Report to Audit Committee

16 December 2020

By the Director of Corporate Resources

DECISION REQUIRED

Not exempt

Capital Strategy 2021/22 incorporating Investment and Treasury Management Strategy

Executive Summary

This report combines an overview of how capital expenditure, capital financing, treasury and other investment activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. The strategies set limits and indicators that embody the risk management approach that the Council believes to be prudent. The strategies are set against the mid-term financial strategy, the context of the UK economy and projected interest rates.

The report sets treasury investment criteria and limits which are largely unchanged with the exception of changes to the limits for money market funds and local authorities detailed in Appendix B.

- Limits on money market funds rises from £30m to £50m
- Limit on individual local authority goes from £4m to £5m

These changes follow advice from the Council's advisor and review of the risks inherent in the type of investment.

The investment strategy in section 5 and appendix C pulls together information on service loans and commercial property to demonstrate the Council's risk management approach in that area. The strategy is largely unchanged apart from recommended increases in the service loans and overall commercial property portfolio limits.

- The limit on service loans increases from £1.5m to £3m
- The limit on overall commercial property rises from £60m to £70m

The increase in loan value is to enable lending to the Council's own Housing Company and the overall portfolio limit increase to cover developments of existing assets and to provide headroom for possible upward revaluations of property values.

Recommendations

The Committee is asked to:

i) approve this Capital Strategy as an appropriate overarching strategy for the Council while leaving the full Council to approve the updated capital strategy that will accompany the 2021/22 budget to Council.

ii) recommend that the full Council approve the Treasury Management Strategy for 2021/22 and the associated limits and specific indicators included in section 4 and appendix B of this report.

iii) recommend that the full Council approve the Investment Strategy for 2021/22 and the associated limits and specific indicators included in section 5 and appendix C of this report.

Reasons for Recommendations

i) The Council is required to have regard to the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) and Prudential Code which requires the Council to approve a Capital strategy, Investment strategy and Treasury Management Strategy before the start of each financial year.

ii) The Ministry for Housing Communities and Local Government (MHCLG) issued revised guidance on local authority investments in 2017 that the Council is required to have regard to.

Background Paper
"Update on the Council's financial position" – Cabinet 26 November 2020

Consultation: Arlingclose Limited

Wards affected: All

Contact: Julian Olszowka, Group Accountant, Technical, 01403 215310

Background Information

1 Introduction

The purpose of this report

1.1 This report covers the requirements of Codes and guidance that the Council must, by statue, have regard to. Section 3 gives a high-level overview of:

- how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services
- how associated risk is managed and;
- the implications for future financial sustainability.

1.2 The Treasury Management Strategy in section 4 covers the aspects of investments that this Committee has historically considered. It covers management of the Council's cash flows, borrowing and investments, and the associated risks.

1.3 The Investment Strategy in section 5 is a requirement introduced for 2019/20 and covers investments held for service purposes or for commercial yield. The changes to guidance were designed to bring together areas which CIPFA and MHCLG consider should be regarded in the round. They were also a response to the increasing commercialisation of local government and especially the increasing investment in commercial property.

1.4 The guidance requires the Capital and Investment Strategies to be approved by the full Council while the Treasury Management Strategy can now be approved by a subcommittee of the Council. However, here we follow the Council's existing Constitution that this Committee recommends the Treasury Management Strategy be approved by the full Council.

2 Background

Economic background

2.1 The Council's strategies must take account of expectations for the economy and specifically the finance sector. The Council receives advice on this from its advisors Arlingclose Ltd. Appendix A is a commentary by them on the current economic background, the outlook for creditworthiness and interest rates.

2.2 The forecast for the Bank Rate is that it remains at current levels in the medium term. For the purpose of the interest budget, any new investments are estimated to be on or about the Bank Rate.

2.3 The treasury management environment remains difficult with yields and quality counterparties which were first reduced in the fallout from the 2008 financial crisis being further depressed by worries around Brexit and the Covid-19 pandemic. Governments and regulators have put in place measures prompted by the financial crisis that restrict any government bail-out of individual financial institutions. This means an institution in difficulty may have to use its own resources and its deposits to continue to operate, exposing any depositor's capital. At the moment the Council's advisers have recommended avoiding almost all financial institutions for any period apart from the short term.

Statutory background

2.4 This report is part of the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the Ministry for Housing, Communities and Local Government (MHCLG) Guidance.

2.5 The regulatory background has been complicated by the revision by both CIPFA and MHCLG codes and guidance. Both CIPFA and the MHCLG state they do not seek to prescribe precisely how councils invest but they clearly have concerns that some councils are taking increasing commercial risks using borrowed money. This approach means that Members are asked to look at a more extensive strategy so that more of the risks that the Codes and guidance highlight are apparent to Members.

Relevant Council policy

2.6 The Council's constitution requires that the Council approve Prudential Code indicators and Treasury Management Strategy. The Investment Strategy covering commercial property has been split from the traditional Treasury Management Strategy here for ease of understanding as it deals with a different type of investment but it can be considered to be encompassed in the definition of the Treasury Management Strategy as used by the Constitution.

