ITEM NO. 9.1

Report of:	**Head of Finance**
Contact Officer:	**Bob Kean**
Telephone No:	**01543 464 334**
Portfolio Leader:	**Leader of the Council**
Key Decision:	**No**
Report Track:	**Cabinet: 07/02/19** **Council: 20/02/19**

CABINET

7 FEBRUARY 2019

TREASURY MANAGEMENT STRATEGY, MINIMUM REVENUE PROVISION POLICY, ANNUAL INVESTMENT STRATEGY AND CAPITAL STRATEGY 2019/20

1 Purpose of Report

1.1 This report is presented to obtain the Council's approval to:-

- Prudential and Treasury indicators - setting of indicators to ensure that the capital investment plans of the Council are affordable, prudent and sustainable;
- The Minimum Revenue Provision (MRP) Policy;
- Treasury Management Strategy Statement for 2019/20 - to set treasury limits for 2019/20 to 2021/22 and to provide a background to the latest economic forecasts of interest rates;
- Annual Investment Strategy 2019/20 - to set out the strategy of investment of surplus funds.
- Capital Strategy 2018/22

2 Recommendation(s)

2.1 To approve:-

(a) The Prudential and Treasury indicators;
(b) The MRP Policy Statement;
(c) The Treasury Management Policy;
(d) The Annual Investment Strategy for 2019/20;
(e) The Capital Strategy 2018/22.

2.2 To note that indicators may change in accordance with the final recommendations from Cabinet to Council in relation to both the General Fund/ Housing Revenue Account Revenue Budgets and Capital Programmes.

3 Key Issues and Reasons for Recommendations

Key Issues

3.1 The Treasury Management Function essentially consists of :

- In the short term ensuring that the cash flow of a Balanced Revenue Budget is adequately planned with surplus monies invested in accordance with the risk appetite of the Council.
- In the long term funding the capital plans of the authority and in particular managing the debt of the Council and any new borrowing requirement.

3.2 The Governance arrangements are detailed in the various policies and strategies as detailed in the report together with the setting of Indicators in accordance with the Capital Financing Prudential Code.

3.3 **Capital Strategy** – The CIPFA revised 2017 Prudential and Treasury Management Codes require, for 2019-20, all local authorities to prepare an additional report, a capital strategy report, which will provide the following:

- a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

3.4 The aim of this capital strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

Reasons for Recommendations

3.5 The Council is required to approve its treasury management ,investment and capital strategies to ensure that cash flow is adequately planned and that surplus monies are invested appropriately.

4 Relationship to Corporate Priorities

4.1 Treasury management and investment activity link in with all of the Council’s priorities and their spending plans.

5 Report Detail

Background

5.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

5.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

5.3 The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

5.4 CIPFA defines treasury management as:

"The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

5.5 Revised reporting is required for the 2019/20 reporting cycle due to revisions of the Ministry Housing Communities and Local Government (MHCLG) Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The Capital Strategy is attached at appendix 6.

5.6 This authority has not engaged in any commercial investments and has no non-treasury investments.

Reporting Requirements

5.7 **Capital Strategy -** The CIPFA revised 2017 Prudential and Treasury Management Codes require, for 2019-20, all local authorities to prepare an additional report, a capital strategy report, which will provide the following:

- a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

5.8 The aim of this capital strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

5.9 **Treasury Management reporting -** The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals:-

5.10 **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report covers:-

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an Investment Strategy (the parameters on how investments are to be managed).

5.11 **A mid year treasury management report** - This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision.

5.12 **An annual treasury report** - This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

5.13 **Scrutiny** - The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit and Governance Committee.

5.14 The Council has adopted the following reporting arrangements in accordance with the requirements of the CIPFA Code of Practice:-

Area of Responsibility	Council/Committee	Frequency
Treasury Management Strategy/ Annual Investment Strategy/ MRP policy	Full council	Annually in January/ February each year
Treasury Management Strategy/ Annual Investment Strategy/ MRP policy/Monitoring of Prudential Indicators	Full council	Mid-year
Treasury Management Strategy/ Annual Investment Strategy/ MRP policy – updates or revisions at other times	Full council	As required
Annual Treasury Outturn Report	Audit & Governance Committee and Council	Annually by 30 September after the end of the year
Scrutiny of Treasury Management Strategy	Cabinet	Annually in December before the start of the year

Treasury Management Strategy for 2019/20

5.15 The strategy for 2019/20 covers two main areas:-

Capital issues

- the capital expenditure plans and the associated prudential indicators;
- the minimum revenue provision (MRP) policy.

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

5.16 These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, MHCLG MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

Training

5.17 The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training has been undertaken by members of the Audit and Governance Committee and further training will be arranged as required.

5.18 The training needs of treasury management officers are periodically reviewed.

Treasury Management Consultants

5.19 The Council uses Link Asset Services, Treasury Solutions as its external treasury management advisors.

5.20 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

The Capital Prudential Indicators 2019/20 - 2021/22

5.21 The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

Capital expenditure

5.22 This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts, which include a review of current schemes, but to note these may change as part of the finalisation of the Budget.

Capital expenditure	2017/18 Actual £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2018/22 Programme £'000
Corporate Improvement	7	509				
Environment	113	205	576	108	90	496
Culture and Sport	1,237	636	1,181			841
Economic Development	102	519	239			5,745
Housing	913	958	842	792	792	
Health & Wellbeing						
Town Centre Regeneration	39	526	219			
Leader of the Council						
Crime & Partnerships	149		55			
Non-HRA	2,560	3,353	3,112	900	882	7,082
Non-HRA programme estimate			466	3,744	2,872	(7,082)
HRA	10,039	7,682	7,185	6,173	5,934	18,735
HRA programme estimate				3,000	3,000	(6,000)
Total	12,599	11,035	10,763	13,817	12,688	12,735

5.23 Other long term liabilities. The financing need excludes other long term liabilities, such leasing arrangements which already include borrowing instruments.

5.24 The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Capital expenditure	2017/18 Actual £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2018/22 Programme £'000
Total Spend	12,599	11,035	10,763	13,817	12,688	12,735
Financed by:						
Capital Receipts	1,329	2,329	1,626	4,846	3,530	678
Capital grants/ contributions	3,011	1,837	1,733	1,081	792	0
Major Repairs	3,512	3,954	3,178	3,241	3,309	3,429
Revenue	4,747	1,900	1,204	4,649	5,057	8,628
Total Financing	12,599	10,020	7,741	13,817	12,688	12,735
Net financing need for the year		1,015	3,022			

5.25 The capital financing of the programme will similarly be reviewed as part of the Budget process and any change will be separately identified in the indicator reported to Council.

The Council's borrowing need (the Capital Financing Requirement)

5.26 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so it's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

5.27 The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life and so charges the economic consumption of capital assets as they are used.

5.28 The CFR includes any other long term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes.

5.29 The Council is asked to approve the following CFR projections, subject to any changes arising from the budget process:-

	2017/18 Actual £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000
Capital Financing Requirement					
CFR – non housing	14,971	10,949	9,594	9,119	8,650
CFR - housing	81,509	82,515	85,529	85,520	85,511
Total CFR	**96,480**	**93,464**	**95,123**	**94,639**	**94,161**
Movement in CFR		**(3,016)**	**1,659**	**(484)**	**(478)**

'* Adjusted following Voluntary MRP reversed

Movement in CFR represented by					
Net financing need for the year		**1,015**	**3,022**		
LAMS receipt		**(2,000)**			
Repayment of Borrowing		**(1,500)**	**(875)**	**0**	**0**
Less MRP and other financing movements		**(531)**	**(488)**	**(484)**	**(478)**
Movement in CFR		**(3,016)**	**1,659**	**(484)**	**(478)**

Core funds and expected investment balances

5.30 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

Year End Resources £m	2017/18 Actual £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000
Earmarked Fund balances / reserves					
General Fund	9,786	8,462	7,873	8,280	8,302
General Fund working balance	3,136	2,868	2,970	2,367	2,378
HRA	2,074	4,808	8,378	7,520	6,377
HRA working balance	1,739	1,531	1,594	1,627	1,663
Sub Total	**16,735**	**17,669**	**20,815**	**19,794**	**18,720**
Capital receipts					
GF	2,471	3,164	6,315	3,307	345
HRA	593	737	881	144	143
Sub Total	**3,064**	**3,901**	**7,196**	**3,451**	**488**
Provisions	**2,266**	**2,266**	**2,266**	**185**	**185**
Major Repairs Reserve	**883**	**0**	**0**	**0**	**0**
Other - grants receipts in advance	**602**	**602**	**602**	**602**	**602**
Total core funds	**23,550**	**24,438**	**30,879**	**24,032**	**19,995**
Working Cashflow requirement	(2,139)	5,000	5,000	5,000	5,000
Under/over borrowing	13,770	9,692	10,921	10,660	10,410
Expected investments	11,919	9,746	14,958	8,372	4,585

*Working cashflow requirement shown are estimated year-end; these may be higher mid-year.

