Council Report

Ward(s) affected: All

Report of Joint Section 151 Officer

Author: Vicky Worsfold, Lead Specialist Finance

Tel: 01483 444834

Email: Victoria.worsfold@guildford.gov.uk

Lead Councillor responsible: Tim Anderson

Tel: 07710 328560

Email: tim.anderson@guildford.gov.uk

Date: 6 December 2022

Capital and Investment outturn report 2021-22

Executive Summary

This annual outturn report includes capital expenditure, non-treasury investments and treasury management performance for 2021-22.

Capital programme
In total, expenditure on the General Fund capital programme was £39.78 million against the original budget of £148.3 million, and revised budget of £141.9 million. Details of the revised estimate and actual expenditure in the year for each scheme are given in **Appendix 3**.

The budget for Minimum Revenue Provision (MRP) was £1.5 million and the outturn was £1.38 million. This was due to slippage in the capital programme in 2020-21.

Officers have reviewed the capital programme and have determined that the following schemes are no longer required:

- Albury closed burial grounds £57,000 in 2022/23
- Mill Lane Flood Protection works - £16,000 2022/23 and £200,000 2023/24
- Merrow & Burpham surface water study - £15,000 in 2022/23

This will reduce the Councils underlying need to borrow for capital purposes and will generate a saving to the revenue account in respect of MRP and Interest of approximately £10,000 over the life of the schemes.

Non-treasury investments
The Council's investment property portfolio stood at £174 million at the end of the year. Our rental income was £8.75 million, and our income return 5.3% against the benchmark of 4.7%.

Treasury management

The Council's cash balances have built up over several years, and reflect our strong balance sheet, with considerable revenue and capital reserves. Officers carry out the treasury function within the parameters set by the Council each year in the Capital and Investment Strategy. At 31 March 2022, the Council held £152 million in investments, £303 million in borrowing of which £147 million is related to the HRA, and £134 million is short term borrowing so net debt of £157 million.

We borrowed short-term from other local authorities for cash flow purposes and aim to minimise any cost of carry on this. We took out 3 loans for Weyside Urban Village under the infrastructure rate. This interest is capitalised against the project and not charged to the GF as interest payable.

This report (section 8) confirms that the Council complied with its prudential indicators, treasury management policy statement and treasury management practices (TMPs) for 2021-22. The policy statement is included and approved annually as part of the Capital and Investment Strategy, and the TMPs are approved under delegated authority.

The treasury management performance over the last year, compared to estimate, is summarised in the table below. The report highlights the factors affecting this performance throughout the report, and in **Appendix 1**.

	Estimate %	**Actual %**	**Estimate (£000)**	**Actual (£000)**
General fund Capital Financing Requirement (CFR)			227,024	157,218
Housing Revenue Account CFR			205,108	199,204
Total CFR			**432,132**	**356,422**
Return on investments	1.57	0.65	1,278	1,878
Interest paid on external debt			5,992	5,127
Total net interest paid			**4,714**	**3,249**
Gain on sale of pooled fund				**1,398**

There was slippage in the capital programme which resulted in a lower CFR than estimated (more information in **Appendix 1**, section 3).

Interest paid on debt was lower than budget, due to less long-term borrowing taken out on the general fund because of slippage in the capital programme.

The yield returned on investments was lower than estimated, but the interest received was higher due to more cash being available to invest in the year – a direct result of the capital programme slippage. Officers have been reporting higher interest receivable and payable and a lower charge for MRP during the year as part of the budget monitoring when reported to councillors during the year.

Due to the council projecting an over-spend earlier in the year, we took the decision to sell a pooled fund that had accumulated a capital gain. This was redeemed in December at a gain of £1.398 million – this is income to the General Fund.

Detailed information on the return on investments, and interest paid on external debt can be found in section 7 of this report.

This report was considered by the Corporate Governance and Standards Committee at its meeting on 29 September 2022. The Committee commended the report to the Executive, subject to a number if comments which are set out in section 15 below. At its meeting on 27 October 2022, the Executive agreed to the removal of the following schemes from the General Fund Capital Programme:

- Albury closed burial grounds £57,000 in 2022/23
- Mill Lane Flood Protection works - £16,000 2022/23 and £200,000 2023/24
- Merrow & Burpham surface water study - £15,000 in 2022/23

The Executive also commended the recommendation to the Council below for adoption.