2.7 The existing strategies and Prudential indicators were approved by the Council on 14 October 2020 the former having been recommended for adoption by this Committee on 18 December 2019. The late approval of the strategy was an unfortunate procedural error.

3 Capital Expenditure and Financing

3.1 Capital expenditure is where the Council spends money on assets, such as property or vehicles that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing or leasing).

3.2 Service managers bid annually in October 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 Senior Leadership Team appraises all bids based on a comparison of service priorities against financing costs and makes recommendations to the informal cabinet. The final capital programme is then presented to Cabinet in January and to Council in February each year.

3.3 The current projected capital programme and financing is shown below. It includes current estimates for capital bids for 2021/22 and beyond. The use of reserves is in line with the Update on the Council's Financial Position report to the Cabinet of 26 November 2020. It will be revised if necessary as the 2021/22 budget process develops and the final figures that appear alongside the Budget in February 2021 will constitute one of the prudential indicators required by the CIPFA Prudential Code.

£millions	2019/20 Actual £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000
Projected Capital Expenditure	9.9	6.5	6.6	9.9	8.7
Financed by:					
External resources	3.1	2.5	3.4	4.2	6.0
Internal Resources *	5.3	2.2	2.5	3.7	2.7
Debt	1.5	1.8	0.7	2.0	0.0
Total Financing	9.9	6.5	6.6	9.9	8.7

* Includes use of New Homes Bonus

3.4 The term 'Debt' used above does not automatically lead to external borrowing as the Council may be able to use cash it holds in reserves and as working capital which is usually termed 'internal borrowing'. Over time all debt whether it be internal or external borrowing must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP). The Council is required to make an annual MRP statement and this will be included in the Budget report in January 2021 and the methodology will be on the same basis as 2020/21. The current planned MRP payments are as follows:

£millions	2019/20 actual	2020/21 forecast	2021/22 budget	2022/23 budget	2023/24 budget
MRP	0.84	0.9	0.9	0.9	1.0

3.5 The Council's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and any capital receipts used to replace debt. The CFR is expected to reduce marginally during 2021/22. The Council's estimated CFR is projected as follows:

£millions	31.3.2020 actual	31.3.2021 forecast	31.3.2022 budget	31.3.2023 budget	31.3.2024 budget
CFR	33.9	34.8	34.5	35.5	34.5

3.6 **Asset disposals:** When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets. Repayments of capital grants, loans and investments also generate capital receipts. Loans repaid below are estimates of those from the Council's Housing Company. The Council projects capital receipts as follows:

£millions	2019/20 actual	2020/21 forecast	2021/22 estimate	2022/23 estimate	2023/24 estimate
Asset sales	1.7	1.1	1.8	2.4	0.8
Loans repaid	0.0	0.0	0.0	0.9	1.4
TOTAL	**1.7**	**1.1**	**1.8**	**3.3**	**2.2**

4 Treasury Management

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 **Borrowing strategy**: The Council has no plans to borrow but could find itself in a position which calls for borrowing. In that circumstance the main objectives when borrowing would be to achieve a low but certain cost of finance while retaining flexibility. These objectives are often conflicting, and the Council therefore would seek to strike a balance between cheap short-term loans (currently available effectively at zero) and long-term fixed rate loans where the future cost is known but higher (currently about 2%).

4.3 Projected levels of the Council's total outstanding debt are shown below, compared with the Capital Financing Requirement. Statutory guidance is that debt should remain below the Capital Financing Requirement, except in the short-term. As can be seen from the table the Council expects to comply with this in the medium term.

£millions	31.3.2020 actual	31.3.2021 forecast	31.3.2022 budget	31.3.2023 budget	31.3.2024 budget
Debt	0	0	0	0	0
CFR	33.9	34.8	34.5	35.5	34.5

4.4 The table above demonstrates that the Council is relying on internal borrowing i.e. using reserves and other cash resources that it holds rather than borrowing from external sources. From projections of the capital programme and use of reserves this strategy is seen as sustainable in the medium term although the Director of Corporate Resources will monitor the actual position against the projections in order to be ready to respond should external borrowing become advisable.

4.5 **Affordable borrowing limit**: Irrespective of plans to borrow or not the Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit. Although no borrowing is planned, limits are set in case a need develops. Further details on borrowing are in appendix B.

£millions	2020/21 limit	2021/22 limit	2022/23 limit	2023/24 limit
Authorised limit – borrowing	15	15	15	15
Authorised limit – leases	6	6	6	6
Authorised limit – total external debt	21	21	21	21
Operational boundary – borrowing	0	0	0	0
Operational boundary – leases	4	0	0	0
Operational boundary – total external debt	4	0	0	0

4.6 **Investment strategy:** 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 and will be dealt with in the Investment Strategy in section 5 and Appendix C.

