Capital, Investment and Treasury Strategies 2021/22 to 2023/24

Capital Strategy

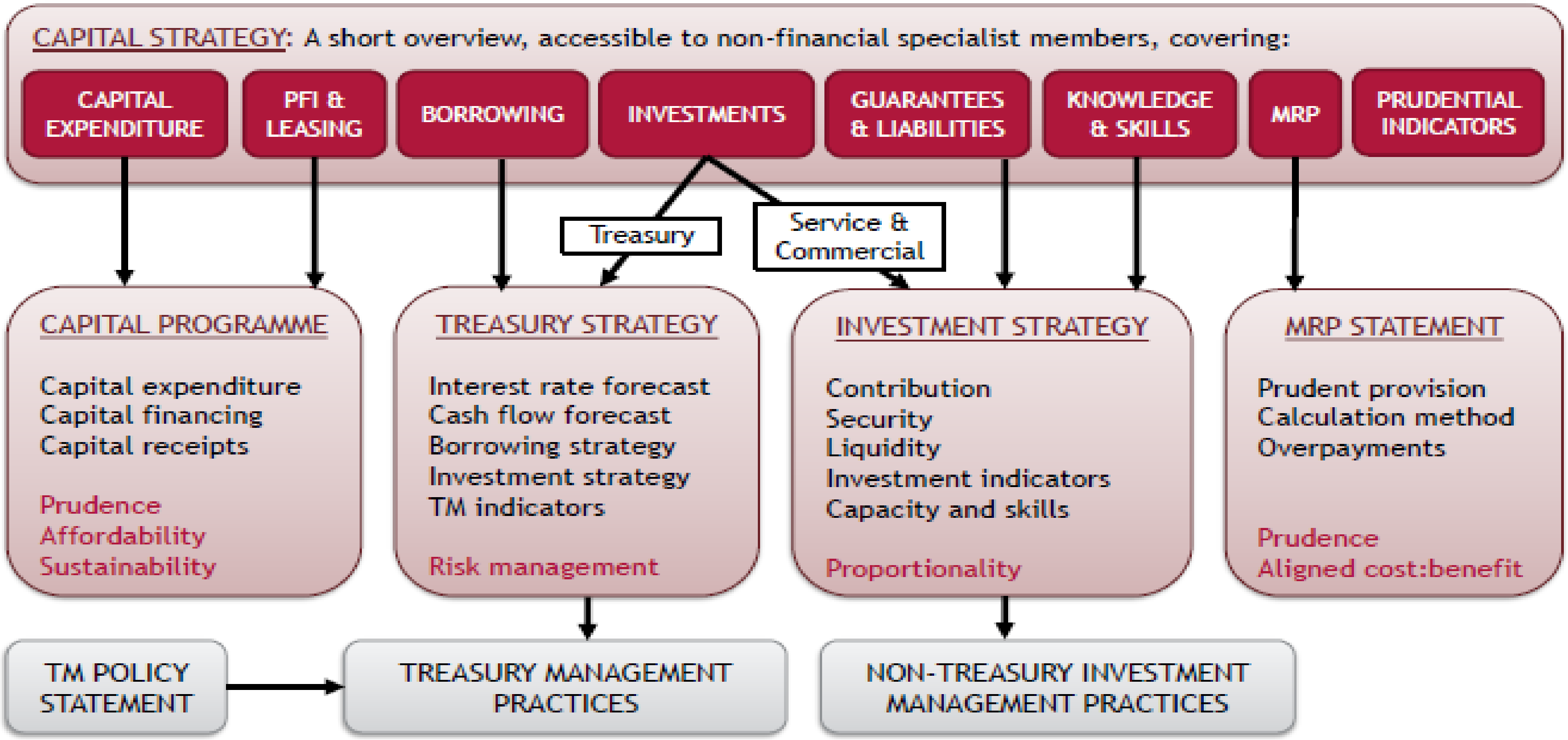
1 Introduction

1.1 This Strategy sets out South Somerset District Council's approach to capital investment and sets out the long-term context in which both capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.

1.2 It provides an overview of how the associated risk is managed, the implications for future financial sustainability and information on how stewardship, value for money, prudence, sustainability and affordability will be secured.

1.3 The investment and treasury management strategies are fundamentally linked to the capital strategy and are therefore included here to provide a holistic view of capital, investment and borrowing requirements.

1.4 The flowchart below provides information on the requirements and the contents of the various strategies that are required on an annual basis, and how the strategies are inter-related.


CAPITAL STRATEGY: A short overview, accessible to non-financial specialist members, covering:
CAPITAL EXPENDITURE
PFI & LEASING
BORROWING
INVESTMENTS
GUARANTEES & LIABILITIES
KNOWLEDGE & SKILLS
MRP
PRUDENTIAL INDICATORS
Treasury
Service & Commercial
CAPITAL PROGRAMME
Capital expenditure
Capital financing
Capital receipts
Prudence
Affordability
Sustainability
TREASURY STRATEGY
Interest rate forecast
Cash flow forecast
Borrowing strategy
Investment strategy
TM indicators
Risk management
INVESTMENT STRATEGY
Contribution
Security
Liquidity
Investment indicators
Capacity and skills
Proportionality
MRP STATEMENT
Prudent provision
Calculation method
Overpayments
Prudence
Aligned cost:benefit
TM POLICY STATEMENT
TREASURY MANAGEMENT PRACTICES
NON-TREASURY INVESTMENT MANAGEMENT PRACTICES

2 Capital Expenditure

Capital Expenditure Estimates

2.1 Capital expenditure is incurred where the Council spends money on constructing or acquiring assets such as land and buildings, vehicles, plant and equipment, which will be used for more than one year, as well as larger scale maintenance works that maintain or enhance the Councils existing assets. In local government capital expenditure can also include spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. The Council has some limited discretion on what counts as capital expenditure. For example, assets costing below £10,000 are not capitalised and are charged as revenue expenditure in the year. This discretion is reflected in the Council's accounting policies which are set out within the Statement of Accounts each year.

2.2 In 2021/22, the Council is planning capital expenditure of £61.3m as summarised below:

Table 1: Prudential Indicator: Actual and Estimates of Capital Expenditure

	2019/20 Actual £k	2020/21 Projection £k	2021/22 Estimate £k	2022/23 Estimate £k	2023/24 Estimate £k
General Fund services	6,426	5,594	5,455	3,000	3,000
Capital investments	59,056	25,930	55,870	18,039	3,300
TOTAL	**65,482**	**31,524**	**61,325**	**21,039**	**6,300**

2.3 The Council's capital investment focusses on the following main areas:

- Investment in new and existing operational assets and issuing capital grants to support the delivery of its services and strategic priorities. This includes schemes such as regeneration and infrastructure projects, grants for accessibility adaptations and equipment to support independent living.

- Investment to grow and balance the Council's commercial investment income portfolio, as set out in the investment strategy. This may include direct property freehold or long-leasehold acquisition, as well as shareholdings and loans to third parties and subsidiaries.

Capital Programme

2.4 The Capital Programme represents the Council's commitment to continue to invest in its operational asset portfolio and wider investment to support housing, economy and place-shaping priorities. It is reviewed annually and approved through the budget setting process, taking into account the availability of capital resources and the financing cost implications on the revenue budget.

2.5 New capital schemes and projects are usually added to the Programme as part of the annual process, however the Council's governance arrangements allow for new schemes and projects to be added or removed from the programme during the year subject to appropriate approvals.

2.6 Service managers have submitted bids to include projects in the Council's capital programme. Bids are collated by Finance who calculate the financing cost (which can be nil if the project is fully externally financed). The Strategic Leadership Team appraises all bids based on a comparison of service priorities against financing costs and makes recommendations to District Executive. The proposed capital programme is then presented to District Executive in January and to Council in February each year.

2.7 The proposed capital programme includes investment of £61.3m in 2021/22, with indicative further investment of £27.3m in the subsequent two years to 2023/24. The details of this investment is included in the General Fund 2021/22 Budget Estimates reports.

Asset Management

2.8 To ensure that capital assets continue to be of long-term use, the Council has an asset management plan, which is incorporated in the Council's Commercial Strategy and an Asset Disposal and Community Asset Transfer Policy.