Recommendation to Council:

(1) That the capital and investment outturn report be noted
(2) That the actual prudential indicators reported for 2021/22, as detailed in **Appendix 1** to this report, be approved

<u>Reasons for Recommendation:</u>

- To comply with the Council's treasury management policy statement, the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on treasury management and the CIPFA Prudential Code for Capital Finance in Local Authorities.

- As per the treasury management code although the scrutiny of treasury management (and indeed all finance) has been delegated to CGSC ultimate responsibility remains with full Council this report therefore fulfils that need.

Is the report (or part of it) exempt from publication? No

1. Purpose of Report

1.1 The Local Government Act 2003 states that the Council has a legal obligation to have regard to both the CIPFA code of practice on treasury management and the

Ministry of Housing, Communities, and Local Government (MHCLG) investment guidance.

1.2 The CIPFA treasury management code of practice, and the MHCLG investment guidance requires public sector authorities to produce an annual capital strategy (incorporating capital expenditure, non-treasury investments and treasury management activity.

1.3 This report covers the outturn of the elements of the strategy and the requirement to report on the prudential and treasury indicators for the year. The position of the Council's investment property portfolio is also presented along with progress on the capital programme.

1.4 The Council borrows and invests substantial sums of money and is, therefore, exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. This report covers treasury activity and the associated monitoring and control of risks. The Council holds a substantial amount of investment property and has a large capital programme, all of which have risk.

1.5 Treasury management is a highly complex, technical, and regulated aspect of local government finance. We have included a glossary of technical terms (**Appendix 10**), to aid the reading of this report.

2. Strategic Priorities

2.1 Treasury management and capital expenditure are key functions in enabling the Council to achieve financial excellence and value for money. It underpins the achievement of all the Corporate Plan 2018-2023 themes.

2.2 This report details the activities of the treasury management function and the effects of the decisions taken in the year in relation to the best use of its resources. It also presents the outturn position for the year of the capital programme, and the performance on non-treasury investments.

3. Background

3.1 Treasury management and the capital programme are intrinsically linked – the capital programme impacts whether the Council has investments or borrowing, which then informs the revenue budget. Providing the information to councillors in a joint report ensures the context of the two areas to be considered alongside each other.

3.2 Treasury management is defined by CIPFA as *“the management of the organisations borrowing, investments and cash flows, including 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”*

3.3 The Council has overall responsibility for treasury management. Treasury management contains a number of risks. The effective identification and management of those risks are integral to the council’s treasury management objectives, as is ensuring that borrowing activity is prudent, affordable and sustainable.

3.4 The Council has a statutory requirement, under the Local Government Act 2003, to adopt the CIPFA Prudential Code and produce prudential indicators.

3.5 The objectives of the prudential code are to ensure, within a clear framework, that capital investment plans are affordable, prudent and sustainable, and the treasury management decisions are taken in accordance with good professional practice.

3.6 The Council has a large capital programme and a large investment property portfolio on its balance sheet. These, together with treasury management, are the management of the Council’s cash and assets.

3.7 The Council operates its treasury management function in compliance with this Code and the statutory requirements.

3.8 This annual report, and the appendices attached to it, set out:

- a summary of the economic factors affecting the approved strategy and counterparty updates (sections 4 and 5 with details in **Appendix 5**)
- a summary of the approved strategy for 2021-22 (section 6)
- a summary of the treasury management activity for 2021-22 (section 7 with detail in **Appendix 1**)
- compliance with the treasury and prudential indicators (section 8 with detail in **Appendix 1**)
- non-treasury investments (section 9)
- capital programme (section 10)
- risks and performance (section 11)
- Minimum Revenue Provision (MRP) (section 12)
- details of external service providers (section 13)
- details of training (section 14)

4. Economic Environment

4.1 This section includes the key points of the economic environment for 2021-22, to show the treasury management activity in context. **Appendix 5** contains more detail

- The major issues for the economy in the year were recovery from Coronavirus pandemic, the war in Ukraine, higher inflation and higher interest rates.
- The Bank of England bank rate was 0.1% at the start of the year, rising persistent inflation caused the bank to increase rates earlier than the market had predicted, up to 0.75% in March.
- UK CPI was 0.7% in March 2021, rising steadily to 6.2% in February 2022.
- Tightening labour market as furlough unwound
- High energy and commodity prices not helped by the war in Ukraine.
- Fitch and Moody's credit rating agencies revised the outlook on a number of UK banks and building societies up to stable, recognising their improved capital positions compared to 2020 and better economic growth prospects in the UK.