4.7 The Council's policy on treasury investments is to prioritise security and liquidity over yield that is 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. The future longer term investments in the table below are strategic pooled funds that the council intends to hold for the longer term although they can be sold if required.

	31.3.2020 actual	31.3.2021 forecast	31.3.2022 estimate	31.3.2023 estimate	31.3.2024 estimate
Near-term investments	19	8	10	11	10
Longer-term investments	20	22	22	22	22
TOTAL	**39**	**30**	**32**	**33**	**32**

4.8 The projections show cash balances at year-end, which is a cash low point, in the region of £30m in the medium term. The Capital programme no longer features major projects while developers' contributions and New Homes Bonus flow in faster than they are spent. The New Homes Bonus projection used follows that in the 2020/21 Budget Report. Further detail on treasury investments are in Appendix B including limits and indicators which the Committee is asked to consider. The significant changes compared to last year's limits are an increase in limits on money market funds from £30m to £50m and on local authorities from £4m to £5m. More detail on the justification is in Appendix B.

4.9 **Governance:** Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Corporate Resources and staff, who must act in line with the Treasury Management Strategy as approved by the Council following this committee's scrutiny and recommendation. The Audit Committee receives a mid-year and full year report and is responsible for scrutinising treasury management decisions.

5 **Investment Strategy (loans, shares and property)**

5.1 This section is the disclosure required in 2019/20 by CIPFA and MHCLG guidance. Both bodies have concerns over the increasing risks that they see in the sector as councils have become more commercial and made large commercial property purchases.

Investments for Service Purposes

5.2 The Council has the ability to make investments to assist local public services, including making loans to local service providers and buying shares and making loans to any Council subsidiaries that provide services. 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 generate a profit after all costs to offset risk. Further details on service investments are in appendix C. the overall limits are £3m on the total exposure to loans for service purposes and £0.5m exposure permitted for shares being held. The former is an increase from this year's £1.5m reflecting the expected activity of the Council's housing company.

5.3 **Governance:** Decisions on service investments are made by the full Council after the relevant Head of Service has submitted a comprehensive analysis in consultation with the Director of Corporate Resources and must meet the criteria and limits. Most loans and shares are capital expenditure and will therefore also be approved as part of the capital programme in the Budget report or by full Council.

Commercial Activities

5.4 With central government financial support for local public services declining, the Council invests in commercial property purely or mainly for financial gain. Total commercial investments were valued at £55m on 31 March 2020. These provide a net return after direct costs of just under 7% based on the last set of final accounts which value the assets at market value rather than historical value.

5.5 As financial return is the main objective, the Council recognises the higher risk on commercial investment compared with treasury investments. The principal risk exposures include individual vacancies, falls in market value, changes in the overall and local economy. Individual property risks are constantly monitored and managed by the Head of Property and Facilities. Should income not meet expectations the Council holds at least £6m of general reserves available to balance the revenue budget in the short term while the Head of Property and Facilities reviews the performance of the portfolio.

5.6 In order that commercial investments remain proportionate to the financial capacity of the Council, these are subject to an overall maximum investment limit which is to be set at £70m which is an increase on this year's £60m. The increase is required to give the Council some headroom as the current value of

£55m will be added to by small developments to existing properties and the revaluation at year-end could increase asset values generally.

5.7 **Governance:** Decisions on new commercial investments are made by the Cabinet after consideration by the Policy Development Advisory Group for Finance & Assets in line with the criteria and limits approved by the Council in this strategy. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme. Further details on commercial investments and limits on their use are in appendix C.

Other Liabilities

5.8 The Council has set aside £1.1m to cover risks of Business Rates Appeals. The Council is also at risk of having to pay for historic insurance claims but has not put aside any money because there is no reasonable assessment of the amount required.

5.9 **Governance:** Decisions on incurring new discretionary liabilities are taken by the relevant director in consultation with the Director of Corporate Resources. If significant these would be discussed at the quarterly corporate risk management meeting and final decisions as to recognition taken by the Director of Corporate Resources. New liabilities exceeding £1m are reported to full Council for approval or notification as appropriate. Further details on liabilities are in note 18 of the 2019/20 statement of accounts.

Revenue Budget Implications

5.10 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP 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. Because the Council has no debt and significant investment income the financing costs are very low.

	2019/20 actual	2020/21 forecast	2020/21 budget	2021/22 budget	2023/24 budget
Financing costs (£m)	0.0	0.1	0.4	0.3	0.1
Proportion of net revenue stream	0%	1%	4%	3%	1%

5.11 **Sustainability:** Due to the 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 40 years into the future. The Director of Corporate Resources is satisfied that the proposed capital programme is prudent, affordable and sustainable because the net budget demand on the Council and the risks in the programme have been reviewed and fall within the Council’s tolerances.

Knowledge and Skills

5.12 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Director of Corporate Resources and S151 Officer is a qualified accountant with over 30 years' experience and the Head of Property is a fellow of RICS with over 35 years' of experience in commercial property. The Council will support junior staff to study towards relevant professional qualifications.