Minimum revenue provision (MRP) policy statement

5.31 The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP).

5.32 MHCLG Regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:-

5.33 The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2008/09, and will assess MRP for 2009/10 onwards in accordance with the recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

5.34 Under powers delegated to the Section 151 Officer, the Council's annual MRP provision for expenditure incurred after 1 April 2008 and before 31 March 2017 will be based on the uniform rate of 4% of the Capital Financing Requirement. The Council's annual MRP provision for expenditure incurred on or after 1 April 2017 will be based on the asset life method i.e. the provision will be calculated with reference to the estimated life of the assets acquired, in accordance with the regulations.

5.35 MRP will be applicable from the year following that in which the asset is brought into operation.

5.36 Repayments included in annual PFI or finance leases are applied as MRP.

5.37 The Council are satisfied that the policy for calculating MRP set out in this policy statement will result in the Council continuing to make prudent provision for the repayment of debt, over a period that is on average reasonably commensurate with that over which the expenditure provides benefit.

5.38 The Section 151 Officer will, where it is prudent to do so, use discretion to review the overall financing of the Capital Programme and the opportunities afforded by the regulations, to maximise the benefit to the Council whilst ensuring the Council meets its duty to charge a prudent provision.

5.39 **MRP Overpayments** - A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. The Council has previously not made any MRP overpayments.

Affordability prudential indicators

5.40 The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

Ratio of financing costs to net revenue stream

5.41 This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Non HRA	5.9%	4.4%	3.8%	3.2%	3.3%
HRA	16.62%*	16.72%	16.85%	16.78%	16.48%

'* Adjusted following Voluntary MRP reversed

HRA ratios

	2017/18 Actual £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000
HRA debt £'000	81,605	82,880	83,527	83,527	83,527
HRA revenues £'000	19,507	19,308	19,487	19,593	20,079
Ratio of debt to revenues %	4.2	4.3	4.3	4.3	4.2
Number of HRA dwellings	5,151	5,155	5,143	5,117	5,091
Debt per dwelling £	15.84	16.08	16.24	16.32	16.41

Borrowing

5.42 The capital expenditure plans provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy.

Current portfolio position

5.43 The Council's forward projections for borrowing are summarised below. The table shows the actual external debt against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

	2017/18 Actual £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000
External Debt					
PWLB debt at 1 April	81,605	81,605	82,880	83,527	83,527
Expected change in Debt		1,275	647		
Other long-term liabilities (OLTL)	1,105	1,105	892	675	452
Expected change in OLTL		(213)	(217)	(223)	(228)
Actual gross debt at 31 March	82,710	83,772	84,202	83,979	83,751
The Capital Financing Requirement	96,480	93,464	95,123	94,639	94,161
Under / (over) borrowing	13,770	9,692	10,921	10,660	10,410

5.44 Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2019/20 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

5.45 The Head of Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals contained in the Financial Plan for 2018/19 to 2021/22.

Treasury Indicators: limits to borrowing activity

5.46 **The operational boundary**. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Operational boundary	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000
Debt	96,993	95,637	95,163	94,694
Other long term liabilities	892	675	452	224
Total	97,885	96,312	95,615	94,918

5.47 The authorised limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
2. The Council is asked to approve the following authorised limit.

Authorised limit	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000
Debt	108,493	107,137	106,663	106,194
Other long term liabilities	892	675	452	224
Total	109,385	107,812	107,115	106,418

5.48 Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

HRA debt limit £m	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000
HRA Debt cap*	86,044	86,044	86,044	86,044
HRA CFR	82,515	85,529	85,520	85,511
HRA headroom	3,529	515	524	533

**** Abolition of HRA debt cap.*** *In October 2018, Prime Minister Theresa May announced a policy change of abolition of the HRA debt cap. The Chancellor announced in the Budget that the applicable date was 29.10.18.*

Prospects for interest rates

5.49 The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives our central view.

Link Asset Services Interest Rate View													
	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

5.50 The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth became increasingly strong during 2018 until slowing significantly during the last quarter. At their November quarterly Inflation Report meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. On a major assumption that Parliament and the EU agree a Brexit deal in the first quarter of 2019, then the next increase in Bank Rate is forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

5.51 The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.25 – 2.50% in December 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We therefore saw US 10 year bond Treasury yields rise above 3.2% during October 2018 and also investors causing a sharp fall in equity prices as they sold out of holding riskier assets.

5.52 However, by early January 2019, US 10 year bond yields had fallen back considerably on fears that the Fed was being too aggressive in raising interest rates and was going to cause a recession. Equity prices have been very volatile on alternating good and bad news during this period.

5.53 From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crises, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

5.54 Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

Investment and borrowing rates

- Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.
- Borrowing interest rates have been volatile so far in 2018/19 and have increased modestly since the summer. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;
- There will remain a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

Borrowing strategy

5.55 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council’s reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considred.

5.56 Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Head of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

5.57 Any decisions will be reported to members appropriately at the next available opportunity.

Treasury management limits on activity

5.58 There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance.

The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

5.59 The Council is asked to approve the following treasury indicators and limits:

£m	2019/20	2020/21	2021/22
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	75%	75%	75%
Maturity structure of fixed interest rate borrowing 2019/20			
		Lower	**Upper**
Under 12 months		0%	100%
12 months to 2 years		0%	100%
2 years to 5 years		0%	100%
5 years to 10 years		0%	100%
10 years and above		0%	100%
Maturity structure of variable interest rate borrowing 2019/20			
		Lower	**Upper**
Under 12 months		0%	75%
12 months to 2 years		0%	75%
2 years to 5 years		0%	75%
5 years to 10 years		0%	75%
10 years and above		0%	75%

Policy on borrowing in advance of need

5.60 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

5.61 Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

Debt rescheduling

5.62 As short-term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long-term debt to short-term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

5.63 The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

5.64 Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

5.65 All rescheduling will be reported to members, at the earliest meeting following its action.

Municipal Bond Agency

5.66 It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. The Agency hopes that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority may make use of this new source of borrowing as and when appropriate.

Annual Investment Strategy

Investment Policy

5.67 The Council's investment policy has regard to the following: -

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018

5.68 The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return).

5.69 The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

5.70 In accordance with the above guidance from the MHCLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

5.71 Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.

5.72 Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

5.73 This authority has defined the list of types of investment instruments that the treasury management team are authorised to use, as per appendix 2.

- Specified investments are those with a high level of credit quality and subject to a maturity limit of one year.
- Non-specified investments are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

5.74 **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments as being 50% of the total investment portfolio.

5.75 **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in the appendix 2.

5.76 **Transaction limits** are set for each type of investment in appendix 2.

5.77 This authority will set a limit for the amount of its investments which are invested for longer than 365 days.

5.78 Investments will only be placed with counterparties from countries with a specified minimum sovereign rating.

5.79 This authority has engaged external consultants, to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

5.80 All investments will be denominated in sterling.

5.81 As a result of the change in accounting standards for 2018/19 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (The Ministry of Housing, Communities and Local Government [MHCLG], are currently conducting a consultation for a temporary override to allow English local authorities time to adjust their portfolio of investments. Members will be updated when the result of this consultation is known.)

