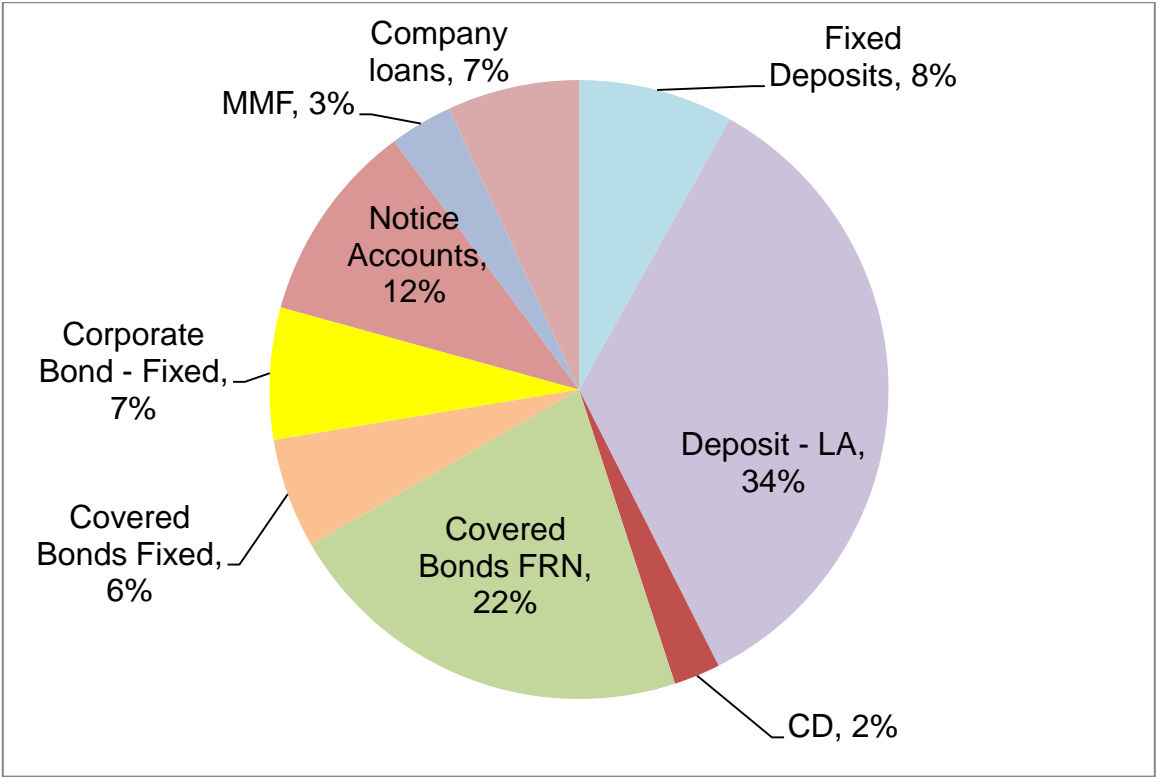
- 4.10 Both the CIPFA TM Code and the CLG Guidance on investments, require the Council to invest its funds prudently, and to have regard to the security (protecting capital sums from loss) and liquidity (keeping money readily available for expenditure when needed or having access to cash) of investments before seeking the highest rate of return or yield. The Council's objective, when 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. The level of return should be commensurate with the level of risk.
- 4.11 Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.
- 4.12 If the UK enters into a recession in 2018-19, there is a small chance that the Bank of England could set its bank rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Strategy

