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Audit Committee Agenda

Wednesday, 23 January 2019 at 6.00 pm

Council Chamber, Muriel Matters House, Breeds Place, Hastings, TN34 3UY.
Please enter the building via the Tourist Information Centre entrance.

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AUDIT COMMITTEE

15 NOVEMBER 2018

Present: Councillors Rankin (Chair), Levane (Vice-Chair), Chowney and Charman

Apologies for absence were notes for Councillor Berelson

34. APOLOGIES FOR ABSENCE

Absence was noted for Councillor Berelson.

35. DECLARATIONS OF INTEREST

None.

36. MINUTES OF THE MEETING HELD ON 31 JULY 2018

RESOLVED – (unanimously) that the minutes of the meeting held on 31 July 2018 be approved and signed by the Chair as a true record.

37. RISK ASSESSMENT OF A NO DEAL BREXIT

The Director of Operational Services presented his comprehensive report to inform the Audit Committee of the risk assessment made of a No Deal Brexit. The report sets out a risk assessment to those risks that might impact on Hastings Borough Council.

Hastings is:-

- An economy which relies heavily on tourism, particularly from overseas, with the majority of these from EU countries, and as part of this, foreign language schools.
- Home to a high profile under ten metre fishing fleet
- Significantly higher levels of poverty and ill health than the average.
- Predominantly a small business economy.
- A substantial care industry
- Traditional success in obtaining European funding for economic, cultural and social inclusion projects.

He referred to the risks addressed in the appendices to the report.

The Director of Operational Services said that HBC was currently in receipt of EU funds e.g. CHART and that he was not sure what funding would replace it. He questioned whether capital funding and/or prosperity funding would be provided.

Councillor Levane referenced mitigation actions such as partnerships and forward plans. The Director of Operational Services explained that it was difficult to plan at this stage. He said that there are systems for dealing with emergencies and the Council is as prepared as it can be.

Councillor Levane acknowledged the importance of the links with the language schools and asked if they will be maintained. The Director of Operational Services noted the risks and said if necessary, they would talk with other local authorities and engage the Marketing and Major Projects Manager in discussions with the Language Schools.

Councillor Rankin asked if manufacture (the supply chain) will affect future relationships. The transition deal includes no details on the future relationship with EU. The Director of Operational Services said they had not undertaken an in-depth analysis at this time of how the council may or may not be affected but would be keeping the situation under review.

Councillor Chowney proposed a motion to approve the report as set out in the resolution below, which was seconded by Councillor Levane.

> **RESOLVED (unanimously) that the Audit Committee accepts the report.**

The reason for the decision was: Increasing public speculation in the recent past that there might be a higher risk of a No Deal Brexit and so the council needs to demonstrate that it is prepared for that possibility.

38. CHIEF AUDITOR'S SUMMARY AUDIT AND RISK REPORT

The Chief Auditor presented his report to inform the Audit Committee of the key findings from the Council Tax, Creditors and Petty Cash audits.

The purpose is to ensure the council has the right processes and procedures for monitoring each agreement and ensuring complete accurate and timely receipt of all income due.

The review had found that the controls in place were good and worked effectively. No significant audit concerns were raised.

Councillor Levane stated that Council Tax achieved a 95.1% in-year collection for 2017/18 and sought clarification on why the level of Council Tax debt was rising. The Assistant Director Financial Services & Revenues said that they had lost a key member of staff from the recovery team and had changed how they operate benefit/council tax. He explained that in some cases debt had been accumulated going back many years; more recently they had removed cases from the bailiffs and had reduced the number of cases going to court. The collection rate he said is predicted to be 98.6%. The surplus will be set when the budget is fixed in 2019.

Councillor Chowney queried the term “cash tin” as referred to in the report. The Assistant Director Financial Services & Revenues Peter Grace assured him that there was minimal cash on premises which is always safely secured.

Councillor Charman asked if there was a more regular process for reconciliation, since it was last undertaken in 2011. The Chief Auditor said it was a risk based assessment, which is rationalised when a discrepancy occurs.

Councillor Rankin referred to new policy relating to the use or administration of petty cash. The Chief Auditor confirmed that they had agreed an extra detailed level of guidance. Writing the policy will follow after the budget has been completed.

Councillor Chowney proposed a motion to approve the report as set out in the resolution below, which was seconded by Councillor Charman.

> **RESOLVED (unanimously) that the Audit Committee accepts the report.**
>
> The reason for the decision was: To monitor levels of control within the organisation.

39. ANNUAL AUDIT LETTER 2017/2018

The Chief Auditor presented his report to the Committee to formally confirm that the Annual Audit Letter 2017/2018 has been noted by the Audit Committee.

The purpose of the Annual Audit Letter 2017/18 was to consider the matters raised by the external auditors (BDO). This was circulated to the Audit Committee on 31st August 2018 and posted to the Council's website for the public and members to view.

Councillor Levane proposed a motion to approve the report as set out in the resolution below, which was seconded by Councillor Charman.

> **RESOLVED (unanimously) that the Audit Committee note the report.**
>
> The reason for the decision was: The Annual Audit Letter is for all councillors and posted to the Council's website. It is of particular interest to those charged with governance.

40. NOTIFICATION OF ANY ADDITIONAL URGENT ITEMS (IF ANY)

None.

(The Chair declared the meeting closed at. 6.50 pm)

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Agenda Item 4

Agenda Item No:

Report to: CAP
Cabinet

Date of Meeting: 17 December 2018
7 January 2019

Report Title: **Treasury Management - Mid Year Report 2018-19**

Report By: Peter Grace
Chief Finance Officer

Purpose of Report

This report advises the Cabinet of the Treasury Management activities and performance during the current year. It provides the opportunity to review the Treasury Management Strategy and make appropriate recommendations to Council to take account of any issues or concerns that have arisen since approving it in February 2018.

Recommendations

1. **Cabinet agree the Mid Year report.**

Reasons for Recommendations

The Code of Practice on Treasury Management requires, as a minimum, a mid-year review of the Treasury Management Strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved (February 2018). It is a requirement of the Code of Practice that the Mid-year review is considered by Cabinet and full Council.

The Council has increased its levels of income generation and this entails new borrowing over potentially long periods, with consequent risks in terms of asset valuations, credit worthiness, cash and reserve fund availability. Such risks cannot be considered in isolation of all the issues facing the Council now and potentially in the future.

Background

1. The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure in combination with funding from reserves. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

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 needs of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

3. Accordingly, treasury management is defined as:

   "The management of the local authority's 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."

Introduction

4. The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017) was adopted by this Council In February 2018.

5. The primary requirements of the Code are as follows:
   - Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
   - Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
   - Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.
   - Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
   - Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Audit Committee.

6. This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

   - An economic update for the first part of the 2018/19 financial year;

- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure (prudential indicators);
- A review of the Council's investment portfolio for 2018/19;
- A review of the Council's borrowing strategy for 2018/19;
- A review of any debt rescheduling undertaken during 2018/19;
- A review of compliance with Treasury and Prudential Limits for 2018/19.

7. The Committee will need to determine whether there are any issues that require the amendment of the Council's Treasury Management Strategy or Investment Policy and that they therefore wish to draw to the attention of Council. The Audit Committee will consider a similar report at their meeting on 23 January 2019.

Economic Update (at 30 September 2018)

8. UK. The first half of 2018/19 saw UK economic growth post a modest performance, but sufficiently robust for the Monetary Policy Committee, (MPC), to unanimously (9-0) vote to increase Bank Rate on 2nd August from 0.5% to 0.75%. Although growth looks as if it will only be modest at around 1.5% in 2018, the Bank of England's August Quarterly Inflation Report forecast that growth will pick up to 1.8% in 2019, albeit there were several caveats – mainly related to whether or not the UK achieves an orderly withdrawal from the European Union in March 2019.

9. Some MPC members have expressed concerns about a build-up of inflationary pressures, particularly with the pound falling in value again against both the US dollar and the Euro. The Consumer Price Index (CPI) measure of inflation rose unexpectedly from 2.4% in June to 2.7% in August due to increases in volatile components, but is expected to fall back to the 2% inflation target over the next two years given a scenario of minimal increases in Bank Rate. The MPC has indicated Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track. Financial markets in September were pricing in the next increase in Bank Rate for the second half of 2019.

10. As for the labour market, unemployment has continued at a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high in July, 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 2.9%, (3 month average regular pay, excluding bonuses) and to a one month figure in July of 3.1%. This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 0.4%, near to the joint high of 0.5% since 2009. (The previous high point was in July 2015.) Given the UK economy is very much services sector driven, an 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 were 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. However, the MPC will need to tread cautiously before increasing Bank Rate again, especially given all the uncertainties around Brexit.

11. 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. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

12. 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, but also an upturn in inflationary pressures. With inflation moving towards 3%, the Fed increased rates another 0.25% in September to between 2.00% and 2.25%, this being four increases in 2018, and indicated they expected to increase rates four more times by the end of 2019. The dilemma, however, is what to do when the temporary boost to consumption wanes, particularly as the recent imposition of tariffs on a number of countries' exports to the US, (China in particular), could see a switch to US production of some of those goods, but at higher prices. Such a scenario would invariably make any easing of monetary policy harder for the Fed in the second half of 2019.

13. **EUROZONE.** Growth was unchanged at 0.4% in quarter 2, but undershot early forecasts for a stronger economic performance in 2018. In particular, data from Germany was 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 2% for 2018, the horizon is less clear than it seemed just a short while ago.

14. 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.

15. **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.

Interest rate forecasts

16. The Council's treasury advisor, Link Asset Services, provided the following forecast in September:

Interest rate Forecasts – September 2018 to March 2021

Link Asset Services Interest Rate View											
	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
3 Month LIBID	0.75%	0.80%	0.80%	0.90%	1.10%	1.10%	1.20%	1.40%	1.50%	1.60%	1.60%
6 Month LIBID	0.85%	0.90%	0.90%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%
12 Month LIBID	1.00%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.60%	1.70%	1.80%	1.80%
5yr PWLB Rate	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
10yr PWLB Rate	2.40%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%

17. The flow of generally positive economic statistics after the end of 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, to 0.75%. However, the MPC emphasised again, 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 they declined to give a medium term forecast. Link Asset Services do not think that the MPC will increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. They also feel that the MPC is more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, the cautious pace of even these limited increases is dependent on a reasonably orderly Brexit.

The Council's Treasury Position – 30 September 2018

Borrowing

18. The Council's debt and investment position at the 30 September 2018 was as follows:

Table 1 – Borrowing

Debt	1 April 2018 Principal	Rate	Maturity	30 Sept 2018 Principal	Rate
PWLB	£7,500,000	4.80%	2033	£7,500,000	4.80%
PWLB	£2,000,000	0.61% (Var)	2019	£2,000,000	0.74% (Variable)
PWLB	£909,027	3.78%	2044	£909,027	3.78%
PWLB (Optivo)	£1,788,235	3.78%	2044	£1,788,235	3.78%
PWLB (FT) (Annuity)	£243,901	1.66%	2026	£229,583	1.66%
PWLB	£1,000,000	2.92%	2056	£1,000,000	2.92%
PWLB	£1,000,000	3.08%	2046	£1,000,000	3.08%
PWLB	£1,000,000	3.01%	2036	£1,000,000	3.01%
PWLB	£1,000,000	2.30%	2026	£1,000,000	2.30%
PWLB	£2,000,000	2.80%	2054	£2,000,000	2.80%
PWLB	£1,000,000	2.42%	2028	£1,000,000	2.42%
PWLB	£2,000,000	2.53%	2057	£2,000,000	2.53%
PWLB	£2,000,000	2.50%	2059	£2,000,000	2.50%
PWLB	£2,000,000	2.48%	2060	£2,000,000	2.48%
PWLB (Annuity)	£7,221,917	2.53%	2057	£7,168,163	2.53%
PWLB (Annuity)	£8,350,000	2.72%	2057	£8,291,664	2.72%
Total Debt	**£41,013,080**	**3.01%**		**£40,886,672**	**3.01%**

19. At the 30 September 2018 the Council had debt amounting to £40.89m (PWLB debt).

20. The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend.

21. Part of the Council's treasury activities is to address the funding requirements for the Council's borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public

Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

22. The Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

23. The total CFR can also be reduced by:

    - the application of additional capital financing resources (such as unapplied capital receipts); or
    - charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

24. The Council's 2018/19 MRP Policy was approved as part of the Treasury Management Strategy Report for 2018/19 by Council in February 2018.