5.82 However, this authority will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year.

Creditworthiness policy

5.83 The Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:-

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

5.84 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:-

- Yellow — 5 years
- Dark pink — 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
- Light pink — 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5
- Purple — 2 years
- Blue — 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange — 1 year
- Red — 6 months
- Green — 100 days
- No colour — not to be used

5.85 The Link creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

5.86 Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of short term rating F1 and a long term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

5.87 All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of our creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

5.88 Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and market information, information on any external support for banks to help support its decision making process.

5.89 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch. The list of countries that qualify using this credit criteria as at the date of this report are shown in appendix 3. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

UK banks – ring fencing

5.90 The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

5.91 Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

5.92 While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

Investment Strategy

5.93 **Inhouse funds**. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

5.94 **Investment returns expectations.** Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1 2022. Bank Rate forecasts for financial year ends (March) are:

- 2018/19 0.75%
- 2019/20 1.25%
- 2020/21 1.50%
- 2021/22 2.00%

5.95 The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

2018/19	0.75%
2019/20	1.00%
2020/21	1.50%
2021/22	1.75%
2022/23	1.75%
2023/24	2.00%
Later years	2.50%

5.96 The overall balance of risks to economic growth in the UK is probably neutral. The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

5.97 **Investment treasury indicator and limit** - total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The Council is asked to approve the treasury indicator and limit: -

Maximum principal sums invested > 364 days			
	2019/20	2020/21	2021/22
Principal sums invested > 365 days	£10m	£10m	£10m

5.98 For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

Investment risk benchmarking

5.99 This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day, 1, 3, 6 or 12 month LIBID uncompounded.

End of year investment report

5.100 At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

6 Implications

6.1 **Financial**

Details of implications or “None”.

6.2 **Legal**

Details of implications or “None”.

6.3 **Human Resources**

Details of implications or “None”.

6.4 **Section 17 (Crime Prevention)**

Details of implications or “None”.

6.5 **Human Rights Act**

Details of implications or “None”.

6.6 **Data Protection**

Details of implications or “None”.

6.7 **Risk Management**

Details of implications or “None”.

6.8 **Equality & Diversity**

Details of implications or “None”.

6.9 **Best Value**

Details of implications or “None”.

7 Appendices to the Report

Appendix 1: Economic Background

Appendix 2: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

Appendix 3: Approved Countries for Investment

Appendix 4: Treasury Management Scheme of Delegation

Appendix 5: The Treasury Management Role of the Section 151 Officer

Appendix 6: Capital Strategy.

Previous Consideration

None.

Background Papers

Available in Financial Services

ITEM NO. 9.25

APPENDIX 1

ECONOMIC BACKGROUND

GLOBAL OUTLOOK. World growth has been doing reasonably well, aided by strong growth in the US. However, US growth is likely to fall back in 2019 and, together with weakening economic activity in China and the eurozone, overall world growth is likely to weaken.

Inflation has been weak during 2018 but, at long last, unemployment falling to remarkably low levels in the US and UK has led to a marked acceleration of wage inflation. The US Fed has therefore increased rates nine times and the Bank of England twice. However, the ECB is unlikely to start raising rates until late in 2019 at the earliest.

KEY RISKS - central bank monetary policy measures
Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as quantitative easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

The key issue now is that that period of stimulating economic recovery and warding off the threat of deflation, is coming towards its close. A new period is well advanced in the US, and started more recently in the UK, of reversing those measures i.e. by raising central rates and, (for the US), reducing central banks' holdings of government and other debt.

These measures are now required in order to stop the trend of a reduction in spare capacity in the economy and of unemployment falling to such low levels, that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this also encouraged investors into a search for yield and into investing in riskier assets such as equities. Consequently, prices in both bond and equity markets rose to historically high valuation levels simultaneously.

This meant that both asset categories were exposed to the risk of a sharp downward correction and we have indeed, seen a sharp fall in equity values in the last quarter of 2018. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery, by taking too rapid and too strong action, or, conversely, let inflation run away by taking action that was too slow and/or too weak. **The potential for central banks to get this timing and strength of action wrong are now key risks.** At the time of writing, (early January 2019), financial markets are very concerned that the Fed is being too aggressive with its policy for raising interest rates and was likely to cause a recession in the US economy.

The world economy also needs to adjust to a sharp change in **liquidity creation** over the last five years where the US has moved from boosting liquidity by QE purchases, to reducing its holdings of debt, (currently about $50bn per month). In addition, the European Central Bank ended its QE purchases in December 2018.

UK. The flow of positive economic statistics since the end of the first quarter of 2018 has shown that pessimism was overdone about the poor growth in quarter 1 when adverse weather caused a temporary downward blip. Quarter 1 at 0.1% growth in GDP was followed by a return to 0.4% in quarter 2 and by a strong performance in quarter 3 of +0.6%. However, growth in quarter 4 is expected to weaken significantly.

At their November quarterly Inflation Report meeting, the MPC repeated their well-worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years time, but declined to give a medium term forecast. However, with so much uncertainty around Brexit, they warned that the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, they warned they could also *raise* Bank Rate in the same scenario if there was a boost to inflation from a devaluation of sterling, increases in import prices and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor could potentially provide fiscal stimulus to support economic growth, though at the cost of increasing the budget deficit above currently projected levels.

It is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Getting parliamentary approval for a Brexit agreement on both sides of the Channel will take well into spring 2019. However, in view of the hawkish stance of the MPC at their November meeting, the next increase in Bank Rate is now forecast to be in May 2019, (on the assumption that a Brexit deal is agreed by both the UK and the EU). The following increases are then forecast to be in February and November 2020 before ending up at 2.0% in February 2022.

Inflation. The Consumer Price Index (CPI) measure of inflation has been falling from a peak of 3.1% in November 2017 to 2.3% in November. In the November Bank of England quarterly Inflation Report, inflation was forecast to still be marginally above its 2% inflation target two years ahead, (at about 2.1%), given a scenario of minimal increases in Bank Rate. This inflation forecast is likely to be amended upwards due to the Bank's report being produced prior to the Chancellor's announcement of a significant fiscal stimulus in the Budget; this is likely to add 0.3% to GDP growth at a time when there is little spare capacity left in the economy, particularly of labour.

As for the **labour market** figures in October**,** unemployment at 4.1% was marginally above a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 3.3%, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates less CPI inflation), earnings are currently growing by about 1.0%, the highest level since 2009. This increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC was right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy.

In the **political arena**, there is a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit. However, our central position is that Prime Minister May's government will endure, despite various setbacks, along the route to reaching an orderly Brexit in March 2019. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary and fiscal policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

USA. President Trump's massive easing of fiscal policy is fuelling a, (temporary), boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2 and 3.5%, (3.0% y/y), in quarter 3, but also an upturn in inflationary pressures. The strong growth in employment numbers and the reduction in the unemployment rate to 3.9%, near to a recent 49 year low, has fed through to an upturn in wage inflation which hit 3.2% in November, However, CPI inflation overall fell to 2.2% in November and looks to be on a falling trend to drop below the Fed's target of 2% during 2019. The Fed has continued on its series of increases in interest rates with another 0.25% increase in December to between 2.25% and 2.50%, this being the fifth increase in 2018 and the ninth in this cycle. However, they did also reduce their forecast for further increases from three to two. This latest increase compounded investor fears that the Fed is over doing the rate and level of increases in rates and that it is going to cause a US recession as a result. There is also much evidence in previous monetary policy cycles, of the Fed's series of increases doing exactly that. Consequently, we have seen stock markets around the world plunging under the weight of fears around the Fed's actions, the trade war between the US and China, an expectation that world growth will slow, Brexit etc.

The tariff war between the US and China has been generating a lot of heat during 2018, but it is not expected that the current level of actual action would have much in the way of a significant effect on US or world growth. However, there is a risk of escalation if an agreement is not reached soon between the US and China.

Eurozone. Growth was 0.4% in quarters 1 and 2 but fell back to 0.2% in quarter 3, though this was probably just a temporary dip. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of nearly 2% for 2018, the horizon is less clear than it seemed just a short while ago. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank ended all further purchases in December 2018. The ECB is forecasting inflation to be a little below its 2% top limit through the next three years so it may find it difficult to warrant a start on raising rates by the end of 2019 if the growth rate of the EU economy is on a weakening trend.

China. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems. Progress has been made in reducing the rate of credit creation, particularly from the shadow banking sector, which is feeding through into lower economic growth. There are concerns that official economic statistics are inflating the published rate of growth.

Japan - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It is likely that loose monetary policy will endure for some years yet to try to stimulate growth and modest inflation.

Emerging countries. Argentina and Turkey are currently experiencing major headwinds
and are facing challenges in external financing requirements well in excess of their reserves of foreign exchange. However, these countries are small in terms of the overall world economy, (around 1% each), so the fallout from the expected recessions in these countries will be minimal.

INTEREST RATE FORECASTS

The interest rate forecasts provided by Link Asset Services in paragraph 3.2 are predicated on an assumption of an agreement being reached on Brexit between the UK and the EU. In the event of an orderly non-agreement exit, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall. If there was a disorderly Brexit, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed for ten years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.

- **Bank of England monetary policy** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

- A resurgence of the **eurozone sovereign debt crisis**, possibly in **Italy**, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has made a lot of anti-austerity noise. The EU rejected the initial proposed Italian budget and demanded cuts in government spending which the Italian government initially refused. However, a fudge was subsequently agreed, but only by *delaying* the planned increases in expenditure to a later year. This can has therefore only been kicked down the road to a later time. The rating agencies have started on downgrading Italian debt to one notch above junk level. If Italian debt were to fall below investment grade, many investors would be unable to hold it. Unsurprisingly, investors are becoming increasingly concerned by the words and actions of the Italian government and consequently, Italian bond yields have risen – at a time when the government faces having to refinance large amounts of debt maturing in 2019.

- Weak capitalisation of some **European banks**. Italian banks are particularly vulnerable; one factor is that they hold a high level of Italian government debt - debt which is falling in value. This is therefore undermining their capital ratios and raises the question of whether they will need to raise fresh capital to plug the gap.

- **German minority government.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD is reviewing whether it can continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018, (a new party leader has now been elected). However, this makes little practical difference as she is still expected to aim to continue for now as the Chancellor. However, there are five more state elections coming up in 2019 and EU parliamentary elections in May/June; these could result in a further loss of electoral support for both the CDU and SPD which could also undermine her leadership.

- **Other minority eurozone governments.** Spain, Portugal, Ireland, the Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile. Sweden is also struggling to form a government due to the anti-immigration party holding the balance of power, and which no other party is willing to form a coalition with. The Belgian coalition collapsed in December 2018 but a minority caretaker government has been appointed until the May EU wide general elections.

- **Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU while **Italy,** in 2018, also elected a strongly anti-immigration government. Elections to the EU parliament are due in May/June 2019.

- Further increases in interest rates in the US could spark a **sudden flight of investment funds** from more risky assets e.g. shares, into bonds yielding a much improved yield. Throughout the last quarter of 2018, we saw sharp falls in equity markets interspersed with occasional partial rallies. Emerging countries which have borrowed heavily in dollar denominated debt, could be particularly exposed to this risk of an investor flight to safe havens e.g. UK gilts.

- There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is now rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.

- **Geopolitical risks,** especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- **Brexit** – if both sides were to agree a compromise that removed all threats of economic and political disruption.

- **The Fed causing a sudden shock in financial markets** through misjudging the pace and strength of increases in its Fed Funds Rate and in the pace and strength of reversal of QE, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.

- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.

- **UK inflation,** whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

Brexit timetable and process

- March 2017 – UK government notified the European Council of its intention to leave under the Treaty on European Union Article 50 on 29 March 2019.

- 25.11.18 – EU27 leaders endorsed the withdrawal agreement;

- Dec 2018 – vote in the UK Parliament on the agreement was postponed;
- 21.12.18-08.01.19 – UK parliamentary recess;
- 14.01.19 – vote in Parliament on a ‘no deal’ scenario;
- 29.03.19 – second vote (?) in UK parliament if first vote rejects the deal;
- By 29.03.19 – if the UK Parliament approves a deal, then ratification by the EU Parliament requires a simple majority;
- By 29.03.19 – if the UK and EU parliaments agree the deal, the EU Council needs to approve the deal; 20 countries representing 65% of the EU population must agree;
- 29.03.19 – UK leaves the EU, (or asks the EU for agreement to an extension of the Article 50 period if the UK Parliament rejects the deal and no deal departure?);
- 29.03.19 – if an agreement is reached with the EU on the terms of Brexit, then this will be followed by a proposed **transitional period ending around December 2020.**
- UK continues as a full EU member until March 2019 with access to the single market and tariff free trade between the EU and UK. Different sectors of the UK economy may leave the single market and tariff free trade at different times during the transitional period.
- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.
- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK could also exit without any such agreements in the event of a breakdown of negotiations.
- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU - but this is not certain.
- On full exit from the EU: the UK parliament would repeal the 1972 European Communities Act.

ITEM NO. 9.

ITEM NO. 9.32

APPENDIX 2

TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' quality criteria where applicable.

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the specified investment criteria. A maximum of 50% will be held in aggregate in non-specified investments.

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:-

	Minimum credit criteria / colour band	**Max % of total investments/ £ limit per institution**	**Max. maturity period**
DMADF – UK Government	N/A	100%	6 months
UK Government gilts	UK sovereign rating	£6 million	12 months
UK Government Treasury bills	UK sovereign rating	£6 million	12 months
Bonds issued by multilateral development banks	AAA (or state your criteria if different)	£6 million	6 months
Money Market Funds CNAV	AAA	100%	Liquid
Money Market Funds LNVAV	AAA	100%	Liquid
Money Market Funds VNAV	AAA	100%	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.25	AAA	100%	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.5	AAA	100%	Liquid

Local authorities	N/A	100%	12 months
Term deposits with housing associations	Blue Orange Red Green No Colour	£6 million	12 months 12 months 6 months 100 days Not for use
Term deposits with banks and building societies	Blue Orange Red Green No Colour	£6 million	12 months 12 months 6 months 100 days Not for use
CDs or corporate bonds with banks and building societies	Blue Orange Red Green No Colour	£6 million	12 months 12 months 6 months 100 days Not for use
Gilt funds	UK sovereign rating	£6 million	12 months

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

ITEM NO. 9.34

APPENDIX 3

APPROVED COUNTRIES FOR INVESTMENT

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- Hong Kong
- U.K.

AA-

- Belgium
- Qatar

ITEM NO. 9.

ITEM NO. 9.35

APPENDIX 4

TREASURY MANAGEMENT SCHEME OF DELEGATION

Full Council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

Committees/Council

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

Body/person(s) with responsibility for scrutiny

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

ITEM NO. 9.

APPENDIX 5

THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER

The S151 (responsible) Officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- preparation of a capital strategy to include capital expenditure, capital financing, and treasury management, with a long term timeframe
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all investments and is in accordance with the risk appetite of the authority.

PAGE INTENTIONALLY BLANK

Appendix 6

Capital Strategy

2018 – 2022

Contents **Page**

CAPITAL STRATEGY 2018-2022

1. Introduction

1.1 The updated Prudential Code and Treasury Management Code of Practice (both issued in December 2017) include new requirements in relation to the setting of a Capital Strategy that covers specific subject areas. In line with the Prudential Code, the aim of this Capital Strategy is to demonstrate how Cannock Chase District Council will make capital expenditure and investment decisions in line with service objectives and properly take account of stewardship, value for money, prudence, sustainability and affordability.

1.2 For the purposes of this strategy unless where indicated the requirements relate to the General Fund capital investment, the Housing Revenue Account is dealt with in section 2.

1.3 The Capital Strategy in relation to General Fund is determined from consideration of the Medium Term Financial Plan of the Council. This is a four year rolling programme plan that considers Revenue; Capital and Reserves of the Council and determines a Budget Strategy for that period.

1.4 The Capital Strategy in relation to the Housing Revenue Account is determined by the 30 year business plan which sets out both the overall resources available together with the capital spend required to be delivered each year to meet the minimum standards in relation to the dwellings held.