5.13 Where Council staff do not have the knowledge and skills required, use is made of external advisers that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers and for any significant property investment would use property consultants with specialist knowledge of the appropriate property sector. This approach ensues access to right knowledge and skills and can be more cost effective than employing such staff directly. The overarching requirement is that the Council has access to knowledge and skills commensurate with its risk appetite.

6 Other courses of action considered but rejected

6.1 The MHCLG Investment Guidance and the CIPFA Codes of Practice do not prescribe any particular strategies for local authorities to adopt. 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 will 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 will be smaller
Borrow additional sums at long-term fixed interest rates using less internal funds	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
Invest more in service loans	Interest income will be higher and service benefits will accrue	Increased risk of losses from credit related defaults or service body being unable to pay loan and provide service
Reduce investment in property	Income will be lower	Lower chance of losses from non-paying tenants or falling property values.
Invest additional sums in property	income will be higher	Increased chance of losses from vacancies or falling property values. Reputational and regulatory risk if Council incurs large loss

7 Staffing consequences

7.1 There are no staffing consequences apart from the need for appropriate training.

8 Financial consequences

8 .1 The budgeted treasury investment income in 2021/22 is £0.79m (2020/21 £0.93m), which is equivalent to an average investment portfolio of £49m at an interest rate of 1.6%. The decline is a consequence of almost zero cash returns and depressed pooled fund dividends. The budget for debt interest paid in 2021/22 is £5,000 which is a contingency for possible short term borrowing. The budget for commercial property net income is £3.6m which is a yield of 6.3% from an investment portfolio of £56m. Income in 2021/22 is expected to be squeezed by the effects of the pandemic.

9 Other considerations

9.1 Risks such as security of funds, liquidity, and interest rate risk are considered in the report. There are no consequences of any action proposed in respect of Crime & Disorder; Human Rights; Equality & Diversity and Sustainability.

Appendix A Economic background and interest rate forecast

Economic background

The impact on the UK from coronavirus, together with its exit from the European Union and future trading arrangements with the bloc, will remain a major influence on the Authority's treasury management strategy for 2021/22.

The Bank of England (BoE) maintained Bank Rate at 0.10% in November 2020 and also extended its Quantitative Easing programme by £150 billion to £895 billion. The Monetary Policy Committee voted unanimously for both, but no mention was made of the potential future use of negative interest rates. Within the latest 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.

UK Consumer Price Inflation (CPI) for October 2020 registered 0.6% year on year, up from 0.2% in the previous month. Core inflation, which excludes the more volatile components, rose to 1.3% from 0.9%. The most recent labour market data for the three months to August 2020 showed the unemployment rate rose to 4.5% while the employment rate fell to 75.6%. 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 August, the headline 3-month average annual growth rate for wages were 0% for total pay and 0.8% for regular pay. In real terms, after adjusting for inflation, total pay growth fell by -0.8% while regular pay was up 0.1%.

GDP growth fell by -19.8% in the second quarter of 2020, a much sharper contraction from -2.0% in the previous three months, with the annual rate falling -21.5% from -1.6%. All sectors fell quarter-on-quarter, with dramatic declines in construction (-35.7%), services (-19.2%) and production (-16.3%), and a more modest fall in agriculture (-5.9%). Monthly GDP estimates have shown the economy is recovering but remains well below its pre-pandemic peak. Looking ahead, the BoE's November Monetary Policy Report 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.

Credit outlook

After spiking in late March as coronavirus became a global pandemic, 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 is likely to 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, as does the

UK not achieving a Brexit deal, 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 end of 2023. 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 Brexit transition period ends. The BoE extended its asset purchase programme to £895 billion in November while keeping Bank Rate on hold. 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 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 0.5% and 0.75% 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.

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

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

Appendix B Treasury Management Strategy

Mid year position and forecast

1 On 30 September 2020 the Council held no borrowing and £53.6m of investments at market value; broken down as follows:

	Principal £m	Interest Rate %
Call accounts	4.0	0.1
Money Market Funds – call	14.5	0.2
Money Market Funds – cash plus or short bonds	9.4	0.9
Short-term deposits	3.0	1.1
Pooled Funds - Property	4.6	4.2
Pooled Funds – Multi-Asset	6.7	4.6
Pooled Funds – Equity	3.5	3.3
Pooled Funds – Bonds	5.9	2.6
REIT	2.0	1.3
Net Investments	**53.6**	**1.7**

2 Taking the forecasts within the capital strategy, the balance sheet of the Council can be projected to estimate the amounts available for investments. Below is the current projected analysis of the balance sheet to illustrate the trajectory of the Council's funds.