25. The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes leased items on the balance sheet, which increase the Council's borrowing need (albeit no additional borrowing is actually required against such items).

Table 2 CFR: General Fund	**2017/18 Actual £000's**	**2018/19 Revised Estimate £000's**
Opening balance	30,078	39,493
Add unfinanced capital expenditure	11,160	23,973
Less Repayments (LAMS)	-1,028	0
Less MRP	-717	-1,304
Closing balance	39,493	62,162

26. Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

27. The Council's long term borrowing must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2018/19 plus the expected changes to the CFR over 2019/20 and 2020/21 from financing the capital programme. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2018/19.

Table 3 Internal Borrowing	2017/18 Actual £000's	2018/19 (Est) As at 30.9.18 £000's
Capital Financing Requirement	39,493	62,162
External Borrowing	41,013	40,887
Net Internal Borrowing	**(1,520)**	**21,275**

28. The table above highlights the Council's gross borrowing position against the CFR, which provides an indication of affordability for the Council. The Council has complied with this prudential indicator.

Investments in 2018-19

29. The table below provides a snapshot of the investments and deposits held on 30 September 2018. The level of investments can fluctuate significantly on a day to day basis, given the level of funding received, precept payments, grants payable and receivable, salaries and wages, etc.

Table 4 – Investments and deposits

Counterparty	Rate/ Return	Start Date	End Date	Principal	Term
Australia & NZ BCG Ltd	0.90%	29/08/2018	29/11/2018	5,000,000	Fixed
Birmingham City Council	1.05%	30/08/2018	28/08/2019	3,000,000	Fixed
Blackpool Borough Council	0.80%	28/09/2018	28/01/2019	2,000,000	Fixed
Blaenau Gwent CBC	0.50%	25/06/2018	03/10/2018	2,000,000	Fixed
DBS Bank Ltd London	0.77%	18/09/2018	18/10/2018	3,000,000	Fixed
Eastleigh Borough Council	0.65%	24/08/2018	25/02/2019	5,000,000	Fixed
London Borough of Harrow	0.75%	10/09/2018	10/04/2019	2,000,000	Fixed
Barclays Corporate	0.40%			2,998,426	Call
NAT West	0.05%			1,720	Call
Santander	0.40%			505	Call
			Total	**25,000,651**	

30. As at 30 September 2018 three longer term loans are outstanding to other organisations.

Table 5 – Loans to Other Organisations

3rd Party Organisations	Rate/ Return (%)	Start Date	End Date	Principal £	Term
Amicus /Optivo	3.78	04/09/2014	02/09/2044	1,788,235	Fixed
The Foreshore Trust	1.66	21/03/2016	20/03/2026	229,583	Annuity
The Source	2.43	17/12/2015	16/12/2024	22,763	Annuity
			Total	2,040,581	

31. Borrowing from the PWLB was taken to fund the Amicus Horizon (now Optivo) loan (£1,788,235- Maturity loan) and the loan to the Foreshore Trust (£300,000 originally borrowed – Annuity loan); these correspond to PWLB loans in Table 1 above.

32. The overall investment performance for the first 6 months of 2018/19 provided an average return of 0.78% (2017/18 0.35%).

33. The total interest receivable for the first 6 months is £82,944 (2017/18 £45,000) These figures exclude the interest receivable in respect of the three loans to other organisations and income from the Property Fund investment.

The Council's Capital Position (Prudential Indicators)

34. This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

Prudential Indicator for Capital Expenditure

35. This table shows the revised estimates for capital expenditure for 2018/19.

Table 6 : Forecast Capital Expenditure (Net)

Capital Expenditure (Net) by Service	2018/19 Original Estimate (net) £'000	2018/19 Revised Estimate (net) £'000
Corporate Resources	20,907	17,180
Operational Services	7,784	6,793
Total Capital Expenditure	28,691	23,973

36. Capital Expenditure – Financing
The new Capital schemes, approved since the budget, will generally be financed by borrowing, unless Capital receipts from the sale of assets are available.

37. The Cabinet approved the Income Generation Strategy on the 11 September 2017. This includes Capital expenditure of £50m spread over a period of 3 years being financed from borrowing in the absence of other resources..

38. The larger schemes in the capital programme which are expected to require financing in 2018/19 from borrowing are:-

    (1) Commercial property purchases estimated at £16,595m

    (2) Loans to Hastings Housing Company Ltd estimated at £5.7m

    (3) Country Park Visitors Centre estimated at £163,000

    (4) ERP system estimated at £465,000

    (5) Temporary accommodation estimated at £620,000

39. Impact on the prudential indicators

    The Capital Financing Requirement has increased significantly over the last 18 months. It is expected to reach some £75m by 2021/22 (based on the capital programme approvals to date). The position at 30 September 2018 is shown in Table 3 above, and highlights that there was an underlying financing requirement of some £21.275m.

40. Compliance with the limits in place for borrowing activity.

    The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed

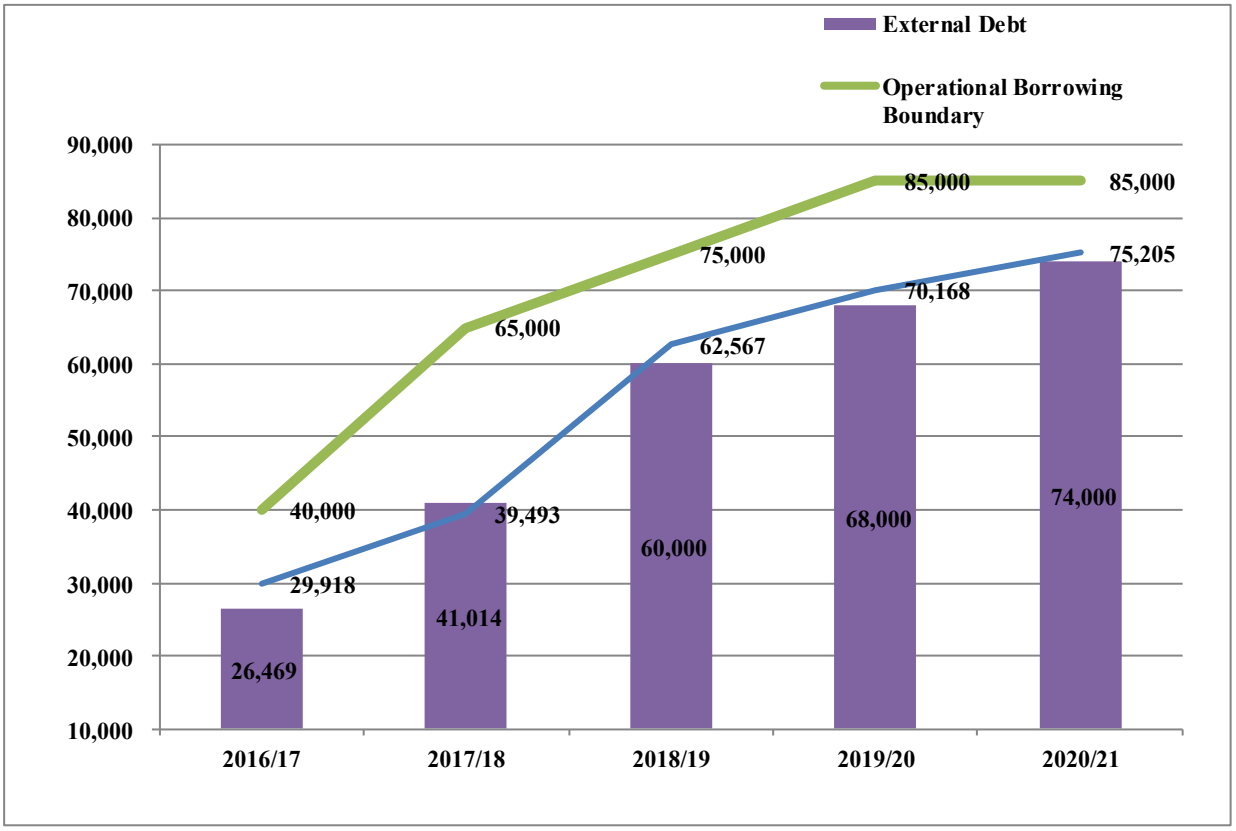
the total of CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and next two financial years.

41. A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

42. In February 2018 the Authorised limit was increased by £10m to allow for temporary borrowing for cash flow purposes, lease liabilities and any debt rescheduling or guarantees agreed by Council. The Operational Boundary limits remained unaltered.

PRUDENTIAL INDICATOR	2018/19	2019/20	2020/21
TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£'000	£'000	£'000
Authorised Limit for external debt -			
borrowing	£85,000	£95,000	£95,000
other long term liabilities	£5,000	£5,000	£5,000
TOTAL	£90,000	£100,000	£100,000
Operational Boundary for external debt -			
borrowing	£75,000	£85,000	£85,000
other long term liabilities	£ 5,000	£ 5,000	£ 5,000
TOTAL	£80,000	£90,000	£90,000

18. **Graph: Estimated CFR/ Debt and Operational Debt Boundary at year end**



Borrowing Strategy

43. The Council had some £40.89m of PWLB debt at 30 September, and could potentially borrow up to a level of £62.5m (estimated CFR at 31 March 2019). This figure does not take account of any new capital spending in future years which could potentially be funded by new borrowing. It should be noted that a £2m variable rate PWLB loan is due to be repaid in January 2019. Additional borrowing has taken place in December 2018 (further £6m as at 12 December 2018)

44. The interest rate forecasts from the Council's treasury advisers identify that it is unlikely that the base rate will increase until September 2019. Borrowing rates available increased by some 10bps from the beginning of April until the end of September. Whilst the borrowing rates are attractive on a historical basis the difference between the return on investment and the cost of borrowing remains – the additional revenue cost falling on the Council taxpayer.

45. New borrowing has been taken over the last 18 months, to not only take advantage of the historically low rates, but to ensure that the Council's own reserves are cash backed should restrictions be placed on the amount and levels of borrowing that authorities can undertake (particularly from the PWLB) and a balanced view will continue to be taken.

46. The plans for income generation require substantial new borrowing by the Council in the future and play a part in the consideration as to when to borrow and the level of internal borrowing. Given the historically low interest rates and the ability of the Council to look at other investment opportunities which are providing higher returns than the cost of borrowing e.g. property funds, there has been a much stronger case for reducing the level of internal funding in order to ensure a lower level of borrowing risk in the future.

Debt Rescheduling

47. The Council keeps under review the potential for making premature debt repayments in order to reduce borrowing costs as well as reducing counterparty risk by reducing investment balances. However, the cost of the early repayment premiums that would be incurred and the increase in risk exposure to significantly higher interest rates for new borrowing, continue to make this option unattractive. When reviewed on the 27 September 2017 the early repayment cost of the £7.5m (4.8%) PWLB loan, maturing in 2033, would amount to £3,177,343. No debt rescheduling is being contemplated at present as the interest rate differences are similar to that of a year ago.

Investment Strategy

48. Priority is given to security and liquidity of investments in order to reduce counterparty risk to the maximum possible extent.

49. The Council has a limit of £5m with any one institution (rated A or above, supported by Government, and given a blue (12 month) rating by Link Asset Services). This generally represents a level of up to 15% of the investment portfolio with any one institution or group at any one time. It is also necessary, at times, to invest sums of this size in order to attract the larger institutions which have the higher credit ratings.