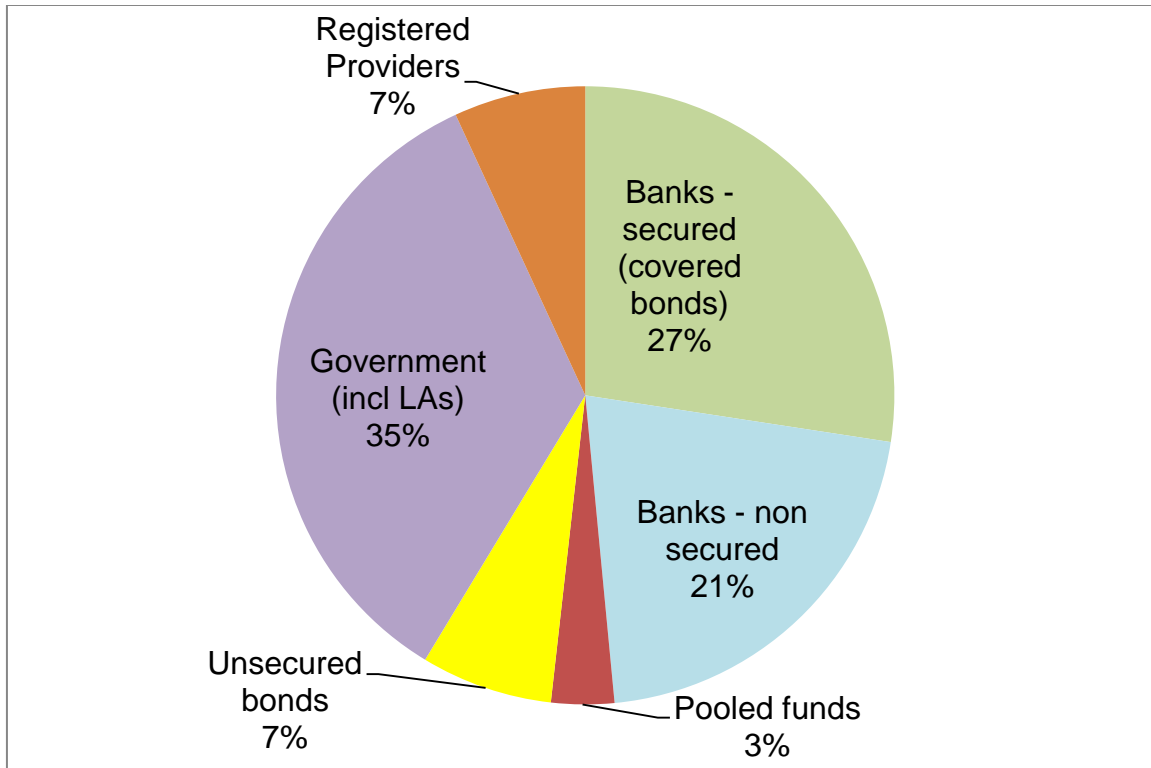
- 4.13 Given the increasing risk (lower rated counterparties and the risk of bail-in), and very low returns from short-term unsecured bank investments, the Council aims to continue to diversify into more secure and where possible, higher yielding asset classes during 2018-19 whilst continuing to ensure

adequate liquidity for operational purposes. This is especially the case for our longer-term investments. This diversification will represent a continuation of the new strategy adopted in 2015-16.

- 4.14 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.
- 4.15 The graph below shows how our current portfolio is diversified by type of investment. 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.



- 4.16 The graph shows how diversified our in-house investment portfolio is (excluding pooled funds). The following graph shows our in-house investment portfolio by security, and following that by credit rating:



4.17 We are required to classify investments as specified, non-specified or loans by the investment guidance issued by CLG. They are defined as:

- Specified investments: any investments that are:
 - denominated in pound sterling
 - due to be repaid within 12 months of the arrangement
 - not defined as capital expenditure by legislation
 - invested with one of the UK Government, a UK local authority, parish or community council, or a body or investment scheme of “high credit quality”
- Non-specified investments: any investment not meeting the definition of a specified investment.
- Loans

4.18 The Council defines high credit quality organisations as those having a long-term credit rating of A- or higher that are domiciled in the UK or foreign country with a long-term sovereign rating of AA or higher. Money market funds do not need to be domiciled in a country with an AA rating.

4.19 The Council will not make any investment denominated in foreign currencies, only sterling.

4.20 We may make an investment that is defined as capital expenditure by legislation, such as company shares.

4.21 The Council may invest 100% of its surplus funds in non-specified investments (long term investments, institutions not meeting our definition of high quality, pooled funds and money market funds not meeting our definition of high credit quality, investments in institutions domiciled in foreign countries rated below AA and investments in the Council's subsidiary companies)

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

Credit Rating	Banks - unsecured	Banks - secured	Government (incl LAs)	Corporates	Registered Providers
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				

4.23 We may invest in institutions without credit ratings, or rated below A- (our defined minimum rating for high credit quality) to ensure we have diversification in our investment portfolio.