1.5 Decisions in relation to the Capital Programme forms part of an overarching budget strategy whereby revenue and capital items are assessed against each other and evaluated against the Corporate Plan Objectives.

1.6 The Capital Strategy sets out the long term context in which capital expenditure and investment decisions are made as part of this overarching process and establishes that the Council gives due consideration to risk, reward, and impact on the achievement of priority outcomes.

1.7 This Capital Strategy Statement sets out the broad principles to be applied by the Council when considering capital investment. It provides the context for how the Council's Capital Programme seeks to support the realisation of the Council's corporate business objectives. It also provides part of the strategic context for the Council's Asset Management Plan.

1.8 The Capital Programme represents significant investment in the acquisition or improvement of long term assets such as land, buildings, infrastructure, plant & equipment and information technology for the purposes of delivering the objectives and priorities set out in the Corporate Plan, including Promoting Prosperity and Community Wellbeing.

1.9 The size of the Capital Programme is therefore dependent upon the Corporate Plan and the capital and revenue resources available. The Council currently has a reasonably large programme due to one off receipts in relation to the sale and development of a specific site. Going forwards however there are no uncommitted resources. Reducing revenue resources and scarce capital resources has meant that prudence, sustainability and affordability are the key determinants of the Budget Strategy.

1.10 The delivery of Legislative/Statutory requirements represents a key part of the capital programme and specific grant funding is a key resource to the Council and funds this Council's Disabled Facilities Programme. External funding in the form of grants and contributions for other non legislative initiatives are also sought. However these are targeted at schemes as derived from the Corporate Plan rather than their availability.

1.11 The proposed four-year Capital Programme for 2018/19 –2021/22 set out in the budget report is summarised in Table 1 below.

Table 1 Capital Programme					
	2018/19 £000	2019/20 £000	2020/21 £000	2021/22 £000	2018/22 Prog £000
Corporate Improvement	509	-	-	-	-
Environment	205	576	108	90	496
Culture and Sport	636	1,181	-	-	841
Economic Development & Regulatory Services	519	239	-	-	5,745
Housing General Fund	958	842	792	792	-
Town Centre Regeneration	526	219	-	-	-
Crime & Partnerships	-	55	-	-	-
Total	**3,353**	**3,112**	**900**	**882**	**7,082**

1.12 The updated programme reflects slippage and new schemes which now form part of the 2019/20 budget process as detailed in the budget report. Table 2 provides an update in relation to the capital resources to fund this programme.

Table 2: Estimates Resources and Expenditure 2018-19 to 2021-22			
	General	Section 106	Total
	£'000	£'000	£'000
Capital resources b/fwd. 1 April 2018	**6,572**	**1,346**	**7,918**
Capital Grants	3,517	0	3,517
Capital Receipts	8,364	0	8,364
Section 106	0	70	70
Reserves	84	0	84
Joint Investment Fund	243	0	243
Draft Capital Programme 2018-19 to 2021-22	(14,818)	(511)	(15,329)
Transfer part of RCCO reserve to revenue	(818)	0	(818)
Debt repayment (loan transferred to HRA)	(2,375)	0	(2,375)
Set A side	(204)	0	(204)
Remaining resources at 31 March 2022	**565**	**905**	**1,470**

1.11 The Council must continue to plan its capital resources efficiently and effectively over the medium to long term, both to support the corporate objectives and service user's needs and also to maintain a sustainable financial base.

1.12 The capital strategy forms part of a suite of strategies in relation to Debt, Borrowing and Investments culminating in the Annual Treasury Management Strategy approved by Council each year.

2. Housing Revenue Account (HRA)

2.1 The HRA is a separate ring fenced account. The revenue and capital framework itself is governed by the 30 year business plan which is required to be in place as part of the developed HRA "self financing system". It sets out the overarching spend profiles for both revenue and capital.

2.2 The capital funding for the HRA comes from the following sources:

- Right to buy sales (£15,000 Allowance per property sold)
- Section 106 monies
- Other Capital receipt disposals
- Revenue Contribution to Capital Outlay (RCCO)
- Depreciation (yearly charge)
- Grants
- Borrowing

2.3 The allocation of the resources to key areas of spend is prioritised as follows;

- 30 year business plan
- Health and safety requirements
- Stock condition survey
- Key demand areas

2.4 The proposed four year plan is summarised in table 3 below

2.5 The updated programme reflects slippage and new schemes which now form part of the 2019/20 budget process as detailed in the budget report of the 7/2/19 Appendix 2. Appendix 1 of this report provides an update in relation to the capital resources to fund this programme.

2.6 Previously the HRA was governed by a credit ceiling which meant that it could only borrow to a certain level. However this ceiling has now been removed to encourage Council's to build more social housing. However, the Council already has an allowance of £12.6m within the current capital programme to build more council housing which was agreed as part of the 2018/19 Capital Programme. For future borrowing a business case would need to be laid out identifying the need and the potential financing of the borrowing as this would need to primarily come from rental income generated from the dwellings.

3. Strategic Objectives

3.1 Capital Investment is guided and prioritised by the Council's key objectives as set out in its Corporate Plan. These objectives must be taken into account in determining appropriate capital investment and asset disposal programmes.

3.2 The Councils has two key priorities within the Corporate Plan being, Promoting Prosperity and Community Wellbeing. These priorities interlink and reinforce each other to improve the opportunities, wellbeing and quality of life of our communities. Over the next five years the Council will focus on the following strategic objectives in relation to each of the priorities:

Promoting Prosperity

- Establishing McArthurGlen Designer Outlet Cannock as a major visitor attraction and maximising the benefits it will bring to the District
- Increasing housing choice
- Creating a positive environment in which businesses in the District can thrive.
- Increasing the skill levels of residents and the amount of higher skilled jobs in the District
- Creating strong and diverse town centres to attract additional customers and visitors
- Increasing access to employment opportunities
- Commencing regeneration of the Rugeley Power Station site

Community Wellbeing

- Opportunities for healthy and active lifestyles
- Sustaining safe and secure communities
- Supporting vulnerable people
- Promoting attractive and healthy environments

4. Corporate Planning Framework

4.1 The current financial strategy gives the following guidelines

- Existing service provision to be maintained (as a minimum)
- To deliver asset management requirements
- Additional Capital resources to be generated to invest in the District
- Focus on income generation and invest to save initiatives
- Revenue and capital resources allocated in accordance with service priorities and customer needs, discharge of legislative requirements and achievement of corporate objectives

4.2 In addition to the above decisions on the use of capital resources are guided by the policy context as set out in the Asset Management Plan and the Corporate Plan.

4.3 This Council will consider the funding of capital investment on a corporate basis. Approved capital investment schemes will only be funded by capital receipts, grants and contributions, the application of revenue funds and borrowing. Other forms of funding such as leasing or working in partnership will be considered , if such an option demonstrably represents the most affordable option to the Council and/or is necessary to secure specialist skills and expertise required to deliver a project otherwise not readily available to the Council.

4.4 The Council does not have a bespoke commercial strategy as such and any such scheme is evaluated as described above. The Council seeks to make best use of its own assets by maximising its lettings whereas the acquisition of commercial or residential properties is based upon its Business Case and affordability.

4.5 In the context of capital spending the authority is guided by the accounting standards with regard to capitalisation and also operates a deminimus threshold of £20,000.

5. Prioritisation of Capital Scheme Proposals

5.1 New capital scheme proposals are primarily driven through the budget process. The budget process requires revenue and capital options to be considered, assessed and evaluated against each other.

5.2 Consideration of growth bids is based upon firm business cases and is prioritised as follows:

- A statutory requirement or compliance with an existing legal obligation
- Health and safety requirements to meet mandatory obligations
- Invest to save proposals which will result in a net revenue budget saving (via reduced expenditure or increased income) and with anticipated financial payback in a reasonable time period or, Schemes that enable the authority to meet its objectives and are affordable.
- Schemes that are fully and securely externally funded.

5.3 The process consists of two stages - An outline Business Case is initially produced by managers as an indicative proposal. These are then reviewed by Leadership team and then Cabinet using the criteria set out in 4.2 above. A Detailed Delivery Business Case is then developed for schemes approved at stage one of the process.