4.2 The key points relevant to investment property are:

- Industrial sector remained resilient
- Office supply declining in Guildford, there has been a departure of key corporate occupiers, which has not helped the office market
- There has been a shift in the demand for High Street retail premises, leading to declining rents and increased vacancy levels.
- Retail was the weakest category going into lockdown and is anticipated to be the worst affected

5. Regulatory Changes

5.1 In August 2021, HM Treasury significantly revised guidance for the PWLB lending facility with more detail and 12 examples of permitted and prohibited use of PWLB loans. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

5.2 CIPFA published its revised Prudential Code for Capital Finance and Treasury Management Code in December 2021. The key changes in the two codes are around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments.

5.3 The principles of the Prudential Code took immediate effect although local authorities could defer introducing the revised reporting requirements until the 2023-24 financial year if they wish. This was due to the late publication of the codes.

5.4 To comply with the Prudential Code, authorities must not borrow to invest primarily for financial return. The Code also states that it is not prudent for local authorities to make investment or spending decisions that will increase the CFR unless directly and primarily related to the functions of the authority. Existing commercial investments are not required to be sold; however, authorities with existing commercial investments who expect to need to borrow should review the options for exiting these investments.

5.5 Borrowing is permitted for cashflow management, interest rate risk management, to refinance current borrowing and to adjust levels of internal borrowing. Borrowing to refinance capital expenditure primarily related to the delivery of a local authority's function but where a financial return is also expected is allowed, provided that financial return is not the primary reason for the expenditure. The changes align the CIPFA Prudential Code with the PWLB lending rules.

5.6 The TM Code now includes extensive additional requirements for service and commercial investments.

5.7 The Council had removed the purchase of property primarily for yield some years ago, shifting the focus to strategic purchases and regeneration, and is, therefore, not affected by these changes in the Prudential Code.

6. Approved strategy and budgets for 2021-22 – a summary

6.1 Council approved the 2021-22 Capital and Investment strategy in February 2021.

6.2 The strategy showed an underlying need to borrow in 2021-22 for the General Fund (GF) capital programme of £143 million.

6.3 The strategy set out how we would manage our cash. It allowed for internally managed investments for managing cash flow and externally managed and longer-term investments for our core cash (cash not required in the short or medium term). See **Appendix 9** for background.

6.4 It highlighted the need to continue to diversify our investment portfolio to reduce credit risk. The approved strategy set the minimum long-term credit rating of A- (or equivalent) for investments in counterparties to be determined as ‘high credit’ using the lowest denominator principal for the three main credit rating agencies.

6.5 Investment property risks were examined in the strategy.

7. Treasury management activity in 2021-22

7.1 The treasury position on 31 March 2022, compared to the previous year is

		31 March 2021 (£'000)	Average Rate	31 March 2022 (£'000)	Average Rate
Fixed Rate Debt	PWLB	147,435	3.22%	170,235	3.22%
Variable Rate Debt	PWLB	45,000	0.48%	0	0.00%
Long-term	LAs	0	0.00%	0	0.00%
Temporary borrowing	LAs	118,500	0.51%	133,500	0.17%
Total Debt		**310,935**	**2.00%**	**303,735**	**1.73%**
Fixed Investments		(94,100)	1.02%	(99,400)	0.41%
Variable Investments		(47,545)	0.23%	(42,150)	0.08%
Externally managed		(17,728)	3.94%	(15,079)	4.35%
Total Investments		**(159,373)**	**1.05%**	**(156,629)**	**0.65%**
Net Debt / (Investments)		**151,562**		**147,106**	

7.2 PWLB is the Public Works Loans Board and is a statutory body operating as an executive of HM Treasury. Its function is to lend money from the National Loans Fund to local authorities and other prescribed bodies.

7.3 The above table shows

- loans decreased by £7.2 million
- investments have decreased by £2.7 million
- net debt has decreased by £4.5 million

7.4 Short-term borrowing has increased due to uncertain cash flows during the year, and to fund the capital programme. We were able to take advantage of some very low borrowing rates from other authorities in the year before we need to take out longer term borrowing from PWLB. We have a range of maturities in 2022-23 to keep cash flows smooth.