50. The Eurozone and Brexit have led to a number of downgrades to banks' credit ratings, making it increasingly difficult to spread investments across a number of institutions. The Chief Finance Officer has the authority to amend the limits if necessary to ensure that monies can be placed with appropriate institutions.

51. The net cost to the Council of borrowing, investment interest and fees will be reviewed as part of the budget setting process.

Property Fund

52. It was agreed in February 2017 that the option for diversification of some of the investments into a property fund be undertaken with CCLA in the sum of £2m. The investment being in respect of the Council's reserves that are not required for a period of at least 5 years in order that any fall in values and entry costs into such funds can be covered. The £2m was invested in April 2017 and the performance is detailed below:

CCLA - LA's Property Prices and Dividend yields						
End of	**Aug-18**	**Jun-18**	**Mar-18**	**Dec-17**	**Sep-17**	**Apr-17**
Offer Price p	324.40	324.10	322.40	319.44	314.48	307.19
Net Asset Value p	303.89	303.61	302.01	299.24	294.60	287.77
Bid Price p	299.18	298.90	297.33	294.60	290.03	283.31
Dividend* on XD Date p		3.28	3.21	3.38	3.34	
Dividend* - Last 12 Months p	13.64	13.64	13.70	13.71	13.13	13.19
Dividend Yield on NAV %	4.49	4.49	4.54	4.58	4.46	4.58
Fund Size £m	1,046.5	1,027.7	976.3	930.8	836.2	710.2

53. The dividend yield is around 4.9% on the net asset value, which results in quarterly cash dividends of around £21,000. Full year dividends are estimated at around £84,000.

54. Capital Value

Units (651,063)	**Aug-18**	**Jun-18**	**Mar-18**	**Dec-17**	**Sep-17**	**Apr-17**
Mid Market Price(£)	1,978,515.35	1,976,692.37	1,966,275.37	1,948,240.92	1,918,031.60	1,873,564.00
Bid Price (£)	1,947,850.28	1,946,027.31	1,935,805.62	1,918,031.60	1,888,278.02	1,844,526.59

The Capital value increased by some 4.95% per annum between April 2017 and March 2018 and that trend is currently continuing. It is important that this is continued to be viewed as a longer term investment (5 years plus) if the original Capital value is to be recovered.

Compliance with Treasury Limits

55. During the financial year to date there have again been a few occasions where it has not been possible to find institutions to take the Council's money given the strict criteria in place. In these circumstances the Council will place money in its existing call accounts and this can thus result in the investments exceeding general limits. Where such an occasion looks likely to arise the approval of Chief Finance officer is required in compliance with the Council's Treasury Management Practices. The Prudential Indicators have been complied with - reproduced in Appendix 1 for reference.

Financial Implications

56. The Council's 2018/19 budget estimated a 0.50% return on investments. With the 0.25% increase in Bank Base Rate in August 2018 interest rates on investments rose

slightly and the Council's actual average rate of return to 30 September was 0.78% (excluding Property Fund and other loans made).

Future Changes

57. The Treasury Management Code of Practice (Cipfa) and the Prudential Code for Capital Finance were revised in late 2017/18, and the requirement for a new strategic planning document introduced – the "Capital Strategy" which seeks to bridge the perceived gaps in understanding between the Capital programme, funding thereof and Treasury Management. This will need to be agreed by full council prior to the start of 2019/20.

58. The 2019/20 Treasury Management Strategy suite of reports will be considered by the Audit Committee on the 23 January 2019 and thereafter considered by Cabinet and then by full Council on 20 February 2019 in conjunction with the budget papers.

Risk Management

59. The additional risks that the Council is taking on with commercial property, housing and energy investments will need to be considered in the context of the totality of risk that the Council faces e.g. Pier claims, Business Rate claims and appeals, robustness of income streams, economic downturns, etc. Where there is more risk and volatility in income streams the Council will need to ensure that it maintains sufficient cash backed reserves to ensure the Council's ability to deliver key services is not jeopardised.

60. The Council spreads its risk on investments by limiting the amount of monies with any one institution or group and limiting the timeframe of the exposure. In determining the level of the investment and period the Council considers formal credit ratings (Fitch) along with its own advisers (Link Asset Services) ratings advice.

61. The security of the principal sum remains of paramount importance to the Council.

Wards Affected

Ashdown, Baird, Braybrooke, Castle, Central St. Leonards, Conquest, Gensing, Hollington, Maze Hill, Old Hastings, Ore, Silverhill, St. Helens, Tressell, West St. Leonards, Wishing Tree

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Area(s) Affected

Central Hastings, East Hastings, North St. Leonards, South St. Leonards

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Policy Implications

Please identify if this report contains any implications for the following:

Equalities and Community Cohesiveness	No
Crime and Fear of Crime (Section 17)	No
Risk Management	Yes
Environmental Issues	No
Economic/Financial Implications	Yes
Human Rights Act	No
Organisational Consequences	No
Local People's Views	No
Anti-Poverty	No

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Agenda Item 5

Agenda Item No:

Report to: **Audit Committee**

Date of Meeting: 23 January 2019

Report Title: **Treasury Management, Annual Investment Strategy and Capital Strategy 2019/20**

Report By: Peter Grace

Assistant Director – Financial Services and Revenues
(Chief Finance Officer)

Purpose of Report

To consider the draft Treasury Management Strategy, Annual Investment Strategy, Minimum Revenue Provision (MRP) Policy and Capital Strategy and make recommendations to Cabinet and full Council as appropriate. This is to ensure that there is an effective framework for the management of the Council's investments, cash flows and borrowing activities prior to the start of the new financial year.

The Council has some £46.7 million of debt (as at 1 January 2019), and investments which can fluctuate between £15m and £30m in the year. The level of debt is set to increase to some £78m by 2020/21.

Recommendations

Audit Committee recommends to Cabinet and full Council that:

1. **The Council approve the Treasury Management Strategy, Minimum Revenue Provision (MRP) Policy, Annual Investment Strategy, and the Capital Strategy.**

2. **That the strategies be updated as necessary in 2019/20 in the light changing and emerging risks, the Council's evolving future expenditure plans, along with further expected guidance on the Codes of Practice and government regulations.**

3. **That the Financial rules and the Financial Operating Procedures of the Council are reviewed and revised (as necessary) to meet the new requirements of the Code.**

4. **That the Investment Policy includes the use of CCLA's Diversified Income Fund with a limit of up to £3m being invested within it (£5m in total with CCLA)**

Reasons for Recommendations

The Council seeks to minimise the costs of borrowing and maximise investment income whilst ensuring the security of its investments. The Council continues to make substantial investments in commercial property, housing and energy generation initiatives, and this will continue to involve the Council in taking on additional borrowing.

The sums involved are significant and the assumptions made play an important part in determining the annual budget. The CIPFA Code of Practice (2017 Edition), adopted by the Council last year, was released to take account of the more commercialised approach being adopted by councils and the enhanced levels of transparency required. The Code represents best practice and helps ensure compliance with statutory requirements.

The Council has the ability to diversify its investments and must consider carefully the level of risk against reward against a background still of historically low interest rates. Investments can help to close the gap in the budget in the years ahead and thus help to preserve services, assist in the regeneration of the town, provide additional housing and enhance the long term sustainability of the town.

Introduction

1. The Council is required to operate a balanced budget, which broadly means that cash raised 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.

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 needs of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

3. Treasury management in this context is defined by CIPFA as:

   "The management of the organisation'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"

4. In December 2017, CIPFA issued a revised Treasury Management Code of Practice and a revised Prudential Code. These revisions have particularly focused on non-treasury investments and especially on the purchase of property with a view to generating income. Such purchases could involve undertaking external borrowing to raise the cash to finance these purchases, or the use of existing cash

balances. Both actions would affect treasury management. As the Localism Act 2011 only gave English local authorities a General Power of Competence, these changes in the revised codes are particularly relevant therefore to the activities of English authorities.

5. CIPFA issued a statement that accepted that the issue of revised codes in the late stages of setting the 2018-19 budget cycle was not helpful and accordingly, full implementation was not expected until 2019-20 across all authorities.

6. The Chief Finance Officer responsibilities have been extended to include a series of new roles in respect of the capital strategy and also a specific role in respect of investment in non-financial assets. Amendments are included within the Appendices.

7. Treasury Management Practices and Financial Operating Procedures will need to be reviewed to ensure they properly take account of changes required by the Codes and government regulations.

Investment guidance

8. In early 2018 the Ministry of Housing, Communities and Local Government (MHCLG) issued new statutory guidance on local government investments). This provided for added focus on non-financial asset investments and includes for example loans made to wholly-owned companies, third parties, joint ventures.

9. Investments made by a local authority can be classified into one of two main categories:

(i) Investments held for treasury management purposes

Where treasury management investments are held the Council discloses the contribution these investments make to the local authority

(ii) Other investments

Councils are required to disclose the contribution that all other investments make towards the service delivery objectives and /or place making role of the authority. Each authority is able to define the types of contribution that investments can make and a single investment can, make more than one type of contribution.

These include:

- Yield/profit
- Regeneration
- Economic benefit/business rates growth
- Responding to market failure
- Treasury management

Minimum Revenue Provision (MRP) guidance

10. The MHCLG issued new MRP guidance in early 2018. This provided new focus on expenditure relating to purchasing non-financial asset investments and limiting the periods over which assets could be financed. This materially affected the Council's Housing Company and particularly any monies that constitute equity (limited to 20 years). It does not affect the Council's ability to lend monies to the Housing company over a 40 year loan period – unless the assets have an estimated useful life of less than that.

The Primary Requirements of the Code

11. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

12. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

13. Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a capital Strategy, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

14. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

15. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Audit Committee.

16. Publication of the Strategies on the Council's website.

Reporting Arrangements

17. The reporting arrangements proposed, in accordance with the requirements of the 2017 Code, are summarised below:-

Area of Responsibility	Council/ Committee/ Officer	Frequency
Treasury Management Strategy / Annual Investment Strategy / MRP policy/ Capital Strategy (in future years)	Cabinet and Council	Annually before the start of the year
Treasury Management Strategy / Annual Investment Strategy / Capital Strategy/MRP policy – Mid Year report	Cabinet and Council	Mid-year

Treasury Management Strategy/Capital Strategy / Annual Investment Strategy / MRP policy – updates or revisions at other times	Cabinet and Council	As required
Annual Treasury Outturn Report	Cabinet and Council	Annually by 30 September after the end of the year
Treasury Management Practices	S151 Officer	Reviewed as required (minimum - annually)
Scrutiny of Treasury Management Strategy	Audit Committee	Annually before the start of the year
Scrutiny of treasury management performance and strategy	Audit Committee	Quarterly Monitoring reports, Mid-Year report,

18. The latest CIPFA Code of Practice on Treasury Management (2017) was adopted by this Council in February 2018. The main clauses adopted are included in Appendix 8.

19. The Audit Committee is required to consider the Prudential Indicators as part of the Treasury Management Strategy and make recommendations to Cabinet and full Council; these are identified in the report and Appendix 4 of the Treasury Management Strategy.

Investment Performance 2018-19

20. The performance for the first 9 months of 2018/19 provided an average return of 0.65%.This compares to 0.34% for the same period last year. These figures exclude the interest receivable in respect of loans to other organisations.

21. The total interest receivable for the first 9 months is £117,000 (2017/18 £67,000). These figures exclude the interest receivable in respect of the three loans to other organisations and income from the Property Fund investment. If all the interest received is included this would amount to some £253,000 (2017/18 £178,500).

22. The Cabinet on 7 January 2019 considered a Mid-Year report on Treasury Management based on the performance and activities arising since setting the strategies before the start of the financial year. The current strategy and policies were considered to be appropriate and no changes were made.