2.9 This Asset Disposal and Community Asset Transfer Policy provides a transparent, robust and strategic framework to enable Asset Disposal and Community Asset Transfer decisions to be made, together with a clear process for both SSDC and community organisations to progress with transfers/disposals, with long term sustainable benefits both to the Council and the community.

2.10 The Disposals element of the policy refers to Council owned assets that are sold on the open market for a financial consideration or otherwise transferred out of Council ownership. The aim is to enable SSDC to retain only sound assets that support the effective and efficient delivery of services, achieve corporate priorities or produce a healthy financial return each year in accordance with the Commercial Land and Property Strategy.

2.11 When a capital asset is identified as surplus to requirements or an enabler for others to deliver council priorities, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. The Council is currently also permitted to spend capital receipts on service transformation projects until 2022/23. Repayments of capital grants, loans and investments also generate capital receipts. The Council estimates it will receive £2.45 million of capital receipts in the 2021/22 financial year.

Table 2: Capital receipts in £ millions

	2019/20 Actual £k	2020/21 Projection £k	2021/22 Estimate £k	2022/23 Estimate £k	2023/24 Estimate £k
Asset sales	37	0	15	430	0
Loans repaid	1,922	2,569	2,433	3,070	3,399
TOTAL	**1,959**	**2,569**	**2,448**	**3,500**	**3,399**

3 Capital Financing

3.1 The Council's capital investment falls within the scope of the CIPFA Prudential Code for Capital Finance in Local Authorities (the 'Prudential Code'), to which the Council must give due regard. The Code was last updated in 2017. Under the Prudential Code the Council has discretion over the funding of capital expenditure and the freedom to determine the level of borrowing it undertakes to deliver the Capital Programme.

3.2 All capital expenditure must be financed, and there are range of potential funding sources the Council may use including its own resources or externally:

- Capital receipts from asset disposals and loan repayments
- Capital grants e.g. from Government or other local authorities
- Contributions from others e.g. Section 106 (S106) and Community Infrastructure Levy (CIL)
- Revenue Contributions to Capital e.g. from the Revenue Budget or Revenue Reserves
- Debt financing e.g. borrowing, capital market bonds, leasing

Capital Financing Plan

3.3 The planned financing of the capital expenditure in Table 1 above is as follows:

Table 3: Capital Financing Plan

	2019/20 Actual £k		2020/21 Budget £k	2021/22 Estimate £k	2022/23 Estimate £k	2023/24 Estimate £k	Totals 2020/21-2023/24 £k
External Sources:							
Grants and general contributions	1,330		1,629	275	2,835	917	5,656
S106	264		267	1	18	17	303
CIL	0		0	0	0	0	0
Sub-total – External	**1,594**		**1,896**	**276**	**2,853**	**934**	**5,959**
Own Resources:							
Capital receipts & Reserves	7,019		5,804	7,735	1,344	0	14,883
Sub-total - Own	**7,019**		**5,804**	**7,735**	**1,344**	**0**	**14,883**
Debt:							
Loans (Internal & External)	56,869		23,825	53,315	13,842	2,366	169,321
Leases							
Sub-total - Debt	**56,869**		**23,825**	**53,315**	**13,842**	**2,366**	**169,321**
Total	**65,482**		**31,525**	**61,326**	**18,039**	**3,300**	**204,222**

3.4 The allocation of resources may vary over time, for example, where additional income is achieved through asset sales or obtaining external funding. The plan is therefore dynamic, and is overseen by the Council's S151 Officer to optimise financing arrangements on an ongoing basis. The estimates will not commit the Council to particular methods of financing. The S151 Officer will determine the actual financing of capital expenditure incurred at the end of the financial year.

3.5 The implications of financing capital expenditure from borrowing is that the expenditure is not funded immediately but charged to the revenue budget over a number of years. The Council may defer the timing of external borrowing on a short to medium term by using temporary cash resources held in reserves and balances. This practice, which is referred to as 'internal borrowing', does not reduce the magnitude of borrowing required or the level of funds held in reserves and balances; the funds are merely being utilised in the short term until they are required for their intended purpose. The timing of external borrowing and the balance of external / internal borrowing is determined by market conditions and the Council's cash flow position. Officers manage this position on a day to day basis in line with the overall Treasury Management Strategy.

3.6 Debt is only a temporary source of finance, since loans and leases must be repaid and this is, therefore, replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP). Alternatively, capital receipts may be used to replace debt finance.

Capital Financing Requirement

3.7 The Council's cumulative amount of debt finance is measured by the Capital Financing Requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP repayments and capital receipts used to replace debt. Based on the above figures for expenditure and financing the Council's estimated CFR is as follows:

Table 4: Prudential Indicator – Actual and Estimated Capital Financing Requirement

	2019/20 Actual £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k	2023/24 Estimate £k
CFR Balance b/f	39,320	95,582	118,610	171,108	184,113
Expenditure financed by debt	65,482	31,525	61,326	18,039	3,300
MRP	-520	-797	-817	-837	-847
Capital receipts used to replace debt	-7,370	-5,804	-7,735	-1,344	0
Grants & Contributions	-1,330	-1,896	-276	-2,853	-933
Total CFR	**95,582**	**118,610**	**171,108**	**184,113**	**185,633**

3.8 The chart shows that the Council's proposed capital strategy and capital investment plans are expected to increase the overall indebtedness position of the next 5 years. It is important to ensure such plans are affordable and the Council can meet the costs of this debt over the short and long term.

Grants and Contributions

3.9 The Council will seek to access external funding towards its capital investment plans where funds are available and our schemes are within scope. Examples of grants may include Government schemes such Housing Infrastructure Fund, Future High Streets Fund and so on. We also receive contributions from other bodies such as developers in the form of S106 planning obligations contributions and Community Infrastructure Levy (see below). It is often the case that the Council will need to put some of its own resources towards a scheme in order to attract the external funding. However, this can be effective in levering in funds to enable larger infrastructure investments to progress and mitigate marginal viability schemes.

S106 Contributions

3.10 S106 contributions are received in respect of certain obligations that have been agreed through planning approvals. Contributions that are in respect of district council services within SSDC are paid to the Council, there are usually restrictions on the nature of costs that S106 monies can fund. Expenditure on items such as public art, play areas and equipment and affordable housing provision are examples service expenditure that S106 contributions can fund. S106 contributions can be used to fund both revenue and capital expenditure and are allocated to the relevant capital and revenue budget accordingly.

3.11 All S106 funds over £10,000 will be included if appropriate in the capital programme once received and included within a quarterly monitoring statement for reporting to District Executive.

Community Infrastructure Levy (CIL)

3.12 The Council operates an approved CIL policy, with the levy payable on development in certain areas within the District. CIL is recognised as capital income and therefore provides resources to contribute to eligible infrastructure investment such as transport/roads, education, town centre regeneration and flood alleviation schemes. 15% (or 25% with an adopted Neighbourhood Plan) of CIL income is passed to town or parish councils, and 5% is allocated to fund administration costs.

3.13 Table 5: Estimated CIL Retained Income (Net of town/parish share and administration costs)

	2019/20 Actual £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k	2023/24 Estimate £k
Net CIL Income	321	872	1,100	1,300	1,500

4 Treasury Management and Borrowing Strategy

4.1 Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council’s spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Council is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

4.2 The Council held £79.50m of external borrowing on 1 April 2020 (£19.5m at 1 April 2019) and treasury investments totalling £35.25m (£30.73m at 1 April 2019).

4.3 The Council's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in the future. These objectives are often conflicting and the Council, therefore, seeks to strike a balance between cheaper short-term loans (currently available at around 0.10%) and long term fixed rate loans where the future cost is known but higher (currently 1.5%-2.5%).

4.4 Council's do not borrow for specific assets and cannot use local authority assets as security. Borrowing is undertaken to meet the capital financing requirement (less any short term use of temporary cash balances).

HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)

4.5 A common source of borrowing for local authorities is the HM Treasury, through the Debt Management Office, which took over the responsibilities of the previous Public Works Loans Board (although the term PWLB is still commonly used). There are a number of advantages to using the HM Treasury's PWLB lending facility as a source of borrowing, such as

- Funds can be accessed quickly – usually within 2-3 days of notice
- It is simple to arrange with limited time and effort required
- The Council does not require a credit rating
- Borrowing is not linked to any specific asset, but can provide the resources need to meet the overall capital financing requirement.