7.5 We took out our first tranche of PWLB local infrastructure rate loan (LIR) for the WUV capital scheme of £22.8 million. The interest on these loans will be capitalised to the scheme so that the borrowing can be repaid from capital receipts generated on the sale of land as part of the scheme. The first tranche of HRA Reform loans became repayable and we decided to repay the £45 million loan based on the level of HRA reserves.

7.6 We budgeted an investment return of 1.57% for the year and achieved 0.65%.

7.7 The Council's budgeted investment income was £1.278 million, and actual interest was £1.878 million (£600,000 higher). This is mostly due to having more cash due to the slippage in the capital programme.

7.8 Our budgeted debt interest payable was £5.992 million. £5.052 million relates to the HRA. The outturn was £5.127 million (£4.878 million for the HRA).

7.9 All our external funds are distributing funds, and they achieved an overall weighted average return of 4.27%, split as follows

Fund	**Balance at 31 March £000**	**Average return**	**Type of fund**
M&G	0	3.25%	Equity focussed
Schroders	773,399	7.31%	Equity focussed with at least 80% on FTSE all share companies
Royal London	2,247,293	4.79%	Investments in SMEs up to a max of £2,000
Funding Circle	212,205	10.90%	Multi asset
RLAM	2,067,200	1.00%	Global bond fund
Fundamentum	2,113,163	4.71%	Supported housing
CCLA	7,665,284	4.41%	Property

7.10 Councillors will recall we made the decision to sell the M&G investment as part of the measures we put in place at Period 6 financial monitoring to mitigate a projected year end overspend on the general fund. The capital gain which we were able to recognise as revenue income during the year was £1.398 million.

7.11 Our external fund portfolio is diverse, and we invest in a range of products and markets. The capital value of the funds can go up as well as down. Across all funds still held at the end of the year, there was a capital gain of £1.07 million, the biggest movement was on the CCLA fund with a gain of £1.17 million.

7.12 We are invested in bond, equity, multi-asset, and property funds. We invest what we call our "core cash" in these funds. Core cash is our cash backed reserves that we know we will not need for liquidity purposes, and we can therefore afford to keep the investment duration longer in a more volatile market to achieve good income returns

7.13 In the nine months to December improved market sentiment was reflected in equity, property and multi-asset fund valuations and, in turn, in the capital values of the Authority's property, equity and multi-asset income funds in the Authority's portfolio. The prospect of higher inflation and rising bond yields did however result in muted bond fund performance. In the January- March quarter the two dominant themes were tighter UK and US monetary policy and higher interest rates, and the military invasion of Ukraine by Russia in February, the latter triggering significant volatility and uncertainty in financial markets

7.14 In light of Russia's invasion, Arlingclose contacted the fund managers of our Money Market Funds (MMF), cash plus and strategic funds and confirmed no direct exposure to Russian or Belarusian assets had been identified. Indirect exposures were immaterial. It should be noted that that any assets held by banks and financial institutions (e.g. from loans to companies with links to those countries) within MMFs and other pooled funds cannot be identified easily or with any certainty as that level of granular detail is unlikely to be available to the fund managers or Arlingclose in the short-term, if at all.

7.15 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 medium to long-term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three to five-year period total returns will exceed cash interest rates.

7.16 The Council also invested more in our subsidiaries and now holds £9.15 million of equity investment in Guildford Borough Council Holdings Ltd and £15.5 million of loans in North Downs Housing Ltd

7.17 The Council agreed an interest rate of base rate plus 5% (5.75% at 31 March 22) on the investment in North Downs Housing Ltd. This is higher than the treasury investments held as it reflects the risk associated with holding such investments. The interest is currently rolled up in the loan of the company.

7.18 The equity investment in Guildford Borough Council Holdings Ltd will be subject to a dividend if a profit is achieved.

Capital Programme

7.19 The actual underlying need to borrow for the year, and the amount of internal borrowing actually taken, for the GF capital programme was £140 million, which is lower than budgeted of £150 million because of slippage in the capital programme, and also unbudgeted for capital contributions received. We will continue to support service managers with the scheduling of schemes in the capital programme to ensure it is kept up to date when project timescales change.

7.20 The Council must charge a Minimum Revenue Provision (MRP) on its internal borrowing, which is setting aside cash from council tax to repay the internal borrowing. MRP charged to the revenue account for the year was £1.381 million, against an original budget of £1.535 million.

7.21 Our overall underlying need to borrow, as measured by the Capital Financing Requirement (CFR) was £327 million (£140 million relates to the GF).