All figures at year-end £m	**Actual 19/20**	**Estimate 20/21**	**Estimate 21/22**	**Estimate 22/23**	**Estimate 23/24**
CFR	33.9	34.8	34.5	35.5	34.5
Less external borrowing	0	0	0	0	0
Internal borrowing	33.9	34.8	34.5	35.5	34.5
Useable reserves, receipts, contributions held	63.3	55.6	57.5	59.6	57.0
Working capital/other balances	9.5	9.6	9.6	9.7	9.7
Estimated Investments	38.9	30.4	32.6	33.8	32.2

3 The Council's strategy has been to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. In spite of the continuation of this, the Council is projected to hold significant investment balances even at the end of the financial year which is the low point for cash.

Borrowing Strategy

4 As shown above the Council is not expecting to borrow long term funds although it may need short term borrowing if short term cash flow issues require it.

5 **Sources of borrowing:** The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board
- Any institution approved for investments (see below)
- Any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except West Sussex County Council Pension Fund)
- Capital market bond investors
- UK Municipal Bond Agency and other special purpose companies created to enable joint local authority bond issues.

6 In addition, capital finance may be raised by the use of leases and hire purchase that are not borrowing, but may be classed as other debt liabilities.

7 The Council has previously raised its long-term borrowing from the PWLB. The government increased PWLB rates by 1% in October 2019 making it a relatively expensive option. On 25 November HM Treasury revised PWLB rates to 0.8% over relevant gilt rate. However, at the same time restrictions were introduced as to the access to PWLB if a council was planning what the Treasury term 'debt for yield'. This could restrict the Council's access to PWLB. In the event longer term borrowing is required the Council would consider long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.

8 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds and lend the proceeds to local authorities. This will be a more complicated than the PWLB due to the need for the Council to provide some degree of guarantee to bond investors and the long lead times. Any decision to use the Agency will therefore be the subject of a separate report to full Council.

9 Short-term and variable rate loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

Investment Strategy

10 The Council holds significant funds, representing income received in advance of expenditure plus balances and reserves held. In the past year, the Council's total investments have ranged between £34m and £82m and although the level of reserves is expected to reduce in the longer term, there will still be significant short to medium-term cash flow surpluses leading to larger sums being held than the

core reserves of the Council would indicate. The current projections show year-end balances in the region of £30m for the next three years.

11 Both the CIPFA Code and the MHCLG Guidance require 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.

12 **Negative interest rates:** It is possible 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. 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.

13 Given the increased risk and very low returns from unsecured bank investments, the Council will continue to move away from them into more secure and/or higher yielding asset classes during 2021/22 continuing the present strategy that has moved investment into pooled funds and other local authorities.

14 **Business models:** Under the IFRS9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows rather than buying and selling investments and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

15 **Approved counterparties**: The Council may invest with any of the counterparty types in the table below; subject to the cash limits (per counterparty) and the time limits shown (changes from 20/21 limits are in bold):

Sector	**Time limit**	**Counterparty limit**	**Sector limit**
The UK Government	50 years	Unlimited	n/a
Local authorities	10 years	**£5m**	Unlimited
Governments and government entities rated A- and above	5 years	£4m	Unlimited
Secured investments rated AA and above	5 years	£4m	Unlimited
Secured investments rated A- to A+	13 months	4m	Unlimited

Banks (unsecured) rated A and above	13 months	£2.5m	Unlimited
Banks (unsecured) rated A-	6 months	£2.5m	Unlimited
Building societies (unsecured)	13 months	£1m	£8m
Registered providers (unsecured) Rated A-and above	5 years	£4m	£8m
Registered providers unrated(unsecured)	3 years	£3m	
Money market funds	n/a	£5m	**£50m**
Strategic pooled funds – Property Investments	n/a	£5m	£7m
Strategic pooled funds – Equity, Bond and Diversified assets	n/a	£5m	£18m
Real estate investment trusts	n/a	£5m	£5m
Other Corporates rated A- and above*	1 year	£2.5m	£5m
Unrated corporates	5 years	£50,000	£2m

This table must be read in conjunction with the notes below.

16 **Credit Rating**: Investment limits are set with reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. 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.

17 **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 an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

18 **UK Local Authority:** The Council will consider investments with a UK local government body up to £5m for up to 10 years. The Council is confident that as a sector local authorities are secure investments in the context of support from Central Government and the legal surcharging framework that guarantees debts will be paid. However, for any investment over six months the financial resilience of the relevant council will be assessed in consultation with the Council's advisor. This is an increase from £4m which has been the limit for a number of years. In view of the decreasing numbers of other counterparties the Council is likely to use the Local Authority market more frequently and dealing sizes of £5m are now quite common and give the Council access to a wider range of investment opportunities.

19 **Secured Investments**: Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

20 **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.

21 **Building Societies:** Although the regulation of building societies is no longer any different to that of banks the Council takes additional comfort from building societies' business model. The Council will therefore consider investing with unrated building societies where independent credit analysis shows them to be suitably creditworthy. A minimum asset size of £250m applies and limits of £1m per Society and £8m in total apply for unrated societies.

22 **Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Regulator of Social Housing and, as providers of public services; they retain the likelihood of receiving government support if needed.