4.6 The HM Treasury's PWLB lending facility currently offers a discounted 'certainty rate' at 0.2% below its standard rates, triggered by the Council completing an annual return to Government. It also offers a discounted 'infrastructure rate' which is 0.4% below its standard rate, which is subject to a competitive bidding process.

4.7 In October 2019, in response to the Treasury's concern about growing total debt balances for local government, the PWLB lending facility's standard and certainty rates were increased by 1% without notice. In March 2020 the Government launched a consultation on revised lending terms and guidance to implement this reform.

4.8 The aim of this consultation was to develop a proportionate and equitable way to prevent local authorities from using PWLB loans to buy commercial assets primarily for yield, without impeding their ability to pursue service delivery, housing, and regeneration under the prudential regime.

4.9 Following this consultation, the Government published revised lending terms for the PWLB and guidance to support Local Authorities to determine if a proposed project is an appropriate use of PWLB loans. The new terms apply to all loans arranged after the 26 November 2020.

4.10 The revised guidance states that authorities that purchase investment assets primarily for yield will be restricted from borrowing PWLB loans in the financial year the purchase takes place. Guidance is high level, rather than a set of strict definitions, due to the diversity and complexity of local government finance. It deliberately avoids providing precise answers, leaving the onus on Section 151 officers, or equivalents, to categorise borrowing activity and certify the authority is not planning purchase investment assets primarily for yield over the next three years.

4.11 The full response to the consultation document (Public Works Loans Board: Future Lending Terms) can be accessed at:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/940281/Response_to_consultation_Public_Works_Loan_Board_future_lending_terms_1.pdf

4.12 As a consequence, the Council is continuing to work on identifying alternative sources of long term finance such as issuing bonds to the capital markets (typically pension funds and insurance companies).

Total Debt Position

4.13 Projected levels of the Council's total outstanding debt are shown below, compared with the CFR (as detailed above). Statutory guidance is that actual debt should remain below the CFR, except in the short-term. As can be seen from the table the Council expects to comply with this in the medium term.

Table 6: Prudential Indicator – Gross Debt and the CFR

	2019/20 Actual £k	2020/21 Budget £k	2021/22 Estimate £k	2022/23 Estimate £k	2023/24 Estimate £k
Debt	79,500	103,113	158,983	172,826	176,126
CFR	95,581	118,608	171,106	184,112	185,632

Liability Benchmark

4.14 To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes that cash and investment balances are kept to a minimum level of £30m at each year-end. This benchmark is estimated to be £74.2m and is forecast to rise to £164.3m over the next five years.

Table 7: Actual Borrowing and the Liability Benchmark

	2019/20 Actual £k	2020/21 Budget £k	2021/22 Estimate £k	2022/23 Estimate £k	2023/24 Estimate £k
Outstanding borrowing	79,500	103,113	158,983	172,826	176,126
Liability Benchmark	74,242	87,268	149,766	162,772	164,292

5 Affordable Borrowing Limit

5.1 The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year and to keep it under review. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach this limit. The Operational Boundary has been calculated based on the forecast CFR plus a tolerance for variations in spending plans during the year and possible volatility in availability of internal and external resources.

Table 8: Prudential Indicators – Authorised Limit and Operational Boundary for external debt

	2019/20 Actual £k	2020/21 Budget £k	2021/22 Estimate £k	2022/23 Estimate £k	2023/24 Estimate £k
Operational Boundary:					
Borrowing	79,500	120,000	170,000	180,000	190,000
Leases	51	15,000	20,000	20,000	20,000
Total Operational Boundary	**79,551**	**135,000**	**190,000**	**200,000**	**210,000**
Authorised Limit:					
Borrowing	124,000	140,000	180,000	195,000	205,000
Leases	1,000	20,000	25,000	25,000	25,000
Total Authorised Limit	**125,000**	**165,000**	**205,000**	**220,000**	**230,000**

5.2 Further details of existing borrowing can be found in the Treasury Management Strategy Statement.

6 Treasury Investment Strategy

6.1 Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management.

6.2 The Council's policy on treasury investments is to prioritise security and liquidity over yield, therefore to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high quality banks to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Council may request its money back at short notice.

6.3 As part of the Council's financial strategy, the aim is to maintain the balance within the investment portfolio with the objective being to sustain, but also grow, the net income available through treasury management to fund services, whilst maintaining a prudent balance between security, liquidity and yield. Subject to long term cash flow forecasts, it is anticipated that funds held in longer term investments will be maintained at current levels.

6.4 Longer term investments may expose a proportion of funds to a higher risk of capital value volatility, this volatility is mitigated by holding a risk-assessed minimum balance of funds in a Treasury Risk Reserve. The balance of funds in this specific reserve is reviewed annually and a decision taken by the S151 Officer on the required transfer to or from the reserve made based on the current and projected performance of the longer term investments. The assessment of adequate general reserves also incorporates an element of risk to investment income assumptions.

Table 9: Treasury Management Investments

	2019/20 Actual £k	2020/21 Budget £k	2021/22 Estimate £k	2022/23 Estimate £k	2023/24 Estimate £k
Near-term investments	8,000	3,000	2,000	2,000	2,000
Long-term investments	27,250	30,000	30,000	30,000	30,000
Total	**35,250**	**33,000**	**32,000**	**32,000**	**32,000**

6.5 Further details of existing treasury investments can be found in the Treasury Management Strategy below.

6.6 The effective management and control of risk are prime objectives of the Council’s treasury management activities. The treasury management strategy therefore sets out various indicators and limits to constrain the risk of unexpected losses and details the extent to which financial derivatives may be used to manage treasury risks.

6.7 Decisions on treasury management and borrowing are made daily and are, therefore, delegated to the S151 Officer and Finance staff who must act in line with the Treasury Management Strategy approved by Full Council. Reports on treasury management activities are presented to the Audit Committee at mid-year and at year-end.

7 Investment for Service Purposes

7.1 The Council can make service investments; service investments can be in the form of a loan to an organisation or the purchase of shares in organisations. The purpose of service investments is to support local public services and to stimulate local economic growth.

7.2 In light of the public service objective, the Council is willing to take more risk than with treasury investments, however it still plans for such investments to break even after all costs.

7.3 Decisions on service investments are presented to Strategic Leadership Team, which includes the Section 151 Officer. Investments must meet the criteria and limits laid down in the investment strategy. Most loans and shares are capital expenditure and purchases will therefore also be approved as part of the capital programme.

7.4 Further details on service investments are contained in the Investment Strategy.

8 Commercial Investment Activities

8.1 The commercial property investment portfolio is an integral part of the Council's medium term financial plan and contributes towards the overall income generation target that is needed to mitigate the significant reduction in government funding, enable the Council to maintain and improve services and service standards, and meet our priorities and objectives. The Commercial Strategy details the Council's approach to commercialisation. One of the aims of the strategy is to align with and support the Council Plan and ensure that the Council is the partner of choice for the community and commercial sectors by demonstrating its commercial awareness and effective delivery of services.

8.2 The value of the property held for investment purposes was £71.97m as at 31 March 2020 (£26.1m at 31 March 2019) and is anticipated to be £81.27m at 31 March 2021, the target average return on properties held for investment purposes is 7% on all new investments. The target net rate of return is a minimum of 2.5% to 3% after accounting and financing provisions (i.e. paying interest, making provision for repayment of the capital sum and following contribution to reserves to offset risk).

8.3 With financial return being the main objective, and as with investments for service purposes, the Council accepts a higher risk on commercial investment than with treasury investments. It has a robust risk assessment process in place which includes assessing the risk of loss before entering into and whilst holding service investments.

8.4 This increased risk is balanced with an efficient and proportional regard to governance, policy, management, processes and systems to ensure robust decision-making, performance and success of new commercial enterprises, contracts and partnerships. All of which will continue to evolve and be refined over time to ensure that the Council adheres to its statutory responsibilities and that public money continues to be appropriately invested, used and accounted for.

8.5 In considering investment opportunities, a predetermined set of assessment criteria for each proposed investment is used and a business case is completed to ensure transparency, due diligence, governance and consistency to aid achievement of the investment objectives.

8.6 In order that commercial investments remain proportionate to the size of the authority, these are subject to an overall maximum investment limit of £150m.