Capital Strategy

23. In the light of the increasing commercialisation within local government in particular, in December 2017, CIPFA issued revised Prudential and Treasury Management Codes.

24. The codes require all local authorities to produce detailed Capital Strategies.

25. The Capital Strategy is intended to give a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability.

26. The development of such a Strategy allows flexibility to engage with full council to ensure that the overall strategy, governance procedures and risk appetite are fully understood by all elected members.

27. The Capital Strategy should be tailored to the authority's individual circumstances but should include capital expenditure, investments and liabilities and treasury management. The Capital Strategy should include sufficient detail to allow all members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured and to meet legislative requirements on reporting.

28. The Capital strategy being a high level document that summarises in appropriate detail the requirements for specific investment appraisals. As a minimum such requirements being:

    - the capital schemes that are proposed and their objectives
    - The legal power to undertake a particular scheme
    - The key aspects of the financial appraisal, including any significant risks that have been identified
    - Qualitative criteria that have underpinned the recommendation for a scheme to proceed e.g. links to Corporate plan, economic growth, job retention, etc.
    - Likely source of funding
    - Long term implications
    - Risks and affordability
    - In assessing new income generating proposals the Council does already consider the above list of issues as part of the due diligence checklist and decisions are fully documented.

29. This capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset.

30. The Capital Strategy would look to cover a much longer planning period than the existing capital programme. Work has commenced on identifying likely future expenditure and as the Council's plans evolve the capital strategy and all the prudential indicators and controls e.g. borrowing limits will need to be determined by full Council.

RISK MANAGEMENT

31. The Investment strategy prioritises security of investments over return. Where investments are made they are limited in size and duration. External treasury

advisers are used to advise the Council and have been used to train members. The Council has introduced further checks on credit worthiness of counterparties over the last six years as and when these have been further developed by its advisers.

32. Whilst there is no absolute security for investments made, the Council has limited its investments to the higher rated institutions, in order to mitigate the risk as far as practical and looks to reduce the risk by spreading its investment portfolio. The Council has adopted the CIPFA Code of Practice.

33. 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. Further training sessions for all members will be arranged prior to the consideration of the future Mid-year review by the Audit Committee and Cabinet.

34. The training needs of treasury management officers will also be reviewed in the light of the Code's requirements and experience of new staff.

35. The additional risks that the Council is taking on with commercial property, housing and energy investments needs to be considered in the context of the totality of risk that the Council faces e.g. Pier claim, rates revaluation, robustness of income streams, loans and guarantees to other parties, economic downturns, etc. Where there is more risk and volatility in income streams the Council will need to ensure that it maintains sufficient reserves to ensure the Council's ability to deliver key services is not jeopardised.

36. The Council spreads its risk on investments by limiting the amount of monies with any one institution or group and limiting the timeframe of the exposure. In determining the level of the investment and period the Council considers formal credit ratings (Fitch) along with its own advisers (Link Asset Services) ratings advice.

37. The security of the principal sum remains of paramount importance to the Council.

Economic/Financial Implications

38. The Council generally has investments in the year of between £15 million and £30 million at any one time, and is estimated to have longer term borrowings approaching £60m by the end of March 2019. Management of its investments, borrowing and cash flow remains crucial to the proper and effective management of the Council. The Strategies and Policies detailed in the report directly influence the Council's Medium Term Financial Strategy and the annual budget.

Organisational Consequences

39. The Cabinet is responsible for the development and review of the Treasury Management Strategy, Minimum Revenue Provision (MRP) Policy, Investment Strategy and the future Capital Strategy. The Audit Committee is responsible for scrutinising these strategies, policies and performance throughout the year. Full Council, as the budget setting body, remains responsible for the approval of the Treasury Management Strategy, MRP Policy, and Investment Strategy and for the

new Capital Strategy.

40. Monitoring reports will be produced and will be presented to Cabinet and the Audit Committee. A mid-year report is presented to full Council on any concerns arising since approving the initial strategies and policies. Only full Council will be able to amend the Treasury Management Strategy, MRP Policy, Investment Strategy or Capital Strategy. The Chief Finance Officer will determine the Treasury Management Practices and associated schedules.

41. There are new responsibilities placed on the Council and the Chief Finance officer from the new Codes of Practice which relate to governance arrangements, ensuring robustness of business cases, and risk management. The risk management requirements relate to asset related properties which the Council has borrowed to finance, and assessments of overall risk.

42. There are specific requirements to maintain schedules of counterparties and of any guarantees that the Council may give or have given in the past in order to fully assess the potential risks that the Council may be exposed to when making investment decisions.

Timetable of Next Steps

Action	Key milestones	Due dates (provisional)	Responsible
Update Treasury Management Practices, produce necessary schedules for full compliance with Codes of Practice	1 April 2019	Full implementation by 2019/20	Chief Finance Officer
Arrange Training for members/ officers	Year End & Mid-Year Review Report	July 2019	Chief Finance Officer

Wards Affected

None

Area(s) Affected

None

Policy Implications

Please identify if this report contains any implications for the following:

Equalities and Community Cohesiveness	No
Crime and Fear of Crime (Section 17)	No
Risk Management	Yes
Environmental Issues	No
Economic/Financial Implications	Yes
Human Rights Act	No
Organisational Consequences	Yes
Local People's Views	No

Documents Attached:
(i)Treasury Management Strategy (including Investment Policy)
Includes the following Appendices
1. MRP Introduction and Policy Statement
2. Interest Rate Forecasts
3. Economic Review
4. Prudential and Treasury Indicators
5. Specified and non-Specified Investments
6. Approved Countries for Investments
7. Treasury Management Policy Statement
8. Purpose and Requirements of the Code
9. Treasury Management Scheme of Delegation
10. The Treasury Management Role of the Section 151 Officer

(ii) Capital Strategy
Includes the following Appendices
1. List of Recent Income Generating initiatives involving Properties - and details where applicable of those financed by borrowing and the debt repayment period (MRP)

Other Supporting Documents:-
CIPFA - Treasury Management Code of Practice (2017)
CIPFA - The Prudential Code (2017)

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Treasury Management Strategy (TMS) for 2019/20

1. The Local Government Act 2003 (the Act) and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

2. The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy; this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. There is also now the new requirement to produce a Capital Strategy – also for determination by full Council.

3. The Treasury Management strategy covers two remain areas:

   (i) Capital issues
   - the capital plans (in summarised form) and the prudential indicators;
   - the Minimum Revenue Provision (MRP) policy.

   (ii) 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.

4. 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.

5. The strategy for 2019/20 in respect of the following aspects of the treasury management function is based upon the Council officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor, Link Asset Services (previously Capita Asset Services).

Key Changes to the Strategy

6. The key changes from the previous year's strategy are:

   i. The Council has taken on additional borrowing in 2018/19 in respect of the Capital programme and the Income Strategy. The level of borrowing has risen significantly but remained within the operational and authorised boundaries.

The income generation plans of the Council are expected to involve considerable new borrowing again in 2019/20 and the years ahead. The borrowing limits proposed in the strategy are those previously agreed when determining the budget for 2018/19 (included the £50m for income generation) and allow very limited headroom to borrow for the current and forthcoming schemes within the Capital programme without reliance on the capital receipts from land and property disposals.

ii. The majority of the new borrowing in future years will be for Capital purposes, but there will inevitably continue to be a smaller requirement for loans that are revenue in nature e.g. loans to the housing company for running costs. Such monies cannot be borrowed from the Public Works Loan Board, and will be financed from existing Council reserves.

iii. The Council is required to make a Minimum Revenue Provision in respect of its borrowing – to ensure debt is repaid over an appropriate period. Where the Council is making significant investments in property, housing or other programmes the Council's MRP policy enables the Council to match the principal repayments made on loans arranged with a near equal MRP payment (an annuity methodology).

iv. Investment returns should increase in the next few years as the bank base rate increases, albeit marginally. The overall cash return may however decrease as the Council's reserves deminish.

v. The Council invested some of its existing reserves in a Property Fund – up to a limit of £2m by 31 March 2018. This strategy proposes to invest further monies up to £3m in another CCLA (Churches, Charities, and Local Authorities) Fund which is less exposed to property and is more liquid (available to be recalled at shorter notice and with less los of capital and interest). This is seen as important given the potential calls on reserves and the considerable uncertainty surrrounding the impact of Brexit.

Balanced Budget

7. It is a statutory requirement under the Local Government Finance Act 1992, for the Council to calculate its Council Tax requirement. In particular, Section 31 requires a local authority in calculating the Council Tax requirement for each financial year to include the revenue costs that flow from capital financing decisions. Thus any increases in costs (running costs & borrowing costs) from new capital projects must be limited to a level which is affordable within the projected income of the Council for the foreseeable future.

PRUDENTIAL AND TREASURY LIMITS FOR 2019/20 TO 2021/22

The Council's Capital Position (Prudential Indicators)

8. The Council's capital expenditure plans are the key driver of treasury management activity.

9. The prudential code requires the local authority to identify prudential indicators that enable members, officers and the public to make a meaningful judgement on

the Council's total exposure from borrowing and investment decisions. The indicators are required to cover both the Council's current position and the expected position assuming all planned investments in the forthcoming years are completed.

10. This part of the report is structured to update:

    The Council's capital expenditure plans;

    How these plans are being financed;

    The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and

    Reviewing the limits in place for borrowing activity.

Prudential Indicator for Capital Expenditure

11. This table shows the revised estimates for capital expenditure for the current and next three financial years.

	Revised 2018/19 £'000s	**2019/20 £'000s**	**2020/21 £'000s**	**2021/22 £'000s**
Gross Capital Expenditure	26,261	18,961	7,347	3,736
Net Capital Expenditure	22,405	16,066	5,808	2,236
Financing from own resources	953	799	208	120
Borrowing Requirement	21,452	15,267	5,600	2,116

12. In terms of **net cost**, the 2018/19 programme has been revised to £22,405,000 from £28,691,000. The 2019/20 programme amounts to £16,066,000 (£18,961,000 Gross).

Capital Expenditure – Financing

13. The table above summarises the capital expenditure plans and how these plans are being financed – either by own resources e.g. Section 106, Capital receipts or through borrowing. New Capital schemes will generally be financed by borrowing, unless Capital receipts from the sale of assets are available.

14. The larger schemes in the capital programme which are expected to require financing in **2018/19** from borrowing are:-

    - Commercial property purchases estimated at £15m
    - Loans to Hastings Housing Company Ltd estimated at £5.7m
    - Temporary accommodation estimated at £640,000

15. The financing requirements for larger schemes in **2019/20** include:

- Loans to Hastings Housing Company Ltd estimated at £5m
- Commercial property purchases estimated at £4.7m (Stage Payment)
- Energy initiatives at £1.66m
- Street Cleaning Vehicles at £780,000
- York buildings at £602,000
- Country Park Interpretive centre at £266,000 (net)
- Housing – Temporary Accommodation at £1.86m

Impact on the prudential indicators

16. The treasury indicators for borrowing activity are the **Authorised Limit** and the **Operational Boundary** for external debt.

The **Authorised Limit**, which is a limit beyond which external debt is prohibited, needs to be set or revised by the full Council; it is a statutory duty under Section 3 (1) of the Local Government Act 2003 and supporting regulations. It reflects the level of borrowing which, while not desired, could be afforded in the short term. It is the expected maximum borrowing need with some headroom for unexpected movements.

Authorised limit	**2017/18 Estimate £**	**2018/19 Estimate £**	**2019/20 Estimate £**	**2020/21 Estimate £**
Debt	75,000,000	85,000,000	95,000,000	95,000,000
Other long term liabilities	5,000,000	5,000,000	5,000,000	5,000,000
Total	80,000,000	90,000,000	100,000,000	100,000,000

17. The **Operational Boundary** is the limit beyond which external debt is not normally expected to exceed.

Operational boundary	**2017/18 Estimate £**	**2018/19 Estimate £**	**2019/20 Estimate £**	**2020/21 Estimate £**
Debt	65,000,000	75,000,000	85,000,000	85,000,000
Other long term liabilities	5,000,000	5,000,000	5,000,000	5,000,000
Total	70,000,000	80,000,000	90,000,000	90,000,000

18. Essentially the Council is required to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future Council Tax levels is ‘acceptable’.

19. Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion in the Capital programme incorporate financing by both external borrowing as well as other forms of liability e.g. Credit arrangements (such as leases).

20. The Authorised Limit and operational boundary are to be set, on a rolling basis, for the forthcoming financial year and two successive financial years by full Council as part of this strategy.

21. **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.**

PROSPECTS FOR INTEREST RATES

22. The Council has appointed Link Asset Services (previously Capita Asset Services) as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates (Appendix 2 – Economic Review). The following table gives their view.

Link Asset Services Interest Rate View	Dec-18	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%	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	0.80%	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	0.90%	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	1.10%	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	2.00%	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%	2.50%	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%	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%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

23. 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 2018 to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth has been healthy since that meeting, but is expected to weaken somewhat during the last quarter of 2018.

24. At their November 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. The timing of the next increase in Bank Rate is very uncertain. Forecast to be in

May 2019 or December 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

25. 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.

26. Rising bond yields in the US have also caused some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure has been dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

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

28. 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.

BORROWING STRATEGY

29. The capital expenditure plans set out in the budget 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.

Current Portfolio Position

30. The Council's forecast debt position for 31 March 2019, if no further borrowing is taken for the rest of the financial year, as at 28 December 2019, amounted to £44.7m (SeeTable below).

Table 1 – Borrowing

Debt	1 April 2018 Principal	Rate	Maturity	01-Apr-19 Principal	Rate
PWLB Loan 1	£7,500,000	4.80%	2033	£7,500,000	4.80%
PWLB Loan 2			2016		
PWLB Loan 3	£0	1.63%	2018	£0	1.63%
PWLB Loan 4	£2,000,000	0.40% (*Variable)	2019		0.40% (*Variable)
PWLB Loan 5	£909,027	3.78%	2044	£909,027	3.78%
PWLB Loan 6	£1,788,235	3.78%	2044	£1,788,235	3.78%
PWLB Loan 7 (Annuity)	£243,901	1.66%	2026	£215,148	1.66%
PWLB Loan 8	£1,000,000	2.92%	2056	£1,000,000	2.92%
PWLB Loan 9	£1,000,000	3.08%	2046	£1,000,000	3.08%
PWLB Loan 10	£1,000,000	3.01%	2036	£1,000,000	3.01%
PWLB Loan 11	£1,000,000	2.30%	2026	£1,000,000	2.30%
PWLB Loan 12	£2,000,000	2.80%	2054	£2,000,000	2.80%
PWLB Loan 13	£1,000,000	2.42%	2028	£1,000,000	2.42%
PWLB Loan 14	£2,000,000	2.53%	2057	£2,000,000	2.53%
PWLB Loan 15	£2,000,000	2.50%	2059	£2,000,000	2.50%
PWLB Loan 16	£2,000,000	2.48%	2060	£2,000,000	2.48%
PWLB Loan 17 (Annuity)	£7,222,996		2057	£7,113,729	2.53%
PWLB Loan 18 (Annuity)	£8,350,000		2057	£8,232,535	2.72%
PWLB Loan 19			2028	£2,000,000	1.98%
PWLB Loan 20 (Annuity)			2058	£4,000,000	2.55%
Total Debt	**£41,014,159**	**3.15%**		**£44,758,674**	**3.03%**

The Council has loaned money to other organisations. As at 30 September 2018 three longer term loans are outstanding. Namely:

Table 2 – Loans to Other Organisations

3rd Party Organisations	Rate/ Return (%)	Start Date	End Date	Principal £	Term
Amicus /Optivo	3.78	04/09/2014	02/09/2044	1,788,235	Fixed
The Foreshore Trust	1.66	21/03/2016	20/03/2026	229,583	Annuity
The Source	2.43	17/12/2015	17/12/2025	19,304	Annuity
			Total	2,037,122	

31. A further loan has been agreed with Freedom Leisure in respect of the new climbing wall at Summerfields leisure Centre (as per the cabinet report of 8 April 2018). The loan agreement for some £134,037 is being finalised.

32. Borrowing from the PWLB was taken to fund the Amicus Horizon (now Optivo) loan (£1,788,235- maturity loan) and the loan to the Foreshore Trust (£300,000 originally borrowed – annuity loan); these correspond to PWLB loans in Table 1 above. The £25,000 loan to the Source is repayable over a 10 year period and is financed from HBC reserves.

Borrowing Limit – Capital Financing Requirement (CFR)

33. The first key control over the treasury activity is a prudential indicator to ensure that borrowing will only be for a capital purpose. The CFR (Capital Financing Requirement) 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 underlying borrowing need. Any capital expenditure which has not been funded from grants, revenue, reserves or capital receipts will increase the CFR.

34. The Council has at the time of writing some £46.7m of PWLB debt, with £2m of debt being repaid in January 2019, and should look to borrow up to the projected level of the CFR (£60.1m) by the end of March 2019 or risk exposure to interest rate movements .

35. There has been, not unexpectedly, a big impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow. The Capital Financing Requirement has increased significantly over the last 18 months. It is expected to reach some £78.6m by 2021/22 (based on the capital programme approvals to date).

36. As a key indicator the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement (CFR) in the preceding year plus the estimates of any additional CFR for 2018/19 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.

37. The Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

38. The total CFR can also be reduced by:

    (i) the application of additional capital financing resources (such as unapplied capital receipts); or

    (ii) charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

39. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and next two financial years.

40. The Council has been looking to be in a fully funded position given the projected future increases in borrowing rates. This means that the capital borrowing need (the Capital Financing Requirement), has been fully funded with loan debt. Previously cash supporting the Council's reserves, balances and flow has been used as a temporary measure to fund the Capital expenditure. This strategy had been considered prudent as borrowing costs are increasing. However there is a cost of doing this as investment returns are low compared to borrowing costs and counterparty risk is still an issue that needs to be considered.

41. The plans for income generation, which require substantial new borrowing by the Council in the future, play a part in the consideration as to when to borrow and the level of internal borrowing. Given the historically low interest rates and the ability of the Council to look at other investment opportunities which are providing higher returns than the cost of borrowing e.g. property acquisitions or property funds, there remains a much stronger case for minimising the level of internal funding in order to ensure a lower level of borrowing risk in the future.

42. The table below provides an estimate of the Council's Capital Financing Requirement (CFR) for the current and next 3 years. Please note the table below excludes the impact of leases (which have minimal impact at present <£10k).

CFR	2018/19 (Adj. Est)	2019/20 (Est)	2020/21 (Est)	2021/22 (Est)	2022/23 (Est)
	£	£	£	£	£
CFR-Opening	39,493,000	60,150,000	74,234,000	78,215,000	78,565,000
Less MRP	-795,000	-1,183,000	-1,619,000	-1,766,000	-1,866,000
Plus, New Borrowing	21,452,000	15,267,000	5,600,000	2,116,000	0
CFR Closing	60,150,000	74,234,000	78,215,000	78,565,000	76,699,000

43. The table below highlights the Council's projected gross borrowing position against the CFR (showing the level that is financed from internal borrowing).

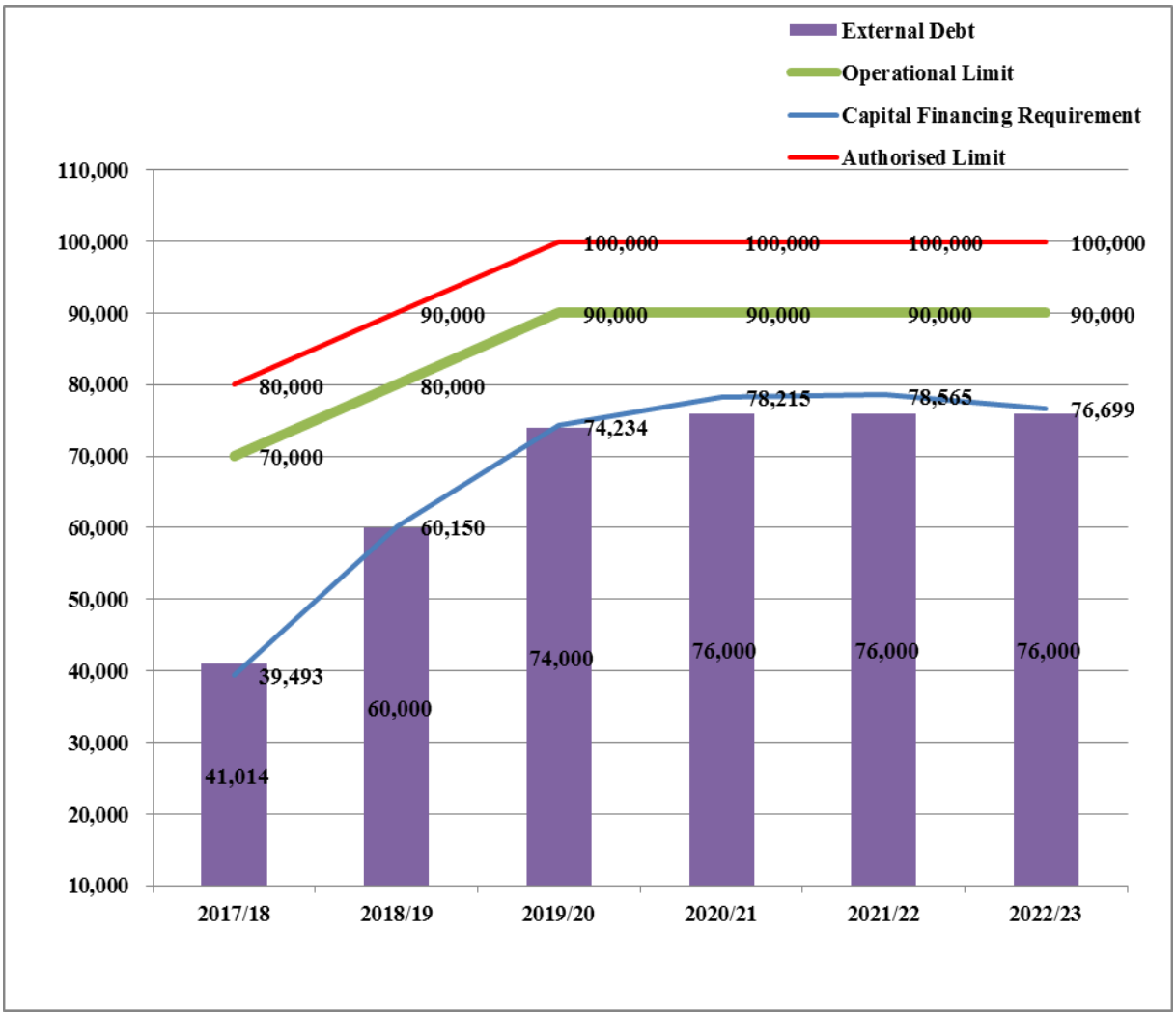
Table 3 Internal Borrowing	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Capital Financing Requirement	60,150,000	74,234,000	78,215,000	78,565,000
External Borrowing Est.	44,750,000	74,000,000	78,000,000	78,000,000
Net Internal Borrowing	15,300,000	234,000	215,000	565,000

44. The Council now has some £44.758m of PWLB debt, and could potentially borrow up to a level of £60.15m (estimated CFR at 31 March 2019). The £60.15 figure does take account of projected new capital spending in the remainder of this year which is expected to be funded by new borrowing.