4.24 We may invest in investments that are termed alternative investments. These include, 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.

4.25 We currently invest in some non-rated building societies, and BBB rated corporate bonds. We need to ensure we have flexibility in our strategy to allow us to ensure an appropriate mix with the security on our portfolio.

4.26 We may invest in covered bonds for security investments to reduce our credit risk, bail in risk and inflation risk, but as these tend to be longer-term investments, we may sell them prior to the maturity date for liquidity purposes..

4.27 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. We propose to allow ourselves to invest in secured investments for longer

periods than unsecured deposits. An example of a counterparty with no credit rating is a non-rated building society where we can invest £1 million per counterparty. The time limits shown are the maximum for the year, and operationally we could have a shorter duration – these are reviewed throughout the year with Arlingclose.

- 4.28 We have 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.
- 4.29 HSBC are our bankers. We do place some investments with them, but 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.
- 4.30 Credit rating: we use the lowest published long-term credit rating from Fitch, Moody's or Standard & Poors (S&P) when making investment decisions, alongside other indicators/factors and external advice. We may consult with other credit rating agencies other than the main three. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.
- 4.31 Banks unsecured: these instruments include, but are not limited to, accounts, deposits, certificated 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.
- 4.32 Banks secured: these instruments include covered bonds, reverse repurchase agreements, and other collateralised arrangements with banks and building societies. These investments are secured on the institutions assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the two will be used to determine cash and time limits. The law states that covered bonds and reverse repurchase transactions cannot be bailed in. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.
- 4.33 Government: instruments include 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 an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50-years.
- 4.34 Corporates: the instruments include loans, bonds and commercial paper issued by companies other than banks, building societies 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 or corporate investments in order to spread the risk widely.

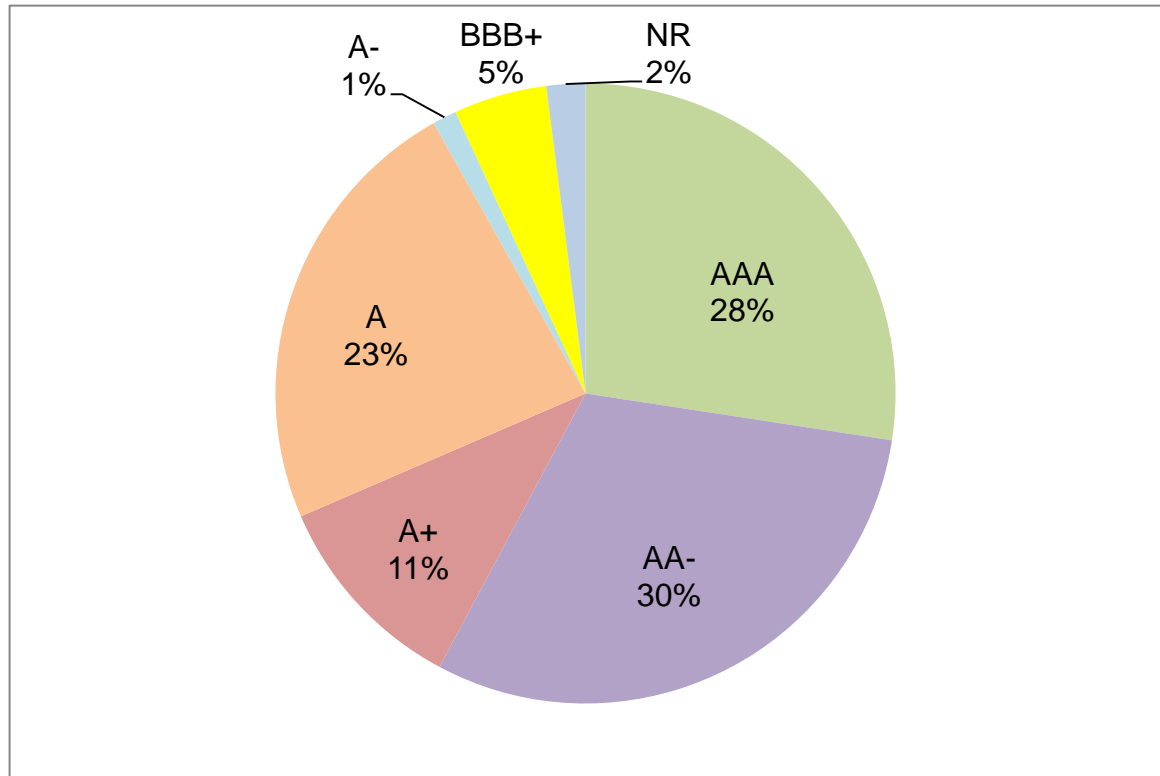
- 4.35 Registered providers: these include loans and bonds issued by, guaranteed by, or secured on the assets of registered providers for social housing, formally known as housing associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retail a likelihood of receiving government support if needed.
- 4.36 Pooled funds: these are shares in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property, and also money market funds. 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.
- 4.37 Bonds, 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, we will monitor their performance and continued stability in meeting the Council's investment objectives regularly.
- 4.38 To mitigate the risk of default, we will ensure that no more than 10% of available reserves will be invested in any one institution or institutions within the same group (other than the UK Government) and therefore limit the amount invested at £10 million. 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.
- 4.39 Operational bank accounts – the Council may incur operational exposures, for example, via current accounts, collection accounts and merchant acquiring services to and 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 bail-in, and balances will therefore be kept to a minimum per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed in than made insolvent, increasing the chance of the Council maintaining operational continuity.