23 **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.

24 Previously the Council's advisor had recommended a sector limit for money market funds which the Council had set at £30m. However, the advisor has reconsidered their advice and recommends that there is no need to have a sector limit as long as the Council takes care to diversify its liquid investments over a variety of providers to ensure access to cash at all times. The Council will relax the limit to £50m in response to the advice. The Council only uses funds from its advisor's recommended list and the list is regularly reviewed for appropriateness. The limits of £5m per fund remains.

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

26 **Real estate investment trusts (REIT):** 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. The Council will carry out a detail appraisal and take expert advice before any investment.

27 **Corporates**: Loans, bonds and commercial paper issued by companies other than banks and registered providers. Non-bank companies cannot be bailed-in but can become insolvent placing the Authority's investment at risk. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £50,000 per company as part of a diversified pool in order to spread the risk widely.

28 **Operational bank accounts:** The Council may incur exposure though its current accounts 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 still subject to the risk of a bank bail-in and balances will therefore be kept below £2.5m. 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. The Council currently banks with NatWest rated A.

29 **Risk Assessment and Credit Ratings:** Credit ratings are monitored by the Council's treasury advisors, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be ended 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

30 Where a credit rating agency announces that a 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 no investments other than call investments 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.

31 **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 and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the Council's credit rating criteria.

32 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 those 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 or with other local authorities. This will reduce investment income earned, but will protect the principal sum invested.

33 **Investment limits**: The Council's revenue reserves available to cover investment losses were in the region of £16m on 31 March 2020 well above the stated minimum long term target of £6m. In order that no more than 2/3 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 or Local Authority) will be £4m. 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, and foreign countries 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.

Category	**Cash limit**
Any group of organisations under the same ownership	£4m per group
Any group of pooled funds under the same management	£10m per manager
Negotiable instruments held in a broker's nominee account	£20m per broker
Foreign countries	£10m per country

Cash flow management

34 The Council's officers maintain a detailed cash flow forecast for each coming year revising it as more information is available. This informs the short term investments such as those to cover precept payments. The forecast is compiled on a prudent

basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Long term investment strategy is based on the Council's medium term financial strategy.

Treasury Management Indicators

35 **Security benchmark: average credit rating** 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. The benchmark for 2021/22 will be an average credit rating of A unchanged from 2020/21.

36 **Liquidity benchmark:** 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. For 2021/22 the benchmark amount available will be £3m unchanged from 2020/21.

Interest rate exposures

37 This indicator is set to control the Council's exposure to interest rate risk. New CIPFA guidance has led to a change in this indicator which is now an upper limits on the one year revenue impact of a 1% rise or fall in interest rates. 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 figures are the same as last year.

	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	£200,000

Maturity structure of borrowing

38 This indicator is set to control the Council's exposure to refinancing risk and is really most useful for councils with a portfolio of loans. The upper and lower limits on the maturity structure of fixed rate borrowing are shown below. The Council is not planning to borrow but will set limits to allow flexibility of term and maturity date for any new borrowing.

	Upper	Lower
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within five years	100%	0%
Five years and within 10 years	100%	0%
10 years and above	100%	0%

Principal sums invested for periods longer than a year

39 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 total long-term principal sum invested to final maturities beyond the period end will be:

	2021/22	2022/23	2023/24
Limit on principal invested beyond year end	£12m	£10m	£8m

Other Treasury Management issues

40 **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).

41 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.

42 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

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

44 **Markets in Financial Instruments Directive**: The Council has opted up to professional client status with its providers of financial services allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. The Director of Corporate Resources believes this to be the most appropriate status.

45 **Ethical Investment:** The investment fund management sector is increasing taking into account Environmental, Social and Governance (ESG) criteria to screen out

investments or to guide their engagement with corporate bodies. Each of the Council's fund managers are reacting differently to this trend and the influence the Council can bring to bear is probably not great. However; the Council will work with its advisers to review the Council's opportunity to promote ESG factors without compromising security, liquidity and yield.

Appendix C Investment Strategy

1. This Investment Strategy was a new report starting in 2019/20, meeting the requirements of statutory guidance widening the coverage beyond strict treasury investments. It focuses on the financial support of local public services by lending to or buying shares in other organisations or its own subsidiaries (service investments) and commercial property investment income.

Service Investments: Loans

2. The Council can lend money to local bodies or its subsidiaries to support local public services and stimulate local economic growth. Historically the Council has only done this in very limited circumstances where a significant service outcome is expected. At present only one £300,000 loan is outstanding with a community run leisure centre for it to develop a specific local service.

3. There is no intention to increase the use of loans to local bodies and they are expected to be infrequent. The Council will, however, be lending to a subsidiary in the guise of its housing company. 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 limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Council, upper limits on the outstanding exposure has been set at £3m. This is an increase on last year's £1.5m to reflect the increase in potential loans to its housing subsidiary. The Council controls the company and so is in a position to determine the level of risk its subsidiary takes on.

4. Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's 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.

5. **Risk assessment**: The Council assesses the risk of loss before entering into service loans by assessing the counterparty's resilience, the service users' needs that the loan is designed to help meet and how these will evolve over time. During the life of the loan any change in original assumptions will be monitored. The Council will use external advisors if felt appropriate by the Director of Corporate Resources. All loans will be subject to contract agreed by Head of Legal. All new classes of loans must be approved by full Council and will be monitored by Director of Corporate Resources.

Service Investments: Shares

6. The Council does not currently intend to invest in any shares except for in its local housing company. The overall limit for 2021/22 is £0.5m.

7. **Security:** One of the risks of investing in shares is that they potentially fall in value meaning that the initial outlay may not be recovered. In order to limit this risk upper limits on the sum invested in subsidiaries will be set at the lowest practical level if and when exposure is allowed.

8. **Risk assessment:** The Council would assess the risk of loss before entering into and whilst holding shares by going through an extensive process of risk analysis. The risk analysis will include an assessment of the market that the subsidiary will be active in including the nature and level of competition, how the market will evolve over time, the barriers to entry and exit and any ongoing investment requirements. The Council will use external advisors as thought appropriate by Director of Corporate Resources.

9. **Liquidity:** Although this type of investment is fundamentally illiquid, in order to limit this the Council, when it sets a limit in this area, will initially set out the maximum periods for which funds may prudently be committed and how the Council will ensure it stays within its stated investment limits. The life of the housing companies has not been explicitly set but the invested equity will be reviewed at a five-year interval.

10. **Non-specified Investments:** Shares are the only investment type that the Council has identified that meets the definition of a non-specified investment in the government guidance. The limits above on share investments are therefore also the Council's required upper limits on non-specified investments. The Council has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

Commercial Investments: Property

11. The Council invests in local commercial property in order to make a return that will be spent on local public services. These include retail units, business centres, and commercial leisure facilities. They contributed £3.7m of income net of direct costs in 2019/20 providing a significant support to the Council's finances.

12. The table below lists the property by major category and by whether they are 'legacy' properties, which is taken as having been on the Council's books on 31 March 2007, and the acquisitions and developments since then. The reason for the choice of 31 March 2007 is twofold: firstly, this was the date of the implementation of asset accounting under International financial reporting

standard that required the Council to keep detail records of historic asset values and secondly it separates out the last decade where the recent purchases are reported. It is these more recent purchases which were made to provide commercial income to support the Council's budget as Central Government support reduced that is the main concern of the guidance. For the recent purchases the cost records are available whereas the Council does not have comprehensive records of actual purchase costs so the 31 March 2007 values are used.

Property by type £millions	**Actual**	**31.3.2020 actual**		**31.3.2021 expected**	
	Purchase cost or 31 March 2007 value	**Gains or losses**	**Value in accounts**	**Gains or losses**	**Value in accounts**
Retail – legacy	2.7	2.2	4.9	1.9	4.6
Retail – Swan Walk	9.7	-7.0	2.7	-7.1	2.6
Light industrial - legacy	9.3	6.3	15.6	6.3	15.6
Healthcare – legacy	6.5	1.3	7.8	1.3	7.8
Office - legacy	1.2	0.9	2.1	0.9	2.1
Retail - recent	14.6	-1.5	13.1	-2.2	12.4
Light industrial – recent	4.7	0.1	4.8	0.1	4.8
Healthcare – recent	0.6	0.3	0.9	0.3	0.9
Education -recent	1.8	-0.1	1.7	-0.1	1.7
Leisure – recent*	1.5	-0.6	0.9	-0.6	0.9
Total	**52.6**	**1.9**	**54.5**	**0.8**	**53.4**

13. In the table above the Swan Walk Centre has been taken out of the legacy retail category as it has a significant effect and has its own distinct history. The major loss in value is due to the movement of the valuation of the Council's equity share in Swan Walk from £8.4m in 2007 to a current value of £2.7m. A true separable purchase price for the Swan Walk equity share is not available as the Swan Walk development was a complex set of multiparty arrangements rather than a simple purchase.

14. The values at year end are uncertain due to the possible effect of the pandemic on the future rental income. The estimates for the end of 2020/21 above assume values broadly hold their value apart from retail where investor sentiment is currently poor and a discount allowance of 5% has been applied.

15. **Security:** 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.

16. The fair value assessment of the Council's investment property portfolio is slightly above the 'purchase' cost which means that the whole portfolio does provide 'security' in terms of the government guidance.

17. The Head of Property and Facilities has considered the prospects for the overall value of the portfolio and bearing in mind it is normal for assets within the portfolio to perform differently depending on market conditions concludes that the best course of action is to hold the assets for the long term as they are sound assets with dependable income streams.

18. The commercial properties are revalued each year-end by an external valuer so should the audited values at the end of 2020/21 fall below their purchase price the Head of Property and Facilities will consider whether their current course of action of holding the assets is appropriate and bring any alternative actions to Council in an update to the Investment Strategy. This is in line with the current government guidance.