45. The Council is now (1 January 2019) maintaining a very small under-borrowed position, but this is set to increase to some £15.3m if the Capital programme completes as forecast. In future years the capital borrowing need (the Capital Financing Requirement), is nearly fully funded with loan debt as against cash supporting the Council's reserves, balances and cash flow being used as a temporary measure. This strategy is seen as prudent when interest rates are forecast to increase. However there is a cost, given that investment returns are low and counterparty risk has been relatively high. New borrowing will continue to be taken if good rates are available in the absence of any meaningful Capital receipts being available to fund Capital expenditure.

46. Borrowing activity is constrained by prudential indicators particularly the CFR, and by the authorised limit. The Council's long term borrowing must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure.

47. **Table: External Debt, Authorised limits and CFR Projections**



48. **Borrowing – Overall Limits**

In determining what is a prudent level of borrowing, the Council needs to ensure that it would still be able to provide core services if its investments or income generating initiatives failed – at least in part. As a guide each £1m of new borrowing, financing an asset with a life of 40 years would currently cost the Council some 5.5 % p.a. (based on a maturity loan with a 3% interest rate) i.e. £55,000 p.a.. The Council if investing money in property based assets as against other ventures would have assets to sell if necessary – thus reducing overall risk.

49. In taking on significant levels of additional debt the Council has to ensure that it can afford to do so. It also needs to ensure that it has an affordable exit strategy in the event that expected returns are not realised. Where property is concerned there is normally an asset to dispose of and such schemes are not therefore at the higher end of the risk spectrum. In arriving at the original figure of an additional £50m on the borrowing limit, it was, and still remains the position, that the Council currently has sufficient reserves to ensure that it could dispose of

assets in a reasonable period and not be forced into an immediate fire sale. In the event that property values fell by say 20% the Council would not be forced to sell assets providing the rental streams were secure.

50. **Borrowing – Certainty Rate**

The Council again registered for the PWLB certainty rate earlier in the year which has given a 20 basis point reduction in the average rate of borrowing. The Council will look to do so again for 2019/20 and thereafter if it remains available.

51. **Borrowing – Change of Sentiment**

In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. The Chief Finance Officer, in conjunction with the treasury advisors, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

a. if it were felt that there was a significant risk of a sharp FALL in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered

b. if it were felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still relatively cheap.

52. **Borrowing – Timing**

The general aim of this treasury management strategy is to minimise the costs of borrowing in both the short and longer term. In the short term it can consider avoiding new borrowing and using cash balances to finance new borrowing. However to minimise longer term costs it needs to borrow when rates are a historically low levels. The timing of new borrowing is therefore important to minimise the overall costs to the Council.

53. Given that rates look set to increase and given an increased borrowing requirement relating to Capital programme it is recommended that new borrowing is taken rather than use internal balances for long life assets. Likewise, given that the Council is increasingly using its reserves these need to be readily available and not subjected to unnecessary risk or exposure.

Summary

54. New borrowing has been taken over the last 18 months, to not only take advantage of the historically low rates, but to ensure that the Council's own reserves are cash backed should restrictions be placed on the amount and levels

of borrowing that authorities can undertake (particularly from the PWLB) and a balanced view will continue to be taken.

55. The plans for income generation require further substantial new borrowing by the Council. The plans play a large part in the consideration as to when to borrow and the level of internal borrowing. Given the historically low interest rates and the ability of the Council to look at other investment opportunities which are providing higher returns than the cost of borrowing e.g. property funds, there has been a much stronger case for reducing the level of internal funding in order to ensure a lower level of borrowing risk in the future.

56. The cheapest borrowing will be internal borrowing by running down cash balances and foregoing interest earned at historically low rates. However, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration has been given to weighing the short term advantage of internal borrowing against the potential increase in long term costs as rates rise. As such additional new borrowing has been, and will continue to be, taken.

57. The use of PWLB variable rate loans for up to 10 years will still be considered as they can be repaid early without early redemption premiums. They can also be converted into longer dated fixed rate debt should it be considered prudent to do so.

58. The use of fixed rate market loans will also be considered should rates be below PWLB rates for the equivalent maturity period.

59. The use of either PWLB maturity or annuity loans will be considered in order to minimise annual borrowing costs.

Policy on borrowing in advance of need

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 considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

61. In determining whether borrowing will be undertaken in advance of need the Council will:

    a. ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need.
    b. ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered.
    c. evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.
    d. consider the merits and demerits of alternative forms of funding.
    e. consider the appropriate funding period.
    f. consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the

consequent increase in exposure to counterparty risk, and the level of such risks given the controls in place to minimise them.

Debt Rescheduling

62. The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt, which has now been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that PWLB to PWLB debt restructuring is now much less attractive than it was before both of these events. In particular, consideration would have to be given to the large premiums which would be incurred by prematurely repaying existing PWLB loans and it is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing.

63. The Council also keeps under review the potential for making premature debt repayments in order to reduce borrowing costs as well as reducing counterparty risk by reducing investment balances. However, the cost of the early repayment premiums that would be incurred and the increase in risk exposure to significantly higher interest rates for new borrowing, continue to make this option unattractive. When last reviewed on the 27 September 2017 the early repayment cost of the £7.5m PWLB loan, maturing in 2033, would amount to £3,177,343. No debt rescheduling is being contemplated at present.

64. The reasons for any rescheduling to take place will include:

    a. the generation of cash savings and / or discounted cash flow savings,

    b. helping to fulfil the strategy outlined above

    c. enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Minimum Revenue Provision (MRP)

65. Appendix 1 of this report provides the detail on what the MRP is and the basis of the calculation. Basically, authorities are required each year to set aside some of their revenues as provision for debt repayment. Unlike depreciation which is reversed out of the accounts, this provision has a direct impact on the Council Tax requirement. The provision is in respect of capital expenditure that is financed by borrowing or credit arrangements e.g. leases.

66. The Council is required to make a “Prudent Provision” which basically ensures that revenue monies are set aside to repay the debt over the useful life of the asset acquired i.e. the Minimum Revenue Provision (MRP). This can be achieved by equal annual instalments (current practice) or an annuity method – annual payments gradually increasing over the life of the asset. Where an annuity loan is taken, the Council’s policy (Appendix 1) was amended last year to reflect the matching, as far as possible, of the MRP with the actual principal repaid (within each debt repayment).

67. The MRP for 2018/19 is estimated at £1,116,000 (the statutory charge to revenue that remains within the accounts).

ANNUAL INVESTMENT STRATEGY

Investment Policy

68. The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the CIPFA TM Code"). The Council's investment priorities will be security first, portfolio liquidity second, and then return.

69. 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.

70. 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 achieve this consideration 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.

71. 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.

72. Investment instruments identified for use in the financial year are listed in an attached Appendix under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.

73. The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

74. In accordance with guidance from the MHCLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agency.

Creditworthiness Policy

75. This Council uses the creditworthiness service provided by Link Asset Services - the potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications. This service has been progressively enhanced over the last couple

of years and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moody's and Standard and Poor's, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays: -

- credit watches and credit outlooks from credit rating agencies
- Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

76. 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 code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments and are therefore referred to as durational bands. This is a service which the Council would not be able to replicate using in house resources.

77. The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Link Asset service's weekly credit list of worldwide potential counterparties. The Council will therefore use counterparties within the following durational bands: -

- Purple 2 years (but HBC will only invest for up to 1 year – except Property Fund and Diversified Income Fund)
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100days
- No Colour not to be used

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

79. Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of 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.

80. This Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties as Moody's tend to be more aggressive in giving low ratings than the other two agencies. This would therefore be unworkable and leave the Council with few

banks on its approved lending list. The Link creditworthiness service does though, use ratings from all three agencies, but by using a risk based scoring system, does not give undue weighting to just one agency's ratings.

81. The Council is alerted to the changes to credit ratings of all three agencies through its use of the Link creditworthiness service. These are monitored on a daily basis with lists updated weekly by Link Asset Services.

82. Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on government support for banks and the credit ratings of that government support.

83. The Council only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 6. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy. The maximum investment in any non UK country is not to exceed £10m.

Investment Strategy

84. The table below provides a snapshot of the investments and deposits held mid year (on 30 September 2018). The level of investments can fluctuate significantly on a day to day basis, given the level of funding received, precept payments, grants payable and receivable, salaries and wages, etc.

Table – Investments and Deposits

Counterparty	Rate/ Return	Start Date	End Date	Principal	Term
Australia & NZ BCG Ltd	0.90%	29/08/2018	29/11/2018	5,000,000	Fixed
Birmingham City Council	1.05%	30/08/2018	28/08/2019	3,000,000	Fixed
Blackpool Borough Council	0.80%	28/09/2018	28/01/2019	2,000,000	Fixed
Blaenau Gwent CBC	0.50%	25/06/2018	03/10/2018	2,000,000	Fixed
DBS Bank Ltd London	0.77%	18/09/2018	18/10/2018	3,000,000	Fixed
Eastleigh Borough Council	0.65%	24/08/2018	25/02/2019	5,000,000	Fixed
London Borough of Harrow	0.75%	10/09/2018	10/04/2019	2,000,000	Fixed
Barclays Corporate	0.40%			2,998,426	Call
NAT West	0.05%			1,720	Call
Santander	0.40%			505	Call
			Total	**25,000,651**	

85. Priority is given to security and liquidity of investments in order to reduce counterparty risk to the maximum possible extent.

86. The Council has various limits depending upon the credit rating e.g. £5m with any one institution with a minimum short term rating of F+, and a long term rating of A+ or above, supported by a red (6 month) rating by Capita Asset Services. The

£5m limit generally represents a level of up to 25% of the investment portfolio with any one institution or group at any one time. It is also necessary, at times, to invest sums of this size in order to attract the larger institutions which have the higher credit ratings.

87. The Eurozone and Brexit have led to a number of downgrades to banks' credit ratings, making it increasingly difficult to spread investments across a number of institutions. The Chief Finance Officer has the authority to amend the limits on a daily basis if necessary to ensure that monies can be placed with appropriate institutions.

Investment Strategy – Property Fund

88. It was agreed in February 2017 that the option for diversification of some of the investments into a property fund be undertaken with CCLA in the sum of £2m. The investment being in respect of the Council's reserves that are not required for a period of at least 5 years in order that any fall in values and entry costs into such funds can be covered. The £2m was invested in April 2017 and the performance is detailed below:

CCLA - LA's Property Prices and Dividend yields							
End of	Dec-18	Sep-18	Jun-18	Mar-18	Dec-17	Sep-17	Apr-17
Offer Price p	329.35	324.17	324.10	322.40	319.44	314.48	307.19
Net Asset Value p	308.53	303.67	303.61	302.01	299.24	294.60	287.77
Bid Price p	303.75	298.97	298.90	297.33	294.60	290.03	283.31
Dividend* on XD Date p	3.32	3.17	3.28	3.21	3.38	3.34	
Dividend* - Last 12 Months p	12.98	13.04	13.64	13.70	13.71	13.13	13.19
Dividend Yield on NAV %	4.21	4.29	4.49	4.54	4.58	4.46	4.58
Fund Size £m	1,099.0	1,047.8	1,027.7	976.3	930.8	836.2	710.2

89. The dividend yield is around 4.9% on the net asset value, which results in quarterly cash dividends of around £21,000. Full year dividends are estimated at around £84,000 (£63,614 as at 31 December 2018).

Table Showing Capital Value Increases since April 2017

Units (651,063)	Dec-18	Sep-18	Jun-18	Mar-18	Dec-17	Sep-17	Apr-17
Mid Market Price(£)	2,008,724.67	1,977,083.01	1,976,692.37	1,966,275.37	1,948,240.92	1,918,031.60	1,873,564.00
Bid Price (£)	1,977,603.86	1,946,483.05	1,946,027.31	1,935,805.62	1,918,031.60	1,888,278.02	1,844,526.59

90. The Capital value increased by some 4.95% per annum between April 2017 and March 2018 and that trend is currently continuing. It is important that this is continued to be viewed as a longer term investment (5 years plus), albeit the original Capital value is now projected to be recovered by April 2019.