Treasury management risk and credit ratings

- 4.40 Arlingclose obtain and monitor credit ratings and they notify us with any changes in ratings as they occur.

- 4.41 Where an entity has its credit rating downgraded and it then 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
 - full consideration will be given to the recall or sale of all other existing investments with the affected institution
- 4.42 Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as “rating watch negative” or “credit watch negative”) so 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.
- 4.43 The Council understands that credit ratings are good, but not perfect, predictors of investment default. We will take account of other available information on the credit quality of institutions, in which we invest, including credit default swops, financial statements, information on potential government support and reports in the quality financial press.
- 4.44 We will not make investments with any organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.
- 4.45 When deteriorating financial market conditions affect the credit worthiness of all organisations, as happened in 2008 and 2011, this is generally not reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those institutions of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security.
- 4.46 The extent of these restrictions will be in line with the prevailing market conditions. If these restrictions mean that if there are insufficient commercial organisations of high credit quality to invest our cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office (DMO) 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 help protect the principal sum invested.
- 4.47 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 a A for 2018-19. The following charge shows how our current portfolio is made up – this is updated monthly



- **Liquidity** – we monitor our liquidity by 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 £25 million as our minimum liquidity requirement. We also have a monthly high-level cash flow projection over four years.

Non-financial investments

- 4.48 Although not classed as treasury management activities, the Council may also purchase property for investment purposes and may also make loans and investments for service purposes.
- 4.49 The Council holds non-financial investments as follows:
- Investment property portfolio
 - loans to its wholly owned companies, Guildford Borough Council Holdings Ltd and North Downs housing Ltd

4.50 Both categories of non-financial investments are held for two purposes, (a) to generate income (yield) and (b) to meet a strategic/corporate plan priority.