8.7 If the returns on investments are not maintained at the required levels contingency plans to continue to provide services are in place. The contingency plan includes holding adequate general reserves and a specific investment risk reserves such as the Treasury Risk Reserve and the Investment Property Risk Reserve.

8.8 Decisions on commercial investments are made in line with the criteria and limits approved by council in the 2021/22 investment strategy. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme.

8.9 Further details on commercial investments and limits are included in the investment strategy.

9 Liabilities

9.1 In addition to capital debt as detailed above the Council is committed to making future payments to cover its pension deficit, which was valued at £79.93m on 1 April 2020. This balance is due to be paid over a 20-year period, and the deficit and annual contributions are revalued every three years. It has also set aside funds to cover provisions for probable costs. The Council is also at risk of having to pay for contingent liabilities but has not put aside any money because payment is contingent on, as yet, unknown events occurring which may crystallise possible amounts due.

9.2 Decisions on incurring new discretionary liabilities are taken by senior managers and service managers in consultation with the S151 Officer. The risk of liabilities crystallising and requiring payment is monitored by the finance team and reported to the S151 officer.

9.3 Further details on liabilities and guarantees can be found in the 2019/20 Statements of Accounts.

10 Revenue Budget Implications

10.1 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans/leases and capital debt repayment provisions are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants.

Table 10: Prudential Indicator – Proportion of financing costs to net revenue stream

	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2022/23 Estimate
Financing Costs (£m)	(0.978)	(1.403)	0.307	0.415	0.539
Proportion of net revenue stream	(5.98%)	(7.54%)	1.84%	2.75%	3.46%

10.2 Financing costs for 2021/22 and subsequent years includes an increase due to a change in the accounting for leases.

10.3 Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 50 years into the future. The S151 Officer is satisfied that the proposed capital programme is prudent, affordable and sustainable.

10.4 All capital investment must be sustainable in the long term through revenue support by the Council or its partners. All capital investment decisions consider the revenue implications both in terms of servicing the finance and running costs of the new assets. The impact of the revenue implications is a significant factor in determining approval of projects. The use of capital resources has been fully taken into account in the production of the Council's Medium Term Financial Plan.

11 Knowledge and Skills

11.1 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the S151 Officer is a qualified accountant, and the Director of Commercial Services and Income Generation is highly experienced in the commercial property field. There are several other professionally qualified Finance Specialists within the Council's finance function and the Council pays for staff to study towards relevant professional qualifications including CIPFA. All officers involved in the treasury and investment management function have access to relevant technical guidance and training to enable them to acquire and maintain the appropriate level of expertise, knowledge and skills to undertake the duties and responsibilities allocated to them.

11.2 Where Council staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers, and utilises services of property consultants who provide a diligent assessment of the market and assists in preparing a bid, acting as the sounding board for the in house Investment Surveyor. This approach is more cost effective than employing such staff directly, and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

11.3 Those charged with governance (Members of the Audit Governance and the District Executive) recognise their individual responsibility to ensure that they have the necessary skills to complete their role effectively. The S151 Officer will ensure that elected Members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and responsibilities.

Investment Strategy

12 Introduction

12.1 The Council invests funds that it holds for three broad purposes:

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

ii) to support local public services by lending to or buying shares in other organisations (**service investments**), and

iii) to earn investment income (known as **commercial investments** where this is the main purpose)

12.2 This investment strategy meets the requirements of statutory guidance issued by the Government in January 2018, and focuses on the second and third of these categories.

13 Treasury Management Investments

13.1 The Council typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and Central Government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy (CIPFA). The balance of treasury management investments is expected to fluctuate between £30m and £60m during the 2021/22 financial year.

13.2 The contribution that these investments make to the objectives of the Council is to support effective treasury management activities.

13.3 Full details of the Council's policies and its plan for 2021/22 for treasury management investments are covered in the treasury management strategy later in this document.

14 Service Investments – Loans

14.1 The Council lends money to local businesses, local charities, other local authority partnerships, and local residents to support local public services and priorities, and stimulate local economic growth. Currently the Council has loans invested with:

- Hinton St George Shop
- Somerset Waste Partnership – for waste vehicles, with added benefit of keeping waste contract costs down
- Opium Power Limited
- Elleston Business Services Limited

Risk Management – Service investment Loans

14.2 The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to minimise this risk and ensure that total exposure to service loans remains proportionate to the size of the Council, upper limits on the outstanding loans to each category of borrower have been set as follows:

Table 11: Loans for Service Purposes

	Actual as at 31/03/2020			2021/22
Category of borrower	Balance Owing £k	Loss Allowance £k	Net Figure In Accounts £k	Approved Limit £k
Local Businesses	149	0	149	200
Local Authorities	4,921	0	4,921	7,500
Joint Operations	13,289	0	13,289	35,000
Community (Small) Loans	0	0	0	1,000
Employees	27	0	27	100
Total	**18,386**	**0**	**18,386**	**43,800**

14.3 Accounting standards require the Council to set aside a loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Councils statement of accounts will be shown net of this loss allowance. However, the Council makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

14.4 No loss allowance is set aside for the current loans made for service purposes. In the case of the loan to the local business and the loan to the joint operation, the Council has a charge over the asset. The asset values are currently higher than the value of the balance owing on the respective loans, therefore no loss allowance is currently required. Assets are revalued in line with the accounting policies and the loss allowance will be revised if asset value reduces to a level below the balance outstanding on the loan.

14.5 The Council assesses the risk of loss before entering into and whilst holding service loans by working up a robust business case and applying due diligence to all requests for service loans, and proportionate monitoring of credit risk of borrowers. For example, with loans to key businesses the Council's finance specialist team (qualified accountants) will review financial statements and service officers will maintain communication with the borrower in order that emerging risks are identified promptly. The Council will use credit rating information where available, and will use external specialist advisors if appropriate.

15 Service Investments – Shares

15.1 The Council does not currently hold any direct investment in the shares of subsidiaries, its suppliers or local businesses. As part of the Council's commercialisation agenda, the Council may explore opportunities to establish wholly-owned or partly-owned trading companies. In any such case, appropriate business cases, due diligence, risk assessment and governance proposals will be developed for consideration of Full Council. In addition, relevant provisions would be added to the Investment Strategy including the expected contribution to the Council's strategies and priorities, and the security and liquidity of investments.

16 Commercial Investments – Property

16.1 The Council invests in a diverse investment property portfolio both locally and nationally with the intention of generating surplus income that will be spent on local public services delivered within the district. This is an essential response to significant reductions in government funding over recent years, in order to meet service delivery objectives and the place making role of the Council, and avoid service cuts. The Council plans to increase its investment by up to £70m over the next 2 years.

16.2 The Council holds a number of assets that were initially acquired for service purposes such as benefitting the local economy but have since been reclassified as investment properties. These are now established and the main purpose for holding the assets is for rental income. The following table summarises the investment properties as at 1 April 2020. This table includes historically held investment properties as well as investments made as part of the Commercial Strategy up to 1 April 2020.

Table 12: Property held for investment purposes

	Value in accounts	
Sector	31st March 2020 £k	31st March 2021 £k
Offices	25,600	**To be confirmed following the audit of the 2020/21 accounts**
Retail	12,265	
Industrial	22,310	
Small Business Units	5,220	
Historic Buildings	310	
Nursery	75	
Commercial	6,070	
Garages	73	
Warehouse	50	
Totals	**71,973**	

16.3 The Council has a number of potential property purchases that have been approved by the Investment Assessment Group, but are not yet completed. Work is progressing and it is anticipated that c£12.5m will be spent on investment property purchases in the remaining part of this financial year. As part of the aims of our Commercial Strategy, the Council is continuing to look for investment opportunities that align with its objectives in terms of risk, return and affordability and that also fit with the wider aims of the Council.

16.4 The total value of property held for investment purposes as at 31 December 2020 is £72.5m. The value in the accounts in respect of these purchases, and the properties held at 1 April 2021, is not known at the stage as the gains and losses on properties are undertaken as part of the closure of accounts.

16.5 In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs. The Council also recognises that asset values may increase and decrease over time due to market volatility, and takes a long term perspective with the assumption that capital values are likely to hold or grow over the life of the asset.