7.22 MRP is charged the year after the internal borrowing occurred. During the budget process we adjust the MRP to allow for slippage so as not to over budget.

Benchmarking and performance indicators

7.23 Arlingclose provide benchmarking data across their clients ("client universe"). It highlights the effect of changes in our investment portfolio and compares the basis of size of investment, length of investment and the amount of credit risk taken.

7.24 The benchmarking shows a snapshot of our average running yield on all investments, also split between internally managed and externally managed. The latest benchmarking data (at 31 March 2022), shows our average rate of investments for our total portfolio as being 0.89% against the client universe of 0.97%. The table shows that we have outperformed our internally managed investments of the client universe by quite some margin, but overall lower which is due to the proportion of investments in external fund by the wider client base.

Benchmark	Guildford	Client Universe
Internally managed return	0.61%	0.46%
Externally managed (return only)	2.76%	3.41%
Total Portfolio	0.89%	0.97%
% of investments subject to bail in	34%	60%
No. of counterparties/funds	35	14

7.25 The difference in our return as part of the benchmarking (0.89%) and our own return (0.65%) is due to a different calculation in the way Arlingclose put the benchmarking return together.

7.26 The table above shows how far the Council has come to mitigate bail in risk – closing the year at 34% of investments subject to bail in. This percentage will change during the course of the year depending on the level of cash we have and what we are invested in.

7.27 One of our key areas in our treasury strategy is to maintain diversification in the portfolio. The number of counterparties and funds we are investing in are far higher than the client universe and shows that we have achieved our aim. This level of diversification will change at different points in the year, however.

8. Non-treasury investments

8.1 **Appendix 2** sets out the Council investment property fund portfolio report for 2021-22. The key points are summarised below:

Sector	No. of assets	Sub-category	No. of assets
Office	6		
Industrial	114		
Retail	9	Shops Shopping centres	7 2
Leisure	6	Restaurants Nightclubs	5 1
Other Commercial	9	Educational Theatre Barn Petrol station Sui Generis Car Park Water treatment works	2 1 2 1 1 1 1
TOTAL	**144**		

8.2 Fund statistics: the fund was valued at circa £174 million with a rent roll of £8.75 million from 145 properties across 4 main sectors, representing a total return of 5.3% gross yield and a reduction in voids to 5.53%.

8.3 The performance shows that our portfolio has performed better than our benchmark.

8.4 In response to the PWLB's new rules during 2020-21, which have been reaffirmed in the CIPFA codes of practice, we have amalgamated the asset investment fund into the strategic acquisition fund and will be assessing all potential acquisitions against the strategic property acquisition procedure approved by the Executive in January 2021. We are only looking to invest in the Borough as per our policy.

9. General Fund Capital programme

9.1 **Appendix 3** sets out the actual expenditure on capital schemes, compared to the updated estimates, together with reasons for variances. Overall, we spent £106,331 million (73%) less on capital schemes than we originally estimated and £108,521 million (72%) less than the revised estimate, the schemes with more than £1 million variance to budget relate to:

- Ash Road Bridge and Footbridge (delays in programme)
- WUV (reprofiling of spend)
- Investment in NDH and Guildford Holdings – (slightly less purchases in year),

- Midleton Industrial estate (delays due to Covid),
- Strategic property purchases (delayed due to Covid),
- Guildford West (decision pending on scope of works)
- GER/SGF (capitalisation of programme delayed)
- SMC Phase 3 (now cancelled, new mandate required if scope changes)

There are significant variations on other approved schemes under £1 million, as detailed in the appendix.

9.2 The table below summarises our capital expenditure and variances in the year

	Original estimate (£m)	Revised estimate (£m)	Actual (£m)	Variance to revised (£m)
GF approved programme	92.7	88.1	38	50.1
GF provisional programme	53.5	53.7	0	53.7
GF Schemes financed from reserves	1.9	4	1.7	2.3
Total	**148.1**	**145.8**	**39.7**	**106.1**

10. Compliance with treasury and prudential indicators

10.1 The CIPFA prudential code and treasury management code of practices require local authorities to set treasury and prudential indicators.

10.2 The objectives of the Prudential Code, and the indicators calculated in accordance with it, provide a framework for local authority capital finance that will ensure

- capital expenditure plans are affordable
- all external borrowing and other long-term liabilities are within prudent and sustainable limits
- treasury management decisions are taken in accordance with professional good practice and
- in taking the above decisions, the Council is accountable by providing a clear transparent framework

10.3 The Prudential Code requires the Council to set a number of prudential indicators for the following and two subsequent financial years, and to monitor against the approved indicators during the year. We can revise these indicators during the year but need full Council approval.