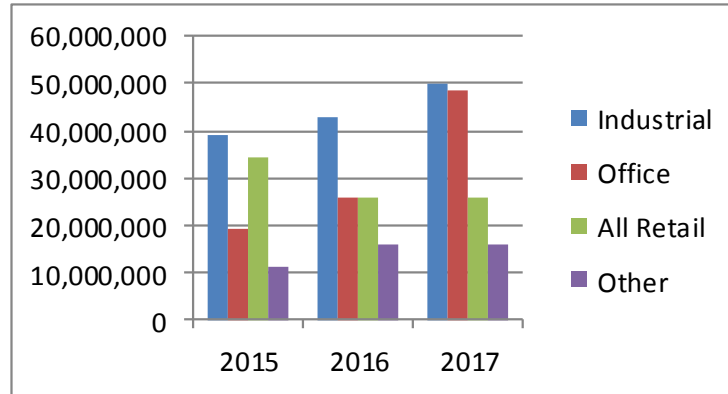
Investment property

4.51 The Council's Asset Strategy and Asset Management Framework, adopted by Executive on 20 January 2015, sets out the context within which investment property acquisitions are made and how property is managed. The vision for the property estate is to own, occupy or use properties that empower the Council to perform excellently in the delivery of its services and Corporate Plan themes on behalf of the borough's residents, businesses and visitors. For investment properties, the assessment is in terms of the financial return (yield) that a property provides as well as other criteria regarding the classification of the lease and the tenancy covenant.

4.52 The Council manages its property estate as a strategic resource as follows:

- 1) The Corporate Plan – This underpins the whole basis upon which the Council owns, occupies and uses its property estate, its purpose, function, operation and why the Council chooses to make changes as part of future planning.
- 2) Asset Strategy – This Asset Strategy underpins how the property estate will deliver the aims and objectives of the Corporate Plan stating the Council's desired outcomes of the estate, objectives and performance targets, plus an action plan to get there.
- 3) Property Review Group – This working group of officers and councillors provides active governance over property planning and decision making with a watching brief to deliver property outcomes and performance.
- 4) Asset Management Framework – This provides policies on how the Council will actively manage, review and challenge the property estate and the properties within it and whether to keep, improve, sell or transfer properties in context of wider strategic and corporate objectives.
- 5) Property Performance – the Council will report annually to the Overview and Scrutiny Committee and the Executive on performance targets, trends and external benchmarks to analyse and explain how the property estate is performing against desired outcomes and comparison with others local authorities.
- 6) Asset Development Team – This team provides in house professional property management skills. Its role is to manage and maintain the property estate, review and update property information on the Asset Manager system, act as corporate landlord on behalf of services and undertake strategic property reviews analysing data on size, use, occupancy, condition, running cost, value and so on.

4.53 The following graph shows how diversified our investment property portfolio is:



4.54 The following table shows the performance of the portfolio, in rental income terms, against the benchmark.

<u>Income return</u>	Industrial	Office	All Retail	Other	All
2015	8.03%	7.46%	5.60%	7.52%	6.84%
2016	7.12%	7.17%	5.59%	6.65%	6.71%
2017	6.77%	6.52%	5.60%	6.73%	6.46%

<u>Benchmark return</u>	Industrial	Office	All Retail	Other	All
2015	6.10%	4.70%	5.40%	4.70%	5.23%
2016	5.40%	4.10%	5.00%	5.50%	4.80%
2017	7.90%	3.90%	2.50%	2.50%	4.20%

Loans to Subsidiary Companies

4.55 In February 2016, the Executive approved the establishment of Guildford Borough Council Holdings (GBCH) Ltd and North Downs Housing (NDH) Ltd. The rationale and business case for setting up the companies and how they meet the Council's strategic objectives were set out in the report. NDH has been set up to deliver on the 4 objectives set out below:

- to meet in, such manner as the Company thinks fit, identified housing need and increase the provision of new housing in the Guildford borough and surrounding areas
- to generate returns for the Council's GF;
- to accelerate development of brownfield land in the Guildford borough
- to carry on any other business or do such other things which may seem to the Company capable of being conveniently carried on in connection with any of the above specified objects, or calculated to enhance the value of the Company's services, assets, property or rights.

4.56 Guildford Borough Council Holdings (GBCH) Ltd is currently dormant with the exception of its equity holding in NDH Ltd.

- 4.57 The Business Plan for NDH Ltd was approved by the Executive Shareholder and Trustee Committee in September 2017. Investment in NDH Ltd is classed as capital expenditure and forms part of the Council's approved capital programme. The Executive Shareholder and Trustee Committee monitors the performance of the company and the security of the Council's investment on an annual basis.