Investment Strategy – Diversified Income Fund (CCLA)

91. The Council's reserves are diminishing and given uncertainties around Brexit and the implications, either way, over the next few years, the Council needs to ensure that it has cash available when required. The Council invested £2m last financial year in the CCLA Property Fund which has been very successful to date, but will have taken some 2 years to recover the original Capital value of the investment made.

92. It is recommended that the Council invests up to £3m in a more diversified fund that returns just above 3% which although a lower return than the Property Fund, has much lower entry and exit costs but still achieves more than if invested solely as cash. In terms of the complete fund, 75% of it could be liquidated within 2 days if necessary – unlike the existing Property Fund.

93. Investing in the fund would still be viewed as a long term investment, would provide a higher rate of return than current cash investments, and provide a more diversified investment income stream. The additional interest earned, estimated at some £60,000 p.a. is included in the 2019/20 budget.

94. Due diligence on CCLA (Churches, Charities and Local Authorities) has been undertaken previously and is owned by its investors. Currently there are 28 authorities and 2 charity clients investing £126m in this fund with more in the pipeline. More details on the fund are included in Appendix 11 and the fact sheet is included in Appendix 12.

Investment Strategy – View on Interest Rates

95. Investment returns have started to increase in 2018/19 and are expected to be on a gently rising trend over the next few years.

Investment Return Expectations.

96. 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%

97. The Council will look to report on the actual return achieved on its cash investments, both in terms of percentage and actual cash. It will look to report separately on different categories of cash investments e.g. Property Fund. It will use the London Interbank Bid Rate (3 month rate) as a comparator.

Investment Strategy – Income Generation

98. The income generation proposals that the Council is looking at require substantial investments to be made by the Council and will necessitate new borrowing. The levels of new borrowing that the Council can afford to take on board for new commercial property purchases and development, housing and energy schemes, etc, will be dependent upon the individual proposals and credit worthiness of the counterparties involved. Due to the timescales within which some property purchasing and disposal decisions have to be made the Council's existing governance arrangements and delegated authorities have been revised e.g. establishment of Income Generation Board.

99. The additional risks that the Council is taking on need to be considered in the context of the totality of risk that the Council faces e.g. Pier claim, rates revaluation, robustness of income streams, economic downturns, etc. Where there is more risk and volatility in income streams the Council will need to ensure that it maintains sufficient reserves to ensure the Council's ability to deliver key services is not jeopardised.

100. The income generation proposals require revenue loans to be provided to Council owned companies. Such funding is not be available from the Public Works Loan Board, and is therefore from existing Council reserves and balances. The rates of interest that are charged to the company (s) are determined at the time of the advance and need to comply with state aid rules where thresholds are exceeded – a market rate being payable.

Accounting Implications

101. International Financial reporting Standard Number 9 (IFRS 9) – This is an important consideration when assessing any investments now and will encompass the 2018/19 Accounting Code of Practice proposals for financial assets.

102. Expected Credit Loss Model – Whilst this should not be material for normal treasury investments, longer dated service investments, loans to third parties or loans to subsidiaries may be more problematic;

103. As the code is currently structured, equity related to the "commercialism" agenda, property funds, equity funds and similar, are likely to be classified as Fair Value through the Profit and Loss (FVPL). It is understood some funds are suggesting the election to Fair Value through Comprehensive Income (FVCI) applies to property funds as it would be deemed to be an equity investment. In late 2018 the government have confirmed there will be a statutory override to FVPL for these types of investment for a period of 5 years.

End of Year Investment Report

104. At the end of the financial year, officers will report to Council on its investment activity as part of its Annual Treasury Report (to be presented by no later than 30 September).

Policy on Use of External Service Providers

105. The Council uses Link Asset Services (Capita Asset Services previously) as its external treasury management advisors. There is currently value in employing external providers of treasury management services in order to acquire access to credit worthiness information and specialist advice.

106. **Training**

The CIPFA Code requires the responsible officer (Chief Financial 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 was provided in November on Joint Ventures. In terms of Treasury management in general, training has been undertaken by members on an annual basis to date and further training is being arranged for all members prior to full Council on 20 February 2019.

The training needs of treasury management officers are periodically reviewed.

107. **MiFID II (Markets in Financial Instruments Directive)**

In brief, this directive requires the Council to distinguish itself as either a retail or professional client. In order to qualify for professional status the Council is required to show that it has more than £10m in investments, invests regularly (more than 10 times a quarter), as well as having appropriately trained and experienced staff.

108. To date only two counterparties have required us to complete the forms in order to maintain the existing professional status. The directive became law on 1 January 2018.

109. The two parties to date are Link Asset Services and CCLA. A schedule of such counterparties will be maintained, as per the requirements of the Code, should the list expand further.

Scheme of Delegation

110. Please see Appendix 9.

Role of the Section 151 Officer

111. Please see Appendix 10.

APPENDIX 1

Minimum Revenue Provision – An Introduction

1. What is a Minimum Revenue Provision?
Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. It would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred therefore such expenditure is spread over several years in order to try to match the years over which such assets benefit the local community through their useful life. The manner of spreading these costs is through an annual Minimum Revenue Provision, which was previously determined under Regulation, and will in future be determined under Guidance.

2. Statutory duty
Statutory Instrument 2008 no. 414 s4 lays down that:

"A local authority shall determine for the current financial year an amount of minimum revenue provision that it considers to be prudent."

The above is a substitution for the previous requirement to comply with regulation 28 in S.I. 2003 no. 3146 (as amended).

There is no requirement to charge MRP where the Capital Financing Requirement is nil or negative at the end of the preceding financial year.

3. Government Guidance
Along with the above duty, the Government issued guidance which came into force on 31st March 2008 which requires that a Statement on the Council's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which the provision will relate.

The Council is legally obliged to "have regard" to the guidance, which is intended to enable a more flexible approach to assessing the amount of annual provision than was required under the previous statutory requirements. The guidance offers four main options under which MRP could be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The requirement to 'have regard' to the guidance therefore means that: -

Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent.

It is the responsibility of each authority to decide upon the most appropriate method of making a prudent provision, after having had regard to the guidance.

Option 1: Regulatory Method
Under the previous MRP regulations, MRP was set at a uniform rate of 4% of the adjusted CFR (i.e. adjusted for "Adjustment A") on a reducing balance method (which in effect meant that MRP charges would stretch into infinity). This historic approach must continue for all capital expenditure incurred in years before the start of this new approach. It may also be used for new capital expenditure up to the amount which is deemed to be supported through the SCE annual allocation.

Option 2: Capital Financing Requirement Method
This is a variation on option 1 which is based upon a charge of 4% of the aggregate CFR without any adjustment for Adjustment A, or certain other factors which were brought into account under the previous statutory MRP calculation. The CFR is the measure of an authority's outstanding debt liability as depicted by their balance sheet.

Option 3: Asset Life Method.
This method may be applied to most new capital expenditure, including where desired that which may alternatively continue to be treated under options 1 or 2.

Under this option, it is intended that MRP should be spread over the estimated useful life of either an asset created, or other purpose of the expenditure. There are two useful advantages of this option: -
Longer life assets e.g. freehold land can be charged over a longer period than would arise under options 1 and 2.
No MRP charges need to be made until the financial year after that in which an item of capital expenditure is fully incurred and, in the case of a new asset, comes into service use (this is often referred to as being an 'MRP holiday'). This is not available under options 1 and 2.

There are two methods of calculating charges under option 3:
equal instalment method – equal annual instalments,
annuity method – annual payments gradually increase during the life of the asset.

Option 4: Depreciation Method
Under this option, MRP charges are to be linked to the useful life of each type of asset using the standard accounting rules for depreciation (but with some exceptions) i.e. this is a more complex approach than option 3.

The same conditions apply regarding the date of completion of the new expenditure as apply under option 3.

Minimum Revenue Provision Policy Statement 2018/19

The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2008/9 , and will assess the MRP for 2018/19 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

A major proportion of the MRP for 2018/19 relates to the more historic debt liability that will continue to be charged at the rate of 4%, in accordance with option 1 of the guidance. Certain expenditure reflected within the debt liability at 31st March 2018 will under delegated powers be subject to MRP under option 3, which will be charged over

a period which is reasonably commensurate with the estimated useful life applicable to the nature of expenditure, using the equal annual instalment method. For example, capital expenditure on a new building, or on the refurbishment or enhancement of a building, will be related to the estimated life of that building.

Estimated life periods will be determined under delegated powers – subject to the limitations of the government's investment requirements (2018). To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

The Council participates in LAMS using the cash backed option. The mortgage lenders require a 5 year deposit from the local authority to match the 5 year life of the indemnity. The deposit placed with the mortgage lender provides an integral part of the mortgage lending, and is treated as capital expenditure and a loan to a third party. The Capital Financing Requirement (CFR) will increase by the amount of the total indemnity. The deposit is due to be returned in full at maturity, with interest paid either annually or on maturity. Once the deposit matures and funds are returned to the local authority, the returned funds are classed as a capital receipt, and the CFR will reduce accordingly. As this is a temporary (5 year) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application. The LAMS scheme should be ending in early 2018, but it is possible if there is outstanding debt that it extends into 2018/19 and hence this paragraph is retained within the policy.

Repayments included in finance leases are applied as MRP. It should also be noted that the Council will not make any MRP in regards of the loans to Optivo (previously Amicus Horizon) in respect of the Coastal Space scheme. Optivo will meet the costs of the loan (Principal and Interest). Likewise for any loan to the Foreshore Trust - as the interest and principal repayments to be made by the Council will be funded in full from the sums payable by the Trust no separate MRP will be made by the Council.

The Council is seeking to generate additional income from capital Investments. The Council will look to make a prudent provision for the repayment of debt over the expected life of the asset. In doing so, where an annuity loan is taken or may be taken at some stage in the future to finance the purchase the MRP made will reflect as far as possible the principal element of the actual loan repayments (rather than accruals). The interest rate to be calculated at the outset being determined by the Chief Finance Officer.

APPENDIX 2 Interest Rate Forecasts

The data below shows Sectors forecast

Link Asset Services Interest rate forecast – Dec 2018 – March 2021

Bank Rate	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	**0.75%**	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%
Capital Economics	**0.75%**	0.75%	0.75%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%	-

5yr PWLB Rate	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	**1.76%**	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
Capital Economics	**1.76%**	1.95%	2.03%	2.15%	2.40%	2.65%	2.70%	2.75%	2.80%	2.85%	-

10yr PWLB Rate	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	**2.18%**	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%
Capital Economics	**2.18%**	2.30%	2.43%	2.55%	2.80%	3.05%	3.05%	3.05%	3.05%	3.05%	-

25yr PWLB Rate	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	**2.80%**	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%
Capital Economics	**2.80%**	2.83%	2.96%	3.08%	3.33%	3.58%	3.53%	3.48%	3.43%	3.38%	-

50yr PWLB Rate	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	**2.68%**	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%
Capital Economics	**2.68%**	2.65%	2.78%	2.90%	3.15%	3.40%	3.40%	3.40%	3.40%	3.40%	-

Link Asset Services Interest Rate View	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
Bank Rate	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%
3 Month LIBID	0.68%	0.80%	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%
6 Month LIBID	0.78%	0.90%	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%
12 Month LIBID	0.95%	1.10%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%

APPENDIX 3 Economic Review (Link Asset Services)

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, 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 which is likely to prompt central banks into a series of increases in central rates. The EU is probably about a year behind in a similar progression.

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 has already started in the US, and 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 now means that both asset categories are vulnerable to a sharp downward correction. 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.**

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. In addition, the European Central Bank has cut back its QE purchases substantially and is likely to end them completely by the end of 2018.

UK. The flow of positive economic statistics since the end of the first quarter this year 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; quarter 3 is expected to be robust at around +0.6% but quarter 4 is expected to weaken from that level.