10.4 Officers can confirm that the Council has complied with its prudential indicators for 2021-22, (see **Appendix 1** for the outturn figures), its treasury management policy statement and its treasury management practices.

10.5 Section 6 outlines the approved treasury management strategy. We have adhered to the strategy by

- financing of capital expenditure from government grants, usable capital resources, revenue contributions and cash flow balances rather than from external borrowing
- taking a prudent approach in relation to the investment activity in the year, with priority given to security and liquidity over yield
- maintaining adequate diversification between counterparties
- forecasting and managing cash flow to preserve the necessary degree of liquidity

11. Risks and performance

11.1 The Council considers security, liquidity, and yield, in that order, when making investment decisions.

11.2 The Council has complied with all the relevant statutory and regulatory requirements, which limit the level of risk associated with its treasury management activities. In particular, its adoption and implementation of both the prudential code and treasury management code of practice means our capital expenditure is prudent, affordable and sustainable, and our treasury practices demonstrate a low-risk approach.

11.3 Short-term interest rates and likely movements in these rates, along with our projected cash balances, determine our anticipated investment return. These returns can be volatile and whilst, loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult.

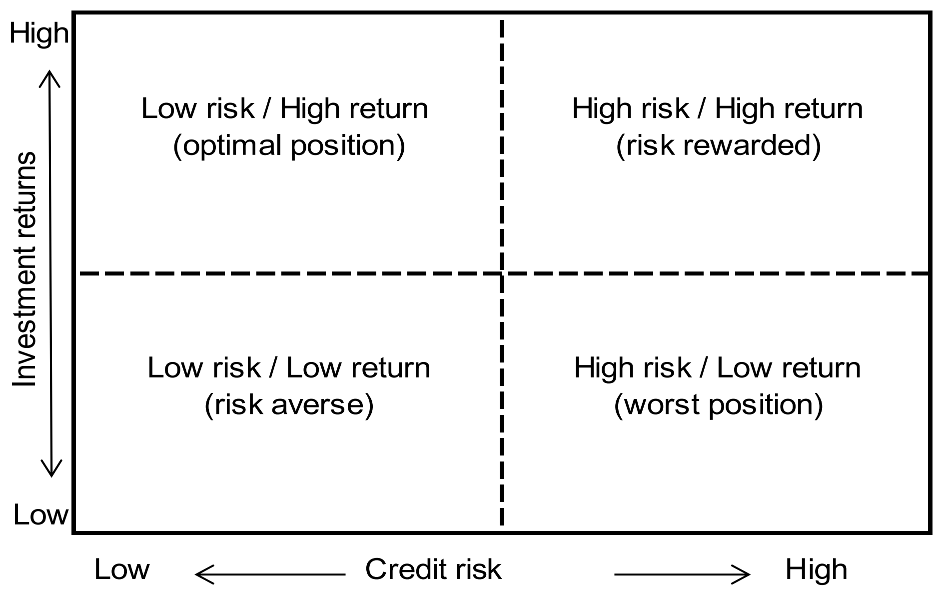
11.4 If the Council were to lose any of its investments, the GF will carry the loss, even if the cash lost is HRA cash. Therefore, to compensate the GF for this, we apply a credit risk adjustment to the rate of interest we apply on the HRA balances and reserves and SPA reserves. Therefore, a lower interest rate is applied than the weighted average investment return for the year. For 2021-22 this is the DMO (Debt management office investment with the Government and is the base “risk-free” investment rate) which is 0.11%.

11.5 The Council invests in externally managed funds. These are more volatile than cash investments but can come with a higher return. Officers continually review our funds to ensure they still have a place in the portfolio. We view most of our funds over a three to five-year time horizon to take account of their potential volatility – they are not designed to be short-term investments, despite being able to get the money from them quickly.

Credit developments and credit risk management during the year

11.6 Security of our investments is our key objective when making treasury decisions. We therefore manage credit risk through the limits and parameters we set in our annual treasury management strategy. One quantifiable measure of credit quality we use is to allocate a score to long-term credit ratings. **Appendix 8** explains the scoring in more detail

11.7 This is a graphical representation used in the Arlingclose benchmarking



11.8 Typically, we should aim to be in the top left corner of the chart where we get a higher return for lower risk. In the actual benchmarking, for average rate versus credit risk (value weighted) we were above the average of all clients and were in the top left box towards the middle vertical line. For time weighted we are well within the top left box (see **Appendix 6** for the two charts).