5. Other items

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

The Council's banker

- 5.2 HSBC Bank plc are our day to day bankers holding all our current accounts. The contract was renewed for seven years from 1 January 2017 – ending on 31 December 2024.
- 5.3 HSBC are currently rated above our minimum credit criteria. Should the credit rating fall below the minimum investment credit rating we have set, we may continue to deposit surplus cash with HSBC providing that investments can be withdrawn on the next working day, and that the bank maintains a credit rating no lower than BBB- (the lowest investment grade rating).

Policy on the use of Financial Derivatives

- 5.4 Local authorities have previously made use of financial derivative embedded into loans and investments both to reduce interest rate risk (for example interest rate collars and forward deals), and to reduce costs or increase income at the expense of greater risk (for example LOBO loans and callable deposits).
- 5.5 The general power of competence in Section 1 of the Localism Act 2011 removed much of the uncertainty over local authorities use of standalone financial derivatives (those that are not embedded into a loan or investment).
- 5.6 The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of 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 the strategy, although the risk they present will be managed in line with the overall treasury risk management strategy.
- 5.7 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.

Policy on apportioning interest to the HRA

- 5.8 The Council operates a two-pooled approach to its loans portfolio, which means we separate long-term HRA and GF loans.
- 5.9 Investment 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 revenue 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. We will calculate an average balance for the year and interest transferred between the GF and HRA at the Council's weighted average return on its investments, adjusted for credit risk and temporary borrowing.
- 5.10 This credit risk adjustment reflects the risk to the GF that any investment default will be a charge to the GF, even if it is HRA cash that is lost.

Training

- 5.11 We assess training requirements for the Council's treasury management staff throughout the year, and additionally when the responsibilities of individual members of staff change.
- 5.12 Staff regularly attend training courses, seminars and conferences provided by Arlingclose, CIPFA and other appropriate bodies. Relevant staff are encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.
- 5.13 Councillors undertake training as and when required, for example when there is a change in committee membership, and on an ad-hoc basis. The Lead Councillor for Finance and the Chairman of the Corporate Governance and Standards Committee attend the quarterly strategy meetings with Arlingclose, and is briefed and updated on treasury management matters as and when required.

Investment consultants / use of consultants generally

- 5.14 Arlingclose are the Council's appointed treasury management advisors, with the contract running until 31 March 2022. We receive specific advice on investments, debt and capital finance issues. We have regular contact with the advisors and hold quarterly meetings with them to discuss changes on all aspects of treasury management and specifically in relation to the changing requirements of the Council.
- 5.15 The Council has access to six brokers to gather information and place deals where it is financially advantageous compared to direct dealing, and, where we are unable to access counterparties directly. We compare the information

received with information from other service providers in the market to gauge its applicability within our strategy.

- 5.16 Where we feel we do not have the expertise in house, we will use external consultants. This could be for many reasons, and the Council currently uses this approach across all council services.

Performance monitoring

- 5.17 CIPFA advocated the principle that councils should create appropriate methods by which the performance of their treasury management activities can be measured and recommend the selection of appropriate measures and setting of benchmarks.
- 5.18 Officers monitor the treasury management activity and prudential indicators on a monthly basis. Reports are made at least annually to the Corporate Governance and Standards Committee half-yearly to full Council. Other monitoring includes:
- the Council will produce an outturn report on its treasury activity no later than 30 September after the end of the financial year
 - the Corporate Governance and Standards Committee is responsible for the scrutiny of the Council's treasury management activity and practices
 - officers prepare a monthly monitoring report which is discussed with the CFO
- 5.19 The Council sets performance indicators to assess the return against the Bank of England base rate on treasury activities over the year. These include the separate monitoring of in-house investments (both longer-term and for cash purposes) and externally managed funds.
- 5.20 We also monitor performance through benchmarking with both CIPFA and other Arlingclose clients. The Council is a member of the Surrey treasury management officers group who meet twice yearly to discuss treasury management issues and share practices.
- 5.21 Monitoring of the investment property portfolio is undertaken by the Investment Property Management Group (IPMG) which consists of Officers with relevant expertise from the asset/property and finance teams. The IPMG reviews the performance of individual assets and annual performance across the portfolio along with commentary on an overview of the local property market. Reports are made on performance of individual assets to the Property Review Group (PRG) and on the overall performance of the portfolio to the Overview and Scrutiny Committee