19. **Risk assessment:** The Council assesses the risk of loss before entering into and whilst holding property investments by :
    - assessing the relevant market including the level of competition, the barriers to entry and exit and future market prospects;
    - using advisors if thought appropriate by the Director of Corporate Resources;
    - consulting Policy Development Advisory Group for Finance & Assets
    - taking final comprehensive report on all new investments to Cabinet
    - continually monitoring risk in the whole portfolio and any specific assets

20. **Liquidity:** Clearly 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 the Head of Property and Facilities ensures that at least £5m of commercial property could be sold as a going concern within a six month period.

Loan Commitments and Financial Guarantees

20 Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Council and are included here for completeness. The Council plans to provide loan commitments up to £6m to its Housing Company subsidiary. It does not plan to provide any guarantees in the foreseeable future.

Proportionality

21 The Council is dependent on profit generating investment activity to achieve a balanced revenue budget. The table below shows the extent to which the expenditure planned to meet the service delivery objectives is dependent on achieving the expected net profit from investments over the lifecycle of the

Medium Term Financial Strategy. The figures are best estimates bearing in mind the uncertainty due to the pandemic. They assume depressed levels of rents for this year and the next before a recovery for 2022/23. There is a risk that this is overoptimistic and that a longer lasting recession depresses income for the whole period.

Proportionality of Investments £m	**2019/20 Actual**	**2020/21 Forecast**	**2021/22 Budget**	**2022/23 Budget**	**2023/24 Budget**
Gross service expenditure	35	36	34	35	36
Investment income	3.7	3.4	3.6	3.9	4.0
Proportion	10%	10%	10%	11%	11%

22 **Capacity, Skills and Culture**

Elected Members and statutory officers: The Council recognises that those elected Members and statutory officers involved in the investments decision making process must have appropriate capacity, skills and information to enable them to:

- take informed decisions as to whether to enter into a specific investment;
- assess individual assessments in the context of the strategic objectives and risk profile of the Council; and
- understand how new decisions have changed the overall risk exposure of the Council.

The Council will ensure that the relevant officers and the Members of Audit Committee and Policy Development Advisory Group for Finance & Assets have appropriate skills, providing training and advisor support where there is a skills gap.

23 **Commercial deals:** The Council will ensure that the Audit Committee, Policy Development Advisory Group for Finance & Assets, Cabinet, and officers negotiating commercial deals are aware of the core principles of the prudential framework and of the regulatory regime within which local authorities operate.

24 **Corporate governance:** Any investment decisions will be scrutinised by Senior Leadership Team, Policy Development Advisory Group for Finance & Assets, and Cabinet before final approval. The Overview and Scrutiny committee review all decisions made by the Cabinet. Although after the event the Committee can make any recommendations to the Council if it sees fit.

Investment Indicators

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

26 **Total risk exposure:** The first indicator shows the total exposure to potential investment losses.

Total investment exposure £m	**31.03.2020 Actual**	**31.03.2021 Forecast**	**31.03.2022 Forecast**
Treasury management investments	39	30	32
Service investments: Loans	0.2	0.2	2.7
Service investments: Shares	0	0.1	0.1
Commercial investments: Property	54	53	56
TOTAL INVESTMENTS	93.2	83.3	90.8
Commitments to lend	0	0	6
Guarantees issued on loans	0	0	0
TOTAL EXPOSURE	93.2	83.3	96.8

27 **How investments are funded:** Government guidance is that these indicators should include how investments are funded. Since the Council does not have any borrowing the Council's investments are funded by usable reserves and income received in advance of expenditure.

28 **Rate of return received**: 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.

Investments net rate of return	**2019/20 Actual**	**2020/21 Forecast**	**2021/22 Forecast**
Treasury management investments	2.1%	1.6%	1.6%
Service investments: Loans	0%	3.0%	3.0%
Service investments: Shares	0	0	0
Commercial investments: Property	6.8%	6.4%	6.3%
ALL INVESTMENTS	4.8%	4.7%	4.7%

29 **Other indicators:** The MHCLG guidance lists other indicators and the Council has selected the indicators below as appropriate.

Indicator	2019/20 Actual	2020/21 Forecast	2021/22 Forecast
Debt to net service expenditure ratio	0%	0%	0%
Commercial income to net service expenditure ratio	35%	31%	32%
Benchmarking of returns – ratio of property income yield to IPD property yield index averaged over 5 year period	130%	130%	130%
Income net of direct cost return target	6.8%	6.4%	6.3%
Operating overheads of property section attributable to commercial property as a proportion of net property income	6.8%	6.5%	6.4%
Average Vacancy levels	1%	3%	2%
Tenant over 5%	5	5	5
Weighted Average Unexpired Lease Term (WAULT)	9yr	9yr	9yr
Bad debts written off	£0	£200,000	£200,000