11.9 We set our definition of high credit quality as a minimum long-term credit rating of A-, which attracts a score of 7. The lower the score, the higher the credit quality of the investment portfolio.

11.10 The table below shows that at each quarter date, the weighted average score of our investment portfolio, on a value weighted and a time weighted basis is well within our definition of high credit quality, ending the year at 4.39 (AA-) and 4.36 (AA-).

Date	Value Weighted Avg Credit Risk Score	Value Weighted Avg Credit Rating	Time Weighted Avg Credit Risk Score	Time Weighted Avg Credit Rating	Average Life (days)
31-03-21	4.63	A+	4.06	AA-	199
30-06-21	4.69	A+	4.39	AA-	236
30-09-21	4.65	A+	3.92	AA-	201
31-12-21	4.66	A+	4.06	AA-	125
31-03-22	4.39	AA-	4.36	AA-	214

11.11 We have maintained security throughout the year within the portfolio on a value weighted basis. We also have a comparable risk score on the time weighted average than the Arlingclose client universe (4.39/AA- and 4.17/AA-). We do, however, have a much longer duration (ours is 214 days compared to the universe of 14 days) and this is due to us having a large portion of investments of covered bonds in the portfolio, which can be sold on the secondary market if required. The longer duration is with AAA rated covered bonds, so this has enhanced the security of the portfolio.

12. Minimum Revenue Provision (MRP)

12.1 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2003 (SI 2003 No 414) place a duty on local authorities to make a prudent provision for debt redemption. Making an MRP reduces the Capital Financing Requirement (CFR) and leaves cash available to replenish reserves used for internal borrowing or making external debt repayments. There are three options for applying MRP available to us:

- asset life method
- depreciation method
- any other prudent method

12.2 Any other prudent method means we can decide on the most appropriate method depending on the capital expenditure

12.3 The latest MRP policy was approved by Council in February 2021, and stated that

- the Council will use the asset life method as its main method, but will use annuity for investment property
- in relation to expenditure on development, we may use the annuity method starting in the year after the asset becomes operational
- where we acquire assets ahead of a development scheme, we will charge MRP based on the income flow of the asset or as service benefit is obtained, and will not charge MRP during construction, refurbishment or redevelopment

- We will apply a life of 50 years for the purchase of land and schemes which are on land (for example transport schemes)
- Where loans are made to other bodies for their capital expenditure, no MRP will be charged, where the other body is making principal repayments of that loan as well as interest. However, the capital receipts generated by the loan principal repayments on those loans will be put aside to reduce the CFR
- For investments in shares classed as capital expenditure, we will apply a life related to the underlying asset in which the share capital has been invested

12.4 The unfinanced capital expenditure in 2021-22 of £24.66 million related to Weyside Urban Village project, loan/equity to North Downs Housing Ltd, Midleton, Walnut Bridge, and transport schemes MRP will be chargeable to the revenue account the later of the next financial year or when the asset goes into use.

13. External Service Providers

13.1 The Council reappointed Arlingclose as our treasury management advisers in March 2015. The contract is for a period of 7 years, ending March 2022. This contract has been retendered and was awarded to Arlingclose on a 3+1+1 basis (ending on 31 March 2027). The Council is clear what services it expects and what services Arlingclose will provide under the contract.

13.2 The Council is clear that overall responsibility for treasury management remains with the Council.

14. Training

14.1 CIPFA's revised treasury management code of practice suggests that best practice is achieved by all councillors tasked with treasury management responsibilities, including scrutiny of the treasury management function, receiving appropriate training relevant to their needs and that they should fully understand their roles and responsibilities.

14.2 The MHCLG's revised investment guidance also recommends that a process is in place for reviewing and addressing the needs of the Council's treasury management staff for training in investment management.

14.3 Following the revised CIPFA code of practice and the stated requirement that a specified body be responsible for the implementation and regular monitoring of the treasury management policies, we use the Corporate Governance and Standards Committee to scrutinise the treasury management activity of the Council.

14.4 Training on treasury management will be given to new councillors and in particular the group leaders and members of the Corporate Governance and Standards Committee.