5.4 Schemes are classed as Maintenance of Assets; Acquisition of Assets; Invest to Save and Development/Enhancement of Service Provision. The bids are assessed against their contribution to corporate objectives and funding sources and categorised as Essential, Highly Desirable or Desirable.

5.5 Capital schemes subject to stage 1 approval then go onto the next stage to include a detailed plan via a completed bid form. The second stage bid form requires more detail of the capital project, detailing timescales, milestones and a Gantt chart which assists in the monitoring of the scheme throughout the project life. Key departments (other than the lead department) that are involved in delivering are identified and confirmation provided, that staff resources are available and can be committed to delivering the proposed project. The bid form also clearly identifies any external dependencies the project has that could impact on the Council achieving its original project and timescales

5.6 A re-assessment of delivery and funding and the overall level of resources available is undertaken before the scheme is included in the Draft Capital Programme for consultation.

5.7 A copy of the Bid forms are attached as appendix A and B

6. Assessment of Revenue Implications of Capital Investment

6.1 In the interests of properly evaluating the affordability of a project, the revenue implications of capital bids are also included on the bid form in order to:

- Evaluate the overall financial business case of the capital project (revenue and capital cost/savings aspects),
- Enable corporate, joined-up, forward financial and service planning.

6.2 The Business Case form also requires the revenue implications of each scheme to be identified and profiled.

6.3 Regardless, of how the scheme is proposed to be financed, Capital financing charges based upon borrowing/ or loss of investment interest (whichever is the higher at that time) are applied to ensure the opportunity cost of the scheme is taken into account for all schemes.

6.4 In addition where the assets are used for generating rental income, whether for investment purposes or economic development, the risks to the income stream should be reflected. The risks of this type of investment include potential vacant periods, decline in market rents, non-payment by tenants or users, etc. These should be evaluated as part of the business case by including a factor for bad debt or vacancy periods, and risks relating to the project should be carefully considered and fully disclosed to decision makers.

7. Performance Measurement and Monitoring

7.1 Evaluation of projects against business objectives, target service outcomes and relevant performance indicators takes place at three stages – prior to implementation, during implementation and on completion.

7.2 The longer a project takes to come to fruition, the greater the risk is that the financial cost of the project will have increased, both due to the additional staff time spent on the project and the inflationary impact on the costs involved in bringing the asset into operation. Likewise, there is degree of correlation between the length of time a project spends in the feasibility and development stage and an increased risk of project failure or abandonment. Should a project fail for any reason, the regulations require all capital costs to be returned to revenue, which may create significant pressures, depending on the level of spend at that point

7.3 Hence the Capital Programme process includes :

- A two stage process for bids
- A Permission to spend report showing the actual delivery timetable
- Ongoing Performance Monitoring
- Post implementation review.

7.4 The Business Case/Capital Bid Proforma includes all aspects of the scheme from contribution to Objectives; Community Benefits: Performance Management; working with key departments/Partners; Dependencies : risks and finances.

7.5 Subject to approval the Bid Proforma becomes the Project Management Performance Template and flows through to completion and post implementation review.

7.6 Prior to commencement of the scheme a Permission to Spend report is submitted to Cabinet to ensure the scheme delivers in accordance with the original objectives and to confirm delivery timescales.

7.7 As a general requirement, the progress in delivering capital schemes on time, within budget and against target service outcomes will be monitored as follows:

- Budgets – on a monthly basis reported to budget managers, Leadership team and Cabinet.
- Timescales and outcomes – these are produced by budget managers on a quarterly basis and identify progress and projected timescales so the programme may be adjusted where necessary. Reports are submitted to Leadership Team as part of Managing the Business performance reporting and Cabinet together with the corrective action as appropriate

7.8 Schemes that are not committed within three years of approval are deleted from the capital programme and will require a new bid if appropriate.

7.9 Post implementation reviews of Capital Projects are undertaken to evaluate against the original submission whereas the Project Management process identifies Lessons learnt on an ongoing basis.

8. Long Term Capital Expenditure Plans

8.1 The Council faces a number of challenges going forward, one of which is the depletion of capital funds available. This affects both capital expenditure and also, both directly and indirectly, revenue net expenditure. The maintenance and replacement of income generating infrastructure / plant and equipment is essential, whereas interest earned on capital investments as resources are depleted will have a negative revenue impact. . Whilst the effect on revenue expenditure has been reduced due to the expectation of low interest rates for some considerable period this position remains a challenge in considering the Council's capital funding needs.

8.2 The Council's capital expenditure can be considered to comprise a combination of recurrent activities, annual and periodic, and those which are of an individual nature.

8.3 Based on the current capital programme the annual recurrent activity relates to two items namely :

- Waste Contract – replacement wheeled bins £0.090 million
- Disabled Facilities Grants £0.792 million

8.4 Based on indicative figures this suggests that at least £0.090 million needs to be made available annually to support such initiatives. This is apart from any new capital projects the Council considers necessary to support its strategic objectives.

8.5 The periodic activities in the main relate to the replacement of vehicles. plant and equipment.

8.6 Individual one off schemes are subject to the capital bidding process. Funding requirements cannot be identified in advance as such since other than requirements arising from the Asset Management plan each business case is likely to be unique and investment schemes by their nature opportunistic.

8.7 The Council therefore needs robust plans to meet its funding needs for future capital expenditure in the longer term. If it were to be funded by borrowing it would increase revenue costs as a result of the interest charge for the borrowing and the Minimum Revenue Provision made in accordance with the regulations made under the Local Government Act 2003. In the absence of other sources of capital this essentially means that capital costs would be funded from revenue resources over time. Borrowing must therefore be affordable.

8.8 The Council will therefore pursue an active strategy of seeking:

a) Income generating investments. It is justified to use the Council's financial resources for these provided they generate in real terms greater net income than that which would be earned by retaining monies in bank deposits, where liquidity of the funds is not necessary. Each such investment meeting that criterion would increase the overall revenue resources available to the Council.

b) Partnerships with developers where this maximises income and achievement of policy objectives as compared to the Council developing or investing alone. Such partnerships may relate to individual sites or schemes, or be more strategic and long term in nature.

c) Generation of income from sales of any valuable assets that are not being used to deliver operational services or are not delivering best value.

8.9 Once a project has been delivered successfully the cash expended is then bound in the asset. In the case of assets that are for service delivery and do not generate a rental income stream, the money invested in the asset is only recovered if and when the asset is sold at a future date. This carries inherent financial risks in that the asset may have decreased in value, depending on market conditions, or may not have increased in value sufficiently to mitigate the effects of inflation. This is justified on the basis of the service delivery in question, since the purpose of such investments is not the financial return. However such costs need to be taken into account for income generating Investments.

9 Capital Finance

9.1 As outlined above, decisions on capital investment are made in the context of limited revenue and capital resources. The Council is reliant on capital receipts and grants/contributions from third parties to fund its capital programme. Other potential funding options include prudential borrowing and direct revenue funding, although these are subject to the constraints outlined above.

Capital Receipts

9.2 Capital receipts are derived from the sale of the Council's assets, and may also include income from the principal element of finance leases where the Council is the lessor.

9.3 In most cases the Council is able to retain 100% of the capital receipt income from these asset sales, which is then available to support new capital expenditure.

Government Grants

9.4 The conditions attached to Government grants vary with each individual grant. Some may fund the full cost of a capital project, while others require the local authority to identify alternative funding for a proportion of the project costs. These grants, such as the Disabled Facilities Grant funding, are usually focussed towards Government priorities.

Third Party Grants and Contributions (including planning obligations / S106 income and Community Infrastructue Levy)

9.5 Conditions attached to third party contributions also tend to vary depending on the grant and the awarding third party. Examples include planning obligations, section 106 agreements or unilateral undertakings, contributions from local bodies (such as parish councils), contributions from national bodies (such as Sport England; Football Foundation Trust) and funding from the Heritage Lottery etc..

9.6 For both Government grants and third party grants and contributions it is important that the grant conditions are adhered to in order to manage the risk of being required to repay the grant or contribution.