16.6 *Where value in accounts is at or above purchase cost:* A fair value assessment of the Council's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment. Should the 2020/21 year end accounts preparation and audit process value these properties below their purchase cost, then an updated investment strategy will be presented to full council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

Or

16.7 *Where value in accounts is below purchase cost:* The fair value of the Council's investment property portfolio is no longer sufficient to provide security against loss, and the Council is therefore taking mitigating actions to protect the capital invested. These actions include: planning to hold the assets for the long term; maintaining assets to appropriate quality; mitigating risk of realised losses through maintaining adequate funds in an Investment Risk Reserve, and reducing capital borrowing through its MRP policy.

16.8 The Council assesses the risk of loss before entering into and whilst holding property investments by undertaking appropriate due diligence including full valuation surveys and operating an asset management plan. The Council also considers strength of local market conditions to give confidence on future re-letting and also considers possible alternative uses if appropriate, and actively monitors the portfolio to ensure tenant obligations for maintaining assets are fulfilled.

16.9 Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the Council actively manages cash flow through its treasury management arrangements and plans to under-borrow against its CFR so that it can temporarily borrow at short notice if required.

16.10 The Council's asset disposal policy includes the approved process for asset disposal and performance indicators (property management indicators) which provide the information on the performance of each property. The performance indicators provide information on assets which are not yielding the level of return required by the Commercial Strategy.

16.11 The Council uses industry standard software, to track the performance of its investment portfolio. The software is capable of monitoring running yields asset by asset and across the portfolio, and adopting multiple scenarios. By continually reviewing the market, the tenant covenant and unexpired lease term of each property, the Council is able to find the optimum time to dispose of assets.

17 Other Categories of Investment

17.1 Special Purpose Vehicles - The Council has setup a special purpose vehicle (SSDC Opium Power Ltd) which has successfully delivered two renewable energy projects, a third project was recently approved and is in the early stages of development. The Council's is continuing its journey into ownership and development of renewable energy which will provide essential support to the National Grid for balancing power demand and storing renewable energy. The company is 50:50 owned between the Council and Opium Power Limited, with the Council providing a secured term loan facility to the SPV. A repayment schedule for both projects has been agreed with the SPV as part of the loan conditions.

17.2 Renewable energy investments – This type of investment not only assist with the Council's income generation needs and contributes towards the objectives of the commercial strategy, they also meet the Council Plan commitment to promote the use of green technology. Renewable energy measures and investments are continually sought to ensure that the Council's existing and future energy costs and requirements on our own operational property are considered.

17.3 Community Benefit - Other investments that do not meet the internal rate of return target, but do provide some financial return and also bring collective benefit to the community in accordance with the wider Corporate Plan objectives are considered with a different form of assessment criteria but similar decision making process. The primary objective may not be to generate income but to deliver a service of community benefit i.e. economic development, jobs, health, welfare, leisure, housing need etc.

17.4 Regeneration Schemes - Major investment in Regeneration Schemes are planned or are in progress, such as the Chard Regeneration Scheme and the Yeovil Refresh, and these are projects with their own strategies and plans for delivery, but they link to the Commercial Strategy objectives in the longer term and the same principles apply in executing these projects.

17.5 Therefore, the council will progress, consider and assess Regeneration proposals, using an investment based approach that seeks to create viable regeneration schemes that not only pay for themselves but generate a return on the investment over the longer term where possible. Regeneration delivers both tangible commercial and community objectives resulting in income generation for the wider district in the medium to long-term, as well as directly to the Council through business rates or council tax, for example.

18 Financial Guarantees

18.1 Although not strictly counted as investments, since no money has exchanged hands yet, financial guarantees carry similar risks to the Council and are included here for completeness.

18.2 The Council had the following guarantees on 1 April 2020, as reported in the Council's Statement of Accounts for 2019/20:

- Environmental risk in the Birchfield Park - £311k
- South West Audit Partnership Limited Pension Liability - £149k
- Mama Bears Nursery Pension Liability - £36k

19 Proportionality

19.1 The Council currently has a low dependency on investment property income, but with increased investment the Council plans to become dependent on income generating investment activity to achieve a balanced revenue budget. Table 16 below shows the extent to which the expenditure planned to meet the service delivery objectives and place making role of the Council is dependent on achieving the expected net income from investments over the lifecycle of the Medium Term Financial Plan.

19.2 Should it fail to achieve the expected net income, the Council's contingency plans for continuing to provide these services including holding adequate funds in an earmarked Investment Risk Reserve as well as carrying adequate General Reserves. Budget estimates are also set using prudent assumptions about net income from the portfolio including an allowance for voids / non-collection.

Table 13: Proportionality of Investments

	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Gross Service Expenditure	**72,396,325**	**70,756,720**	**69,117,320**	**62,216,900**	**64,255,910**
Investment Income					
- Treasury Investments	2,892,755	3,500,220	1,945,560	1,984,250	1,908,320
- Commercial Investments	4,275,000	5,024,590	6,944,460	10,103,210	10,201,710
Total Investment Income	**7,167,755**	**8,524,810**	**8,890,020**	**12,087,460**	**12,110,030**
Proportion	9.90%	12.05%	12.86%	19.43%	18.85%

19.3 Investment income shown in the above table is the gross income included in the budget estimates, disregarding asset management and capital financing costs.

20 Borrowing In Advance of Need

20.1 Government guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. The Council has chosen not to follow this guidance and plans to borrow for this purpose because generating investment income is now essential to respond to the large scale reductions in grant funding from Government. The Council (and its predecessors) has already sought to mitigate this reduction through service cost reductions, combining into a single workforce followed by the creation of the single new council entity, and driving further efficiency by transforming how we work and effectively managing demand for services. Increasing income is also part of the strategy to mitigate the significant funding reductions.

21 Capacity, Skills and Culture

21.1 The Council have enterprising staff, partners and Members, their skills and ideas need to be clearly and effectively communicated and harnessed to help achieve our Commercial Strategy. The Council have invested in staff training to enhance staff and Member skills and raise the level of commercial expertise across the Council. Staff training is a continuing priority in this area with continuing professional development being an integral part of this.

21.2 The Council has recruited a highly experienced commercial director and qualified property specialists, which ensures that the necessary skills and knowledge are in place to achieve the aims of the Commercial Strategy and ensures that the risks involved in commercial investments are fully understood.

21.3 Officers involved in the investment making decision process are governed by internal procedures and processes and external statutory guidance in the form of the CIPFA Treasury Management Code and MHCLG Investment guidance. Internally limits are set in the annual Treasury Management Strategy Statement and the overriding Treasury Management Practices. The Council team dealing with investment assessments and management are professionally qualified and experienced in their field of property, finance and legal, with access to training as required. Specialist advice will also be bought in for non-traditional property investments as required.

21.4 Members on the Investment Assessment Group will have access to relevant commercial property training for example as provided by the LGA or CIPFA as well as being advised by professional specialists.

21.5 Reporting to Members on a regular basis on the performance on current investments, and on potential new investments is an integral part of the Commercial Strategy, the continual reporting ensures that elected Members have the information needed to assess the risks and rewards that are associated in this area.

21.6 In considering investment opportunities, a predetermined set of assessment criteria for each proposed investment is used and a business case is completed to ensure transparency, due diligence, governance and consistency to aid achievement of the investment objectives.

21.7 Officers who are tasked with negotiating commercial deals have been provided with the necessary training and information and are aware of the core principles of the prudential framework and of the regulatory regime within which local authorities operate.

- Briefings and guidance provided to, and discussed with the senior leadership team and officers involved in commercial deals.
- There is a requirement for continuing professional development for qualified professionals who are part of the decision making process for commercials deals.

21.8 The Council has robust governance arrangements in place, the Commercial Strategy (2017-2021) includes comprehensive governance processes and procedures which ensure that all capital investments are scrutinised and are subject to a number steps before the capital investment is authorised:

- The strategy sets out the approved budget for the financial years that the strategy covers, the authority to manage the budget of either borrowings or reserves is delegated to the S151 officer in consultation with the Investment Assessment Group.
- An Investment Assessment Group (IAG) is in place which undertakes due diligence, reports on performance and recommends investments to acquire, or assets to dispose of, to the CEO that meet required criteria set out in the Commercial Strategy
- The IAG comprises of suitable experienced and skilled individuals, namely the Property, Land and Development Manager, Director of Commercial Services & Income Generation, S151 Officer, Monitoring Officer, and Portfolio Holder.
- Details of the level of delegated authority for individual investment / acquisition approvals is included in the strategy. The delegated authority level being £10 Million for any single transaction to the Chief Executive Officer in consultation with the Leader.
- A predetermined set of assessment criteria for each proposed investment project is used.
- A business case is completed in each case to ensure transparency, due diligence, governance and consistency to aid achievement of the Commercial Strategy and the Corporate Plan objectives.
- Where the criteria are met, there is a schedule of delegation agreed that enables positive decisions to be made that respect market requirements for swift action and confidentiality.
- If a unanimous recommendation to proceed is made by the IAG, the proposal will be recommended to the Chief Executive Officer for a final decision in consultation with the Council Leader.
- There is regular performance monitoring to demonstrate how investments are performing over time, and to enable portfolio review to take place to maximise benefit over time.