14.5 Officer training is undertaken on a regular basis, by attending workshops held by Arlingclose, and seminars or conferences held by other bodies, such as CIPFA. On the job training and knowledge sharing are undertaken when required. Those involved in treasury management are either a fully qualified accountant, or AAT qualified. The Lead Specialist for Finance, and Deputy s151 officer holds the 'Certificate in International Treasury Management for Public Finance' qualification, which is a joint qualification between the ACT (Association of Corporate Treasurers) and CIPFA.

14.6 Certain officers of the Council are deemed professional by the financial industry and therefore demonstrate the level of skill and expertise in the treasury function to ensure the Council retains professional status under the MiFID II regulations.

15. Consultations

15.1 Officers have consulted with the Lead Councillor for Resources about the contents of this report

Corporate Governance & Standards Committee – 29 September 2022

15.2 At its meeting on 29 September 2022, the Corporate Governance and Standards Committee considered this report and commended it to the Executive subject to the following comments made by the Committee during its debate:

- A need to ensure that we have up-to-date information on the schedule of investments and the need to review the overall situation in respect of the prudence of investments in other local authorities.
- Clarification was sought as to the position in respect of reviewing existing investments.
- In relation to the proposed schemes that had been recommended for removal from the capital programme, concern was expressed in respect of two of the schemes, which sought to address flooding issues, that insufficient information had been provided to justify their removal.

16. Key Risks

16.1 This is a backward-looking report, and the mitigation of risks has been highlighted throughout the report

17. Financial Implications

17.1 The detailed financial implications are summarised above and in **Appendix 1**

18. Legal Implications

18.1 A variety of professional codes, statutes and guidance regulate the Council's treasury management activities. These are:

- the Local Government Act 2003 ("the Act") provides the powers to borrow and invest. It also imposes controls and limits on these activities
- the Act permits the Secretary of State to set limits on either the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken. There are no current restrictions
- statutory instrument 3146 (2003 ("The SI"), as amended, develops the controls and powers within the Act
- the SI requires the council to undertake any borrowing with regard to the prudential code. The prudential code requires indicators to be set – some of which are limits – for a minimum of three forthcoming years
- the SI also requires the council to operate the treasury management function with regard to the CIPFA treasury management code of practice
- under the terms of the Act, the Government issued "investment guidance" to structure and regulate the council's investment activities. The emphasis of the guidance is on the security and liquidity of investments.

19. Human Resource Implications

19.1 There are no human resource implications arising from this report other than the training discussed in section 14, which is already in place

20. Equality and Diversity Implications

20.1 This duty has been considered in the context of this report and it has been concluded that there are no equality and diversity implications arising directly from this report.

21. Climate Change/Sustainability Implications

21.1 There are no direct implications.

22. Summary of Options

22.1 We could have invested in lower credit quality investments, but this would have increased our risk exposure.

22.2 We could have borrowed longer-term for our capital programme but would have suffered a cost of carry due to the slippage in the programme.

23. Conclusion

23.1 The Council has complied with the objectives of the CIPFA treasury management code of practice by maintaining the security and liquidity of its investment portfolio.

23.2 We maintained the security of our investment portfolio and did not borrow long-term in advance of need.

23.3 We have also complied with the requirements of the prudential code by setting, monitoring and staying within the prudential indicators set, except the variable limit on net investments due to higher investment balances than when the indicator was set.

24. Background Papers

- CIPFA Treasury Management in the Public Services – Code of Practice and Cross Sectoral Guidance Notes (2018 edition)
- CIPFA Treasury Management in the Public Services – Guidance Notes for Local Authorities including Police Authorities and Fire Authorities (2018 edition)
- CIPFA the Prudential Code for Capital Finance in Local Authorities (2018 edition)
- CIPFA the Prudential Code for Capital Finance in Local Authorities – Guidance Notes for Practitioners (2018 edition)
- Treasury management annual strategy report 2021-22

25. Appendices

Appendix 1: Treasury management activity, treasury and prudential indicators 2021-22
Appendix 2: Investment property fund portfolio report 2021-22
Appendix 3: capital programme
Appendix 4: schedule of investments at 31 March 2022
Appendix 5: economic background – a commentary from Arlingclose
Appendix 6: benchmarking graphs
Appendix 7: credit score analysis
Appendix 8: credit rating equivalents and definitions
Appendix 9: background to externally managed funds
Appendix 10: glossary