9.7 The allocation of Community Infrastructure Levy (CIL) funds to infrastructure projects consists of two distinct stages

- Determination of resources available
- Bidding and allocation process

9.8 The process however needs to ensure that the allocation of resources maximises the impact of the use of such resources and is prioritised in line with the strategic objectives of the Council and its partners from a strategic medium to long term view rather than an annual first come first serve basis.

9.9 The process therefore needs to be tailored to the medium term three year rolling programme allocation process of the Council whereby a capital programme is approved for the next financial year and two subsequent years and reflects the resources available over that period.

9.10 The determination of resources will then need to reflect the level of resources available over that three year period and when resources will be able to finance the project. Financing will not be provided in advance of CIL funds being received.

9.11 The Key principles of the scheme are considered to be :

- CIL funds will be allocated based upon prioritising the schemes included on the Regulation 123 list to reflect the strategic objectives of the Council and its partners

- The allocation will attempt to maximise the impact of the CIL resources after taking into the outcomes of the schemes; the business case and match funding

- The process will involve initially a three year window with bids thereafter relating to the rolling new year of the rolling programme In year bids following approval of the three year programme will not be accepted unless it can be demonstrated that unforeseen circumstances beyond the control of the bidder have materialised .

- The process will not commence until sufficient resources are considered to be available within the three year period to enable the above objectives to be achieved.

- To aid this process the Regulation 123 list will be refreshed on an annual basis to identify the potential schemes falling due in the 3 -5 year period and the current shortfall requiring potential CIL allocations.

- Approval of any scheme will be at the risk of the bidder. The Council will not incur /reimburse any CIL related scheme expenditure until sufficient resources have been received. (Risks in this instance include the developer defaulting on the instalment schedule etc.)

Capital and Revenue Reserves

9.7 As part of its Medium Term Financial Strategy, the Council has set aside various reserves in order to make funding available for its capital programme. These include, among others, the RCCO (revenue contribution to capital outlay) and the Capital Receipts Reserve.

Revenue Contributions

9.8 Due to ongoing pressures on the revenue budget, direct revenue funding for capital is traditionally a minimal source of funding for capital projects. However, the current capital programme shown in table 2 shows £xxxxm of Direct Revenue Funding for capital covering the period 2018/19 to 2021/22.

External Borrowing (sometimes referred to as Prudential Borrowing)

9.9 Councils may borrow money from external sources such as the Public Works Loan Board (PWLB), other local authorities, etc. to fund capital expenditure under the provisions of the Local Government Act 2003, provided that it is prudent, affordable and sustainable to do so. The Council must set prudential indicators each year, which include parameters for borrowing, including the upper limits for the value, nature and maturity of the debt incurred.

9.10 As mentioned above, there is a revenue cost attached to external borrowing relating to both the interest charges payable and the statutory prudent revenue provision required under the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended).

9.11 The Council has in the past identified prudential borrowing requirements however the increase in other resources maintained by the Council has enabled this requirement to be completely offset or repaid.

Other

9.12 Other appropriate funding sources will be considered as they arise.

9.13 Sometimes it is possible to deliver a desired capital project by working with an external partner. While this is not a direct source of funding to the council, it is a potential means of delivering key capital projects for the authority.

10 Capital Funding Strategy

10.1 The Council's capital funding strategy is normally to allocate funding streams in the order outlined below, although the Council may make changes to this strategy if it is deemed necessary in order to deliver priority outcomes. In all cases any time limited funding will be applied before funding that has no time limits on its use.

- Time limited funding – funding that must be used within a specified time period will usually be applied first, assuming that there is expenditure that it can be legitimately be applied to. This is subject to any requirements for match funding.
- Ring fenced funding – Funding linked to a particular scheme or type of scheme will be allocated in full to the relevant capital project. One example is Government funding for Disabled Facilities Grants.
- Other external funding – Funding from external bodies is applied first unless the conditions attached require it to be match funded from the Council's own resources, in which case the two funding streams will be applied in tandem.
- Capital receipts (including those held in the capital receipts reserve) – This is currently the main funding source for the capital programme. Due to low interest rates since the economic crisis of 2008, use of capital receipts comes at a relatively low cost of financing, and this situation is expected to continue throughout the medium term.
- Direct Revenue Funding – This may come from revenue reserves or from contributions from revenue budgets.
- Borrowing – This as compared to other funding streams does come at a cost. Whereas other funding has an indirect cost in the loss of investment income on the funds being applied borrowing, entails both a requirement to pay interest on the loan and repay the borrowing. Due to the higher costs associated with external borrowing (statutory minimum revenue provision and interest), this form of capital funding sits low in the priority list. As a last resort borrowing may be considered where no other suitable funding source is available and a valid business case exists. . Ideally the full ongoing costs of funding the interest and MRP costs of borrowing should be fully covered by income or cashable savings generated by the asset purchased.

Where this is not the case members must be aware of the long term commitment that the decision to borrow places on the revenue budget and have confidence that the service delivery potential of the capital investment merits the associated revenue growth. These costs must be affordable in the context of the Medium Term Financial Plan.

11 Governance Arrangements

Annual Capital Programme Approval

11.1 Governance arrangements for the Capital Programme are set out in Part 4 Rules of Procedure but more specifically in Part 4 Section 32 Financial Regulations paragraph 4.1 to 4.9 of the Councils Constitution.).A flow chart of the approval process is attached as Appendix C.

11.2 Bids (Business Cases) for new schemes for the following year's three year capital programme are invited alongside revisions to existing schemes during the summer each year. The nature and profile of the expenditure and funding plans are identified at this stage. The consideration of requirements for the next three years enables priorities to be determined for both revenue and capital items after taking into account available resources.

11.3 The Capital Programme is considered by Cabinet in January each year and updated and approved by Council in February each year as part of the Medium Term Financial Plan.

11.4 Additional projects may be added, or amendments to existing schemes may be made, to the Capital Programme during the financial year on an exception basis with approval of Council. This may be by means of a budget update report or a specific report seeking approval for one or more new projects or changes to/deletion of existing projects.

11.5 Should it be necessary, provisions for urgent decisions set out in the Constitution may be used to amend the Capital Programme.

Decision Making

11.6 When making decisions in respect of capital expenditure the Council will take account of stewardship of public funds, value for money, prudence, affordability, and sustainability.

Monitoring Arrangements

11.7 Monitoring arrangements for the Capital Programme are set out as part of the Performance Management Regime described earlier.

11.8 It is the duty of every Manager to monitor and regulate the financial performance of their area of responsibility during the currency of each estimate period .

11.9 The capital and revenue monitoring position will be reported to budget managers, Leadership team and Cabinet each month.

Risk Management

11.10 All large capital projects are managed under the council's Project Management regime, which incorporates risk identification and risk management.

11.11 For all capital projects, project managers update financial forecasts on a quarterly basis identifying any areas subject to risk of overspend, underspend, or slippage.

11.12 There is also a degree of funding risk in the Capital Programme, where reliant on grant funding claims. Should claims not be completed or targets not met in accordance with planned objectives, this risk would need to be mitigated, for example by reducing, or reviewing the planned expenditure.

12 Overview of Asset Management Planning

12.1 The Corporate Asset Management Plan sets out three main priorities, which are:

- To review and where appropriate rationalise the portfolio the Council holds, both freehold and leasehold, so as to maximise receipts and minimise property costs.
- Ensure that those assets that are retained for service delivery are well maintained, suitable, accessible, safe and fit for purpose.
- To use the property portfolio to assist with the regeneration and economic development of the District and to support health and well being outcomes.

12.2 These themes and the strategic priorities influence the way the Council involves property at a strategic level as well as day-to-day property management activities.