22 Investment Indicators

22.1 The Council has set the following quantitative indicators to allow elected measures and the public to assess the Council's total risk exposure as a result of its investment decisions.

Total investment exposure:

22.2 This indicator shows the Council's total exposure to potential investment losses. It includes amounts the Council is contractually committed to lend but have yet to draw down and guarantees the Council has issued.

Table 14: Total Investment Exposure

	Actual 1/4/2020 £k	Forecast 31/3/2021 £k	Forecast 31/3/2022 £k	Forecast 31/3/2023 £k
Treasury Management Investments – Strategic Funds	23,250	30,000	30,000	30,000
Treasury Management Investments – Other	12,120	3,000	2,000	2,000
Service Investments – Loans	5,070	4,925	4,800	4,175
Commercial Investment – Property	71,970	72,235	118,400	118,400
Other investments – SPV	13,157	30,406	31,600	31,600
Total Investments	**125,567**	**140,566**	**186,800**	**186,175**
Guarantees Issued on Pension Liabilities	496	496	496	496
Total Commitments and Guarantees	**496**	**496**	**496**	**496**
Total Exposure	**126,063**	**141,062**	**187,296**	**186,671**

How investments are funded:

22.3 Government guidance is that these indicators should include how investments are funded. Since the Council does not normally associate particular assets with particular liabilities, it is difficult to comply with this guidance. However, the following investments could be described as being funded by borrowing. The remainder of the Council's investments are funded by usable reserves and income received in advance of need.

Table 15: Investments funded by Borrowing

	Actual 1/4/2020 £k	Forecast 31/3/2021 £k	Forecast 31/3/2022 £k	Forecast 31/3/2023 £k
Treasury Management Investments	0	0	0	0
Service Investments – Loans	4,125	4,653	4,669	4,669
Commercial Investment – Property	71,970	72,235	118,400	118,400
Other investments - SPV	13,157	30,406	31,600	31,600
Total Funded by Borrowing	**89,252**	**107,294**	**154,669**	**154,669**

Rate of return received:

22.4 This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Table 16: Investment Net Rate of Return

	Actual 1/4/2020	Forecast 31/3/2021	Forecast 31/3/2022	Forecast 31/3/2023
Treasury Management Investments	3.58%	2.10%	2.00%	2.00%
Service Investments – Loans	2.64%	2.72%	2.72%	2.72%
Commercial Investment – Property	3.06%	3.50%		
Other investments - SPV	5.00%	6.00%	6.00%	6.00%
Total All Investments	**3.57%**	**3.58%**	**3.56%**	**3.56%**

Other investment indicators:

22.5 The Government’s investment guidance suggests authorities should consider a range of other quantitative indicators to show risks and opportunities in respect of investment and borrowing. The table below summarises indicators proposed for this Council.

Table 17: Other investment indicators

	Actual 1/4/2020	Forecast 31/3/2021	Forecast 31/3/2022	Forecast 31/3/2023
Commercial Income to Net Service Expenditure	26.14%	27.20%	41.48%	67.04%
Investment cover ratio	3.16	3.87	4.84	6.47
Loan to value ratio	75.86	67.98	74.64	74.80

22.6 Commercial Income to Net Service Expenditure: Indicates dependence on commercial income to deliver core services.

22.7 Investment cover ratio: The total net income from commercial property investment compared to the interest expense relating to investment properties funded by borrowing.

22.8 Loan to value ratio: The amount of debt compared to the total assets value on the Council's balance sheet.

Treasury Management Strategy

23 Introduction

23.1 Treasury management is the management of the Council's cash flows, borrowing and investments and the associated risks. The Council has borrowed and invested 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. The successful identification, monitoring and control of finical risk are, therefore, central to the Council's prudent financial management.

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

23.3 Investments held for service purposes and for commercial income generation are considered in the Investment Strategy above.

24 External Context

24.1 The treasury strategy appropriately considers the wider economic picture. The Council's treasury advisor – Arlingclose – has provided a summary commentary on this wider context and their own interest rate forecasts, which is provided in Appendix A.

25 Local Context

25.1 On 31st December 2020, the Council had external borrowing of £67.5m and £27.4m of treasury investments. These balances are summarised below.

Table 18: Existing Debt and Investment Position

	1/4/2020 Balance £k	31/12/2020 Balance £k
External Borrowing:		
Local Authorities	-79,500	-67,500
Total External Borrowing	**-79,500**	**-67,500**
Treasury Investments:		
Covered bonds (secured)	2,000	2,000
Term Deposits (Other LA's & Banks)	8,000	0
Money Market Funds & Business Reserve	2,000	1,925
Property & Pooled funds	23,250	23,500
Total Treasury Investments	**35,250**	**27,425**
Net Debt(-)/Investment	**-44,250**	**-40,075**

25.2 Forecast changes in these sums are shown in the balance sheet analysis in Table 19 below.

Table 19: Balance Sheet Summary and Forecast

	1/4/2020 Actual £k	31/3/2021 Estimate £k	31/3/2022 Estimate £k	31/3/2023 Estimate £k	31/3/2024 Estimate £k
Capital Financing Requirement	95,582	118,608	171,106	184,112	185,632
Less: External Borrowing	-79,500	-102,113	-144,483	-158,326	-161,626
Less: Other debt liabilities (leases)	-51	-1,000	-14,500	-14,500	-14,500
Internal Borrowing	**16,031**	**15,495**	**12,123**	**11,286**	**9,506**
Less: Usable reserves	-48,550	-48,550	-48,550	-48,550	-48,550
Less: Working capital surplus (-) / deficit	-2,800	-2,800	-2,800	-2,800	-2,800
Treasury Investments / New Borrowing (-)	**35,319**	**35,855**	**39,227**	**40,064**	**41,844**

25.3 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investments. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

25.4 The Council has an increasing CFR due to the planned spending within the capital programme including expected investment property acquisitions and significant expenditure on regeneration schemes. The trend of increased expenditure indicates it will be required to borrow up to £186m over the forecast period.

25.5 The financing approach agreed in the governance for the regeneration programmes is quite elastic meaning the CFR could grow further in line with supported business cases, however a 'worst case' position in terms of potential up front borrowing has been taken into account in setting the required borrowing limit.

25.6 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 20 shows that the Council expects to comply with this recommendation over the medium term.

Liability benchmark:

25.7 To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 19 above, but that cash and investment balances are kept to a minimum level of £30m at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 20: Liability benchmark

	1/4/2020 Actual £k	31/3/2021 Estimate £k	31/3/2022 Estimate £k	31/3/2023 Estimate £k	31/3/2024 Estimate £k
Total CFR	95,582	118,608	171,106	184,112	185,632
Less: Usable reserves	-48,550	-48,550	-48,550	-48,550	-48,550
Less: Working capital	-2,800	-2,800	-2,800	-2,800	-2,800
Plus: Minimum investments	30,000	30,000	30,000	30,000	30,000
Liability benchmark	**14,232**	**37,258**	**89,856**	**102,762**	**104,282**

Borrowing Strategy

25.8 The Council currently holds £67.50m of loans (as at 31 December 2020), compared to £79.50m on 1 April 2020, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 20 shows that the Council expects to borrow up to £145m in 2021/22. The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £205m.

25.9 The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

25.10 Given the significant cuts to public expenditure and in particular local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short term to either use internal resources, or to borrow short term loans instead.

25.11 By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this ‘cost of carry’ and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2021/22 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

25.12 Alternatively, the Council may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period (although forward loan interest rates will usually factor in an allowance for interest rate risk during the intervening period).

25.13 Additionally, the Council may borrow further short term loans to cover unplanned cash flow shortages.

25.14 The approved sources of long-term and short-term borrowing are:

- HM Treasury’s PWLB lending facility (formerly the Public Works Loan Board)
- Any institution approved for investments (see below)
- Any other bank or building society authorised to operate in the UK
- Any other UK public sector body
- UK public and private pension funds (except Somerset County Pension Fund)
- Capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

25.15 Other sources of debt finance: In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- Leasing
- Hire purchase
- Private finance initiative
- Sale and leaseback

25.16 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lend the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons:

- borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason

- there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

25.17 **Short-term and variable rate loans:** These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section below).

25.18 **Debt rescheduling:** The HM Treasury's PWLB lending facility allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

26 Treasury Investment Strategy

26.1 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between £26m and £46m, and similar levels are expected to be maintained in the forthcoming year.

26.2 The CIPFA Code requires the Council to invest its funds prudently, and to have regard to the security and liquidity of its 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. 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.

26.3 The COVID-19 pandemic has increased the risk 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. Since investments cannot pay negative income, negative rates will be applied by reducing the value of investments. 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.

26.4 Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to continue to diversify into more secure and/or higher yielding asset classes during 2021/22. The Council has increased its strategic (long-term) investments from £23.25m at the start of the financial year to an estimated £24.50m by the 31 March 2020. The COVID-19 pandemic has resulted in uncertainty in cashflow and therefore the increase in strategic investments to the level planned at the start of 2020/21 (£27.50m) has not been possible. This diversification will represent a continuation of the strategy adopted in earlier years.

26.5 The Council will continue to monitor the risk and returns on its strategic (long-term) investments and will work closely with its treasury advisors ensuring that strategic investments continue to be an appropriate option for the Council.

26.6 A proportion of the Council’s surplus cash is currently invested in short-term unsecured bank deposits, money market funds and other local authorities.

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

Approved Counterparties

26.8 The Council may invest its surplus funds with any of the counterparty types in table 21 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 21: Approved investment counterparties and limits

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£3 m 5 years	£6 m 20 years	£6 m 50 years	£3 m 20 years	£3 m 20 years
AA+	£3 m 5 years	£6 m 10 years	£6 m 25 years	£3 m 10 years	£3 m 10 years
AA	£3 m 4 years	£6 m 5 years	£6 m 15 years	£3 m 5 years	£3 m 10 years
AA-	£3 m 3 years	£6 m 4 years	£6 m 10 years	£3 m 4 years	£3 m 10 years
A+	£3 m 2 years	£6 m 3 years	£3 m 5 years	£3 m 3 years	£3 m 5 years
A	£3 m 13 months	£6 m 2 years	£3 m 5 years	£3m 2 years	£3 m 5 years
A-	£3 m 6 months	£6 m 13 months	£3 m 5 years	£3 m 13 months	£3 m 5 years
None	n/a	n/a	£6 m 25 years*	n/a	£3 m 5 years
Money market funds, Strategic pooled funds and real estate investment trusts	£10m (nominal value) per fund or trust				

This table must be read in conjunction with the notes below

26.9 **Credit rating:** Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

26.10 **Banks unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

26.11 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

26.12 **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £2m per company as part of a diversified pool in order to spread the risk widely.

26.13 **Registered providers (unsecured):** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

26.14 **Money market funds:** Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

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

26.16 **Real estate investment trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

26.17 **Operational bank accounts:** The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £200,000 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.

26.18 **Risk assessment and credit ratings:** Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. The credit rating agencies in current use are listed in the Treasury Management Practices document. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty

26.19 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 that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation 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.

26.20 **Other information on the security of investments**: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

26.21 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

Investment Limits

26.22 The Council's revenue reserves available to cover investment losses are forecast to be £3m on 31 March 2021. In order that no more than 20% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £10m. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 22: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£10m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£20m per group
Any group of pooled funds under the same management	£20m per manager
Negotiable instruments held in a broker's nominee account	£30m per broker
Foreign countries	£12m per country
Registered providers and registered social landlords	£8m in total
Unsecured investments with building societies	£8m in total
Loans to unrated corporates	£4m in total
Money market funds	£20m in total
Real estate investment trusts	£10m in total

26.23 **Liquidity management**: The Council uses an in-house spreadsheet based cash flow forecasting model to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast.

26.24 The Council will spread its liquid cash over at least three providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

27 Treasury Management Indicators

27.1 The Council measures and manages its exposures to treasury management risks using the following indicators.

Security

27.2 The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (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.

Credit risk indicator	Target
Portfolio average credit rating	5.0

Liquidity

27.3 The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

Liquidity risk indicator	Target
Total cash available within 3 months	£10m

Interest Rate Exposures

27.4 This indicator is set to control the Council's exposure to interest rate risk. The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% rise in interest rates	£200,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	£150,000

Maturity Structure of Borrowing

27.5 This indicator is set to control the Council's exposure to refinancing risk. The limits set for each category within this indicator is wide since the indicator is only to cover the risk of replacement loans being unavailable, not interest rate risk. Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	100%	100%
12 months and within 24 months	100%	100%
24 months and within 5 years	100%	100%
5 years and within 10 years	100%	100%
10 years and above	100%	100%

Principal Sums Invested For Periods Longer Than a Year

27.6 The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price risk indicator	2021/22	2022/23	2023/24
Limit on principal invested beyond year end	£30m	£25m	£25m

28 Related Matters

28.1 **Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

28.2 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 the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

28.3 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.

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

28.5 Markets in Financial Instruments Directive: The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the S151 Officer believes this to be the most appropriate status.

29 Financial Implications

29.1 The budget for investment income and debt interest in 2021/22 is summarised as follows:

Table 23: Interest Income and Costs Budget Estimates

	2021/22 Investment Income £k	**2021/22 Average Interest Rate %**	**2021/22 Interest Costs £k**	**2021/22 Average Interest Rate %**	**2021/22 Net Income or Costs £k**
Total	-1,946	2.10%	1,436	1.00%	-510

29.2 If actual levels of investments and borrowing, or actual interest rates differ from those forecast, performance against budget will be correspondingly different. Significant variances will be identified in budget monitoring reports to the Senior Leadership Team and the District Executive.

30 Other Options Considered

30.1 The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The S151 Officer, having consulted the Portfolio Holder for Finance believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Appendix A

External Context – Commentary by Arlingclose (January 2021)

Economic background: The impact on the UK from coronavirus, lockdown measures, the rollout of vaccines, as well as the new trading arrangements with the European Union (EU), will remain major influences on the Authority's treasury management strategy for 2021/22.

The Bank of England (BoE) maintained Bank Rate at 0.10% in December 2020 and Quantitative Easing programme at £895 billion having extended it by £150 billion in the previous month. The Monetary Policy Committee (MPC) voted unanimously for both, but no mention was made of the potential future use of negative interest rates. In the November Monetary Policy Report (MPR) forecasts, the Bank expects the UK economy to shrink -2% in Q4 2020 before growing by 7.25% in 2021, lower than the previous forecast of 9%. The BoE also forecasts the economy will now take until Q1 2022 to reach its pre-pandemic level rather than the end of 2021 as previously forecast. By the time of the December MPC announcement, a COVID-19 vaccine was approved for use, which the Bank noted would reduce some of the downside risks to the economic outlook outlined in the November MPR.

UK Consumer Price Inflation (CPI) for November 2020 registered 0.3% year on year, down from 0.7% in the previous month. Core inflation, which excludes the more volatile components, fell to 1.1% from 1.5%. The most recent labour market data for the three months to October 2020 showed the unemployment rate rose to 4.9% while the employment rate fell to 75.2%. Both measures are expected to deteriorate further due to the ongoing impact of coronavirus on the jobs market, particularly when the various government job retention schemes start to be unwound in 2021, with the BoE forecasting unemployment will peak at 7.75% in Q2 2021. In October, the headline 3-month average annual growth rate for wages were 2.7% for total pay and 2.8% for regular pay. In real terms, after adjusting for inflation, total pay growth was up by 1.9% while regular pay was up 2.1%.

GDP growth rebounded by 16.0% in Q3 2020 having fallen by -18.8% in the second quarter, with the annual rate rising to -8.6% from -20.8%. All sectors rose quarter-on-quarter, with dramatic gains in construction (41.2%), followed by services and production (both 14.7%). Monthly GDP estimates have shown the economic recovery slowing and remains well below its pre-pandemic peak.