12.3 As at 1 April 2018 the Councils General Fund assets had a total value of approximately £60.147 million as follows:

Fixed Assets		
	31.03.18	31.03.17
	£	£
Property, Plant and Equipment		
Other Land & Buildings	54,563,978.19	51,425,010.03
Community Assets	319,055.00	319,055.00
Vehicles, Plant & Equipment	496,515.22	560,371.21
Assets under construction	1,654,448.09	360,668.10
Leased Vehicles	1,106,339.02	-
	58,140,335.52	**52,665,104.34**
Investment Properties		
Investment Properties	**1,675,000.00**	**1,675,000.00**
Intangible Assets		
Intangibles	**35,239.67**	**44,049.67**
Heritage Assets		
Heritage Assets	**296,358.00**	**296,358.00**
Total Fixed Assets	**60,146,933.19**	**54,680,512.01**

12.4 The Council has a relatively small portfolio of public buildings and is unlikely to generate significant resources from disposal. However, property, land and buildings are reviewed on an ongoing basis which will:-

- Identify opportunities to rationalise properties/land
- Look at ways of reducing costs
- Maximise efficient use of buildings/land
- Identify future requirements
- Justify why surplus/property land is held
- Challenge the holding of investment property land

The Public Building's Manager and the relevant Head of Service will review all building assets. This review will examine issues of sufficiency and suitability and will utilise consultative exercises in relation to those criteria.

Disposal of small parcels of land is delegated to the Legal section but any major disposals would be initially considered by the Leadership Team, for approval, and subsequently to the appropriate Cabinet Member.

13 Commercial Activity

13.1 The Council does not currently have any specific areas of commercial activity. It does however have a number of properties which it holds for other business objectives which it leases out and receives a rental income for. In particular the Council seeks to make the most effective and efficient use of its Civic Centre with a number of public sector partners letting floor area on a number of floors.

13.2 The Council is not averse to investing into commercial activities but these would need to be on the basis of a sound invest to save business case after considering the key aspects of affordability, sustainability risk and investment returns generated.

Appendix A

Outline Stage 1 Capital Bid Proforma

Budget Bid Title:

Service Area:

Lead Officer:

Total Bid:

External Funding Contribution: YES / NO

Brief Project Description

Contribution to Corporate Objectives

Please outline how the proposal supports strategic priorities and describe how it contributes towards the themes of the Corporate Plan. Delete as appropriate the priorities that are addressed:-

Promoting Prosperity	YES / NO
Community Wellbeing	YES / NO

Lead Officer Comments

Financial Summary

	2019/20	2020/21	2021/22 onwards	Estimated Total Cost
Project costs (provide details of key areas of spend)	£	£	£	£
External Funding Sources: Grants & contributions				
Project costs (net of external funding)	£	£	£	£
Ongoing revenue costs (if applicable)				

Other financial issues

For externally funded projects – please provide details of the funding sources and whether or not the funding is guaranteed.
For Capital Schemes – please provide details of ongoing revenue costs.
For invest to save schemes – details of the future revenue streams and the payback period

Head of Service Approval / Comments

Appendix B

Stage 2 Capital Bid proforma

Deadline for submission: - *******

Introduction

The Council continues to face a challenging financial situation over the next four years and resources will continue to be tight. However, the Cabinet has indicated that it will give careful consideration to budget bids, particularly "invest to save" projects where spending now can generate additional income in the future or can reduce future revenue costs.

Process

Budget bids for additional service initiatives/improvements that may be **revenue or capital** in nature must be set out in the attached business case pro-forma and returned electronically to Alison Kendall (alisonkendall@cannockchasedc.gov.uk) by no later than **********, if they are to be considered for inclusion in the 2018/19 Budget or the Capital Programme 2018/19 to 2020/21.

Bids will initially be categorised as "Essential", "Highly Desirably" and "Desirable if resources allow". Where bids can be justified on an "invest to save" basis, the higher its relative ranking is likely to be.

Bids will also of course be assessed to establish how well they contribute to the Council's priorities.

Please be concise, but remember that it is important that the business case provides enough detail for the Cabinet to be able to assess the proposal's impact on the community and the potential to pay for itself in financial terms.

The bids will require sign off by all departments prior to submission as detailed below.

Attachments – Checklist

Detailed Timetable / Milestones
Gantt Chart of projects requirement identified from stage 1

Bid Cleared by

Department	**Officer**	**Date**
Finance	____________________	____________________
Human Resources	____________________	____________________
Legal	____________________	____________________
Property Services	____________________	____________________

Budget Bid Title:

Service Area:

Lead Officer:

Brief Project Description:

TOTAL BID:	**CAPITAL**	**REVENUE**

1. CONTRIBUTION TO THE COUNCIL'S PRIORITIES

Please outline how the proposal supports strategic priorities and describe how it contributes towards the themes of the Corporate Plan. Tick below the priorities that are addressed:-

☐ Promoting Prosperity (1) ☐ Community Wellbeing (2)	**Lead Officer comments:**

Strategic Objectives

1. Establishing McArthurGlen Designer Outlet Cannock as a major visitor attraction and maximising the benefits it will bring to the District
2. Increasing housing choice
3. Creating a positive environment in which businesses in the District can thrive.
4. Increasing the skill levels of residents and the amount of higher skilled jobs in the District
5. Creating strong and diverse town centres to attract additional customers and visitors
6. Increasing access to employment opportunities
7. Commencing regeneration of the Rugeley Power Station site

2. COMMUNITY BENEFIT

Will the proposal contribute towards community need which has been identified and evidenced?

Lead Officer Comments:

3. PERFORMANCE MANAGEMENT
(a) Please provide a timetable and project milestones, describing how the milestones will be monitored, managed and reported .
(b) highlight proposals for controlling the factors that could cause delay or cost overrun.
(c) Provide details of how the impact of the project will be measured in terms of improved service delivery or use of assets.

Lead Officer Comments.

4. WORKING WITH OTHER KEY COUNCIL DEPARTMENTS
(a). please describe the extent to which key departments will be required to contribute to the project and meeting proposed timescales (for example property services)

Lead Officer comments

(4b). KEY DEPARTMENTS IDENTIFIED – if key departments are identified in section 4a above, the said department to please complete 4b clarifying if they have recourses to contribute to the project as proposed above and to meet timescales set out.

Key Department Lead Officer comments

5. WORKING WITH PARTNERS
Please describe the extent to which partners will be involved in the project and the percentage of the gross project cost that will be funded by partners. Please include details of exit strategy if applicable.

Lead Officer comments

6. DEPENDENCIES/ EXTERNALITIES
Please describe the extent to which the project is dependent on a partner or externality to meet the proposed scheme timescales. (For example the County Council or land being available?) What will be the impact if such dependencies are delayed?

Lead Officer comments

7. LEGAL ISSUES

Please identify the legal implications of taking and not taking the proposed course of action.

Lead Officer comments

8. FINANCIAL ISSUES

Please identify: -

- Project costs / savings (incl. cost of feasibility studies);
- any external financial contributions towards the project;
- the phasing of expenditure for capital projects;
- the total cost of project.

FINANCIAL SUMMARY

	2018/19	**2019/20**	**2020/21 onwards**	**Estimated Total Cost**
Project costs (provide details of key areas of spend)	£	£	£	£
External Funding Sources: Grants & contributions				
Project costs (net of external funding)	£	£	£	£
Ongoing revenue costs (if applicable)				

Other financial issues

For externally funded projects – please provide details of the funding sources and whether or not the funding is guaranteed.
For Capital Schemes – please provide details of ongoing revenue costs.
For invest to save schemes – details of the future revenue streams and the payback period.

Lead Officer comments:

9. RISK ASSESSMENT

Please identify the key risks for the scheme.

Description of Risk

10. HEAD OF SERVICE ENDORSEMENT

Head of Service comments:

Please return to Alison Kendall alisonkendall@cannockchasedc.gov.uk by no later than *********.**

Appendix C

Capital Approval Process flow chart

Oct	Stage 1 Bid Process to get proposed project into the capital programme (not budget) – service complete bid proforma and submit to Finance
Oct	Bids reviewed by Leadership Team & Cabinet against Council Priorities
Nov	Cabinet give initial approval to develop stage 2 bid
Dec	Stage 2 Bid Process form completed to get proposed project into the capital programme (not budget) – service complete bid proforma and submit to Finance
Jan	Draft Capital Programme submitted to Cabinet
Feb	Programme submitted to Council for approval as part of the budget process*
	`Permission to spend` report to Cabinet before inclusion in Capital budget

***Exceptional Circumstances**: Additional schemes may be added to the programme throughout the year if Cabinet approval is sought.