Looking ahead, the BoE's November MPR forecasts economic growth will rise in 2021 with GDP reaching 11% in Q4 2021, 3.1% in Q4 2022 and 1.6% in Q4 2023.

GDP growth in the euro zone rebounded by 12.7% in Q3 2020 after contracting by -3.7% and -11.8% in the first and second quarters, respectively. Headline inflation, however, remains extremely weak, registering -0.3% year-on-year in November, the fourth successive month of deflation. Core inflation registered 0.2% y/y, well below the European Central Bank's (ECB) target of 'below, but close to 2%'. The ECB is expected to continue holding its main interest rate of 0% and deposit facility rate of -0.5% for some time but expanded its monetary stimulus in December 2020, increasing the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.

The US economy contracted at an annualised rate of 31.4% in Q2 2020 and then rebounded by 33.4% in Q3. The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% and announced a change to its inflation targeting regime to a more flexible form of average targeting. The Fed also provided strong indications that interest rates are unlikely to change from current levels over the next three years.

Former vice-president Joe Biden won the 2020 US presidential election. Mr Biden is making tackling coronavirus his immediate priority and will also be reversing several executive orders signed by his predecessor and take the US back into the Paris climate accord and the World Health Organization.

Credit outlook: After spiking in late March as coronavirus became a global pandemic and then rising again in October/November, credit default swap (CDS) prices for the larger UK banks have steadily fallen back to almost pre-pandemic levels. Although uncertainly around COVID-19 related loan defaults lead to banks provisioning billions for potential losses in the first half of 2020, drastically reducing profits, reported impairments for Q3 were much reduced in some institutions. However, general bank profitability in 2020 and 2021 may be significantly lower than in previous years.

The credit ratings for many UK institutions were downgraded on the back of downgrades to the sovereign rating. Credit conditions more generally though in banks and building societies have tended to be relatively benign, despite the impact of the pandemic.

Looking forward, the potential for bank losses to be greater than expected when government and central bank support starts to be removed remains a risk, suggesting a cautious approach to bank deposits in 2021/22 remains advisable.

Interest rate forecast: The Authority's treasury management adviser Arlingclose is forecasting that BoE Bank Rate will remain at 0.1% until at least the first quarter of 2024. The risks to this forecast are judged to be to the downside as the BoE and UK government continue to react to the coronavirus pandemic and the new EU trading arrangements. The BoE extended its asset purchase programme to £895 billion in November while keeping Bank Rate on hold and maintained this position in December. However, further interest rate cuts to zero, or possibly negative, cannot yet be ruled out but this is not part of the Arlingclose central forecast.

Gilt yields are expected to remain very low in the medium-term while short-term yields are likely to remain below or at zero until such time as the BoE expressly rules out the chance of negative interest rates or growth/inflation prospects improve. The central case is for 10-year and 20-year to rise to around 0.60% and 0.90% respectively over the time horizon. The risks around the gilt yield forecasts are judged to be broadly balanced between upside and downside risks, but there will almost certainly be short-term volatility due to economic and political uncertainty and events.

Arlingclose Economic & Interest Rate Forecast January 2021

Underlying assumptions:

- The medium-term global economic outlook has improved with the distribution of vaccines, but the recent upsurge in coronavirus cases has worsened economic prospects over the short term.
- Restrictive measures and further lockdowns are likely to continue in the UK and Europe until the majority of the population is vaccinated by the second half of 2021. The recovery period will be strong thereafter, but potentially longer than previously envisaged.
- Signs of a slowing UK economic recovery were already evident in UK monthly GDP and PMI data, even before the second lockdown and Tier 4 restrictions. Employment is falling despite an extension to support packages.
- The need to support economic recoveries and use up spare capacity will result in central banks maintaining low interest rates for the medium term.
- Brexit will weigh on UK activity. The combined effect of Brexit and the after-effects of the pandemic will dampen growth relative to peers, maintain spare capacity and limit domestically generated inflation. The Bank of England will therefore maintain loose monetary conditions for the foreseeable future.
- Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid longer-term inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or the deployment of vaccines.

Forecast:

- Arlingclose expects Bank Rate to remain at the current 0.10% level.
- Central case for Bank Rate is no change, but further cuts to zero, or perhaps even into negative territory, cannot be completely ruled out.

- Gilt yields will remain low in the medium term. Shorter term gilt yields are currently negative and will remain around zero or below until either the Bank expressly rules out negative Bank Rate or growth/inflation prospects improve.

- Downside risks remain, and indeed appear heightened, in the near term, as the government reacts to the escalation in infection rates and the Brexit transition period ends.

A summary of the forecast rates is included on the next page.

	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Official Bank Rate													
Upside risk	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3-month money market r													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.15	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
1yr money market rate													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	0.15	0.15	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Downside risk	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15
5yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.00	0.00	0.05	0.10	0.15	0.20	0.20	0.20	0.25	0.25	0.25	0.25	0.25
Downside risk	0.40	0.45	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60
10yr gilt yield													
Upside risk	0.30	0.35	0.40	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.25	0.30	0.35	0.35	0.40	0.40	0.45	0.45	0.50	0.55	0.55	0.55	0.60
Downside risk	0.50	0.50	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55
20yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.70	0.70	0.75	0.75	0.75	0.80	0.80	0.85	0.85	0.85	0.85	0.90	0.90
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
50yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.60	0.60	0.65	0.65	0.65	0.70	0.70	0.75	0.75	0.75	0.75	0.80	0.80
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Minimum Revenue Provision (MRP) Statement

1 Policy Statement

1.1 Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Council to have regard to the Ministry of Housing, Communities and Local Government's Guidance on Minimum Revenue Provision (the MHCLG Guidance) most recently issued in 2018.

1.2 The broad aim of the MHCLG Guidance is to ensure that capital expenditure is financed over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits.

1.3 The MHCLG Guidance requires the Council to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance as well as locally determined prudent methods.

1.4 For capital expenditure incurred before 1st April 2008, MRP will be determined in accordance with the former regulations that applied on 31st March 2008, incorporating an "Adjustment A" of £9,113k.

1.5 For capital expenditure on operational assets incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset by either of the following methods:

a) In equal instalments

b) Using an annuity basis

1.6 For freehold land, MRP will be applied over 50 years, except where there is a structure on the land which the Council considers to have a life of more than 50 years where in such cases the longer life may also be applied to the land.

1.7 For capital expenditure not related to council assets but which has been capitalised by regulation or direction (e.g. capital grants to third parties) will be charged in equal instalments over a period of up to 25 years.

1.8 For assets acquired by leases, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

1.9 For capital expenditure loans to third parties that are repaid in annual or more frequent instalments of principal, the Council will make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement instead. In years where there is no principal repayment, MRP will be charged in accordance with the MRP policy for the assets funded by the loan, including where appropriate, delaying MRP until the year after the assets become operational. While this is not one of the options in the MHCLG Guidance, it is thought to be a prudent approach since it ensures that the capital expenditure incurred in the loan is fully funded over the life of the assets.

1.10 For investment properties, MRP will be calculated over a period of no more than 50 years, and MRP may be calculated by either of the following methods:

a) In equal instalments

b) Using an annuity basis

c) Weighted to reflect projected net income cash flows over the expected life of investment (up to 50 years)

1.11 MRP will be charged from the start of the financial year after the expenditure is incurred, meaning capital expenditure incurred during 2021/22 will not be subject to a MRP charge until 2022/23.

2 Capital Financing Requirement and MRP Estimates

2.1 Based on the Council's latest estimate of its capital financing requirement (CFR) on 31 March 2021, the budget estimate for MRP has been set as follows:

Capital Financing Requirement and MRP	31/03/2021 Estimated CFR £k	2021/22 Estimated MRP £k
Capital Expenditure before 1 April 2008	9,113	0
Unsupported Capital Expenditure since 31 March 2008	109,495	817
Voluntary overpayment or use of prior year overpayments	0	0
Total	**118,608**	**817**

3 MRP Overpayments

3.1 Overpayments: In earlier years, the Council has made no voluntary overpayments of MRP that are available to reduce the revenue charges in later years. It is not planned to make an overpayment in 2021/22, however the S151 Officer may determine such an overpayment during the year and report this through the Outturn Report.