At their November 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 has held back some spare capacity to provide a further fiscal stimulus if needed.

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 next year. 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. 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 2.4% in October. 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 inflation 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 September**,** 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 3.2%, (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 0.8%, 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. In particular, wage rates were increasing at 3.1% y/y in October and heading higher due to unemployment falling to a 49 year low of 3.7%. With CPI inflation over the target rate of 2% and on a rising trend towards 3%, the Fed increased rates another 0.25% in September to between 2.00% and 2.25%, this being the fourth increase in 2018. They also indicated that they expected to increase rates four more times by the end of 2019. The dilemma, however, is what to do when the temporary boost to consumption wanes, particularly as the recent imposition of tariffs on a number of countries' exports to the US,

(China in particular), could see a switch to US production of some of those goods, but at higher prices. Such a scenario would invariably make any easing of monetary policy harder for the Fed in the second half of 2019. However, a combination of an expected four increases in rates of 0.25% by the end of 2019, together with a waning of the boost to economic growth from the fiscal stimulus in 2018, could combine to depress growth below its potential rate, i.e. monetary policy may prove to be too aggressive and lead to the Fed having to start on cutting rates. The Fed has also been unwinding its previous quantitative easing purchases of debt by gradually increasing the amount of monthly maturing debt that it has not been reinvesting.

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. The results of the mid-term elections are not expected to have a material effect on the economy.

Eurozone. Growth was 0.4% in quarters 1 and 2 but fell back to 0.2% in quarter 3, though this is 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 has indicated it is likely to end all further purchases in December 2018. Inflationary pressures are starting to build gently so it is expected that the ECB will start to increase rates towards the end of 2019.

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 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. At the time of writing, the EU has rejected the proposed Italian budget and has demanded cuts in government spending which the Italian government has refused. 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 actions of the Italian government and consequently, Italian bond yields have risen sharply – 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. 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, 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.

- **Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU while **Italy,** this year, has 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. In October 2018, we have seen a sharp fall in equity markets but this has been limited, as yet. 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.

APPENDIX 4 Prudential Indicators

The Council's Capital expenditure plans are the key driver of treasury management activity. The output of the Capital expenditure plans (detailed in the budget) is reflected in the prudential indicators below.

TREASURY MANAGEMENT PRUDENTIAL INDICATORS	2017/18*	2018/19	2019/20	2020/21	2021/22
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt					
Borrowing	£75,000	£85,000	£95,000	£95,000	£95,000
other long term liabilities	£5,000	£5,000	£5,000	£5,000	£5,000
TOTAL	£80,000	£90,000	£100,000	£100,000	£100,000
Operational Boundary for external debt -					
borrowing	£65,000	£75,000	£85,000	£85,000	£85,000
other long term liabilities	£5,000	£5,000	£5,000	£5,000	£5,000
TOTAL	£70,000	£80,000	£90,000	£90,000	£90,000

2017/18* - proposed revision to authorised boundary from £70m to £80m. Operational boundary unaltered.

Interest Rate Exposures	2018/19	2019/20	2020/21
	Upper	Upper	Upper
Limits on fixed interest rates based on **net** debt	100%	100%	100%
Limits on variable interest rates based on **net** debt	100%	100%	100%
Limits on fixed interest rates:			
· Debt only	100%	100%	100%
· Investments only	100%	100%	100%
Limits on variable interest rates			
· Debt only	30%	30%	30%
· Investments only	100%	100%	100%

Maturity Structure of fixed interest rate borrowing 2018/19			
		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 to 20 years		0%	100%
20 years to 30 years		0%	100%
30 years to 40 years		0%	100%
40 years to 50 years		0%	100%

Maturity Structure of variable interest rate borrowing 2018/19			
		lower	Upper
Under 12 Months		0%	30%
12 months to 2 years		0%	30%
2 years to 5 years		0%	30%
5 years to 10 years		0%	30%
10 years to 20 years		0%	10%
20 years to 30 years		0%	10%
30 years to 40 years		0%	10%
40 years to 50 years		0%	10%

Affordability prudential indicator - Ratio of financing costs to net revenue stream

This indicator assesses the affordability of the capital investment plans. It provides an indication of the impact of the capital investment plans on the Council's overall finances 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.

Prudential Indicator: Financing Cost to Net Revenue Stream	2017/18 Actual	2018/19 Rev.Est	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Financing Costs	£'000	£'000	£'000	£'000	£'000
1. Interest Charged to General Fund	925	1,366	1,983	2,296	2,394
2. Interest Payable under Finance Leases and any other long term liabilities	-	-	-	-	-
3. Gains and losses on the repurchase or early settlement of borrowing credited or charged to the amount met from government grants and local taxpayers	-19		0	0	0
4. Interest and Investment Income	-305	-366	-553	-834	-1,062
5. Amounts payable or receiveable in respect of financial derivatives	-	-	-	-	-
6. MRP, VRP	717	795	1,183	1,610	1,766
6. Depreciation/Impairment that are charged to the amount to be met from government grants and local taxpayers	-	-	-	-	-
Total	1,318	1,795	2,613	3,072	3,098
Net Revenue Stream					
Amount to be met from government grants and local taxpayers	13,373	13,459	13,421	13,182	13,477
Ratio					
Financing Cost to Net Revenue Stream	**10%**	**13%**	**19%**	**23%**	**23%**

This prudential indicator shows that the ratio of financing costs to the net revenue stream is increasing. This is not unexpected given that the Council has an income generation strategy that has identified an additional £50m of Capital expenditure over the period 2017/18 to 2020/21. The above ratio does not take into account the income that will be generated from the energy initiatives and commercial property acquisitions.

Other Prudential Indicators

Internal Borrowing and Gearing ratios for the authority are included in the Capital Strategy. Additional prudential indicators will be developed as the forward capital plans of the authority are developed.

APPENDIX 5 Specified and Non-Specified Investments

Specified Investments:

The idea of specified investments is to identify investments offering high security and high liquidity. All these investments should be in sterling and with a maturity of up to a maximum of one year.

Schedule A

	Security / Minimum Credit Rating	Maximum Maturity Period
Local authorities	N/A	1 year
DMADF – UK Government	N/A	1 year
Money market funds (CNAV, LVAV,VNAV)	AAA	Liquid
Term deposits with banks and building societies	Blue Orange Red Green No Colour	Up to 1 year Up to 1 year Up to 6 months Up to 3 months Not for use
Certificates of deposits (CDs) issued by credit rated deposit takers (banks and building societies)	Blue Orange Red Green No Colour	Up to 1 year Up to 1 year Up to 6 months Up to 3 months Not for use
UK Government Gilts	UK sovereign rating	12 months
UK Government Treasury Bills	UK sovereign rating	12 months

Non-Specified Investments

These are any investments which do not meet the specified investment criteria. The aim is to ensure that proper procedures are in place for undertaking risk assessments of investments made for longer periods or with bodies which do not have a “high” credit rating. As far as this Council is concerned the risks are in relation to the value of the investments, which may rise, or fall, rather than deficient credit rating.

There is no intention to invest in Non-Specified Investments, other than those Property Funds where there are no Capital accounting implications, without taking specialist advice first. The limits on Investments in Property Funds will be agreed as part of this Treasury Management Strategy and Investment Policy. For clarity any increase in the level of the investment would need Council approval.

Schedule B

Investment	Security / Minimum credit rating	(A) Why use it? (B) Associated risks
Property Funds	*The use of these instruments can be deemed capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using. Appropriate due diligence will also be undertaken before investment of this type is undertaken.*	
UK Government Gilts with maturities in excess of 1 year Custodial arrangement required prior to purchase	Government backed	(A) (i) Excellent credit quality. (ii) Very liquid. (iii) if held to maturity, known yield (rate of return) per annum – aids forward planning. (iv) If traded, potential for capital gain through appreciation in value (i.e. sold before maturity) (v) No currency risk. (B) (i) 'Market or interest rate risk': Yield subject to movement during life of sovereign bond which could negatively impact on price of the bond i.e. potential for capital loss.

APPENDIX 6 Approved Countries for Investments

The list is based on those countries which have sovereign ratings of AA- or higher (the lowest rating shown from Fitch, Moody's and S&P) and also have banks operating in sterling markets which have credit ratings of green or above in the Link Asset Services credit worthiness service.

Countries that meet our criteria 1, 2, 3, 4 (at 29.12.2018)

1. AAA
   - Australia
   - Canada
   - Denmark
   - Germany
   - Netherlands
   - Singapore
   - Sweden
   - Switzerland
   - U.S.A.

2. AA+
   - Finland

3. AA
   - Abu Dhabi (UAE)
   - France
   - U.K.

4. AA-
   - Belgium
   - Qatar

Examples of Countries that do not meet our criteria:

Japan
Kuwait
Greece
Spain

APPENDIX 7 Treasury Management Policy Statement

The Council defines the policies and objectives of its treasury management activities as:

"The management of the organisation'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".

This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management."

APPENDIX 8 Key Principles and Clauses formally adopted

The Code identifies three key principles:

Key Principle 1

Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities

Key Principle 2

Their policies and practices should make clear that the effective management and control of risk are the prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and portfolio liquidity when investing treasury management funds.

Key Principle 3

They should acknowledge that the pursuit of value for money in treasury management and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

Clauses formally adopted

1. This organisation will create and maintain, as the cornerstones for effective treasury management:

- a Treasury Management Policy Statement, stating the policies, objectives and approach to risk management of its treasury management activities

- suitable Treasury Management Practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The content of the policy statement and TMP's will follow the recommendations contained in Sections 6 and & of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the Codes key principles.

2. This organisation (i.e. full board/council) will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid- year review and an annual report after its close, in the form prescribed in its TMPs.

3. This council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury decisions to the Chief Financial Officer, who will act in accordance with the organisations policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

4. This Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

APPENDIX 9 Treasury Management Scheme of Delegation

(i) Full Council

1. Approval of the Treasury Management Strategy - prior to the new financial year
2. Approval of the Investment Strategy - prior to the new financial year
3. Approval of the MRP Policy - prior to the start of the new financial year
4. Approval of any amendments required to the Strategy during the year
5. Receipt of a Midyear report on the Treasury Management Strategy, to include consideration of any recommendations of the Cabinet or Audit Committee arising from any concerns since the original approval.

(ii) Cabinet

1. Developing and determining the Treasury Management strategy, Investment Strategy and MRP policy and recommending them to full Council - prior to the start of the new financial year.
2. Receipt of a midyear report on the Treasury Management Strategy and any concerns since the original approval and making recommendations to Council as appropriate.
3. Receiving, and reviewing reports on treasury management policies, practices, activities, and performance reports (based on quarterly reporting).
4. Approval of/amendments to the organisation’s adopted clauses, treasury management policy statement;
5. budget consideration and approval;
6. approval of the division of responsibilities;

(iii) Audit Committee

1. Scrutinising the Council's Treasury Management Strategy, Investment Strategy and MRP policy, Treasury Management Policy Statement and Treasury Management Practices and making recommendations to Cabinet and Council as appropriate.

2. Receiving and reviewing monitoring reports (based on quarterly reporting) and making recommendations as appropriate.

APPENDIX 10 The Treasury Management Role of the Section 151 Officer

Chief Finance Officer (S151 Officer) responsibilities

- recommending clauses, treasury management policy for approval, detemining Treasury Management Practices, 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.

Additional Responsibilities following new Codes of Practice/ Investment Guidance

The above list of specific responsibilities of the S151 officer in the 2017 Treasury Management Code has not changed. However, implicit in the changes in both the Prudential and the Treasury Management Codes, is a major extension of the functions of this role, especially in respect of non-financial investments, (which CIPFA has defined as being part of treasury management). Namely:-

1. preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe (say 20+ years – to be determined in accordance with local priorities. Please also note that CIPFA has provided advice that it recognises that it may be too late in the current budget round for 2018/19 for many local authorities to produce a capital strategy this year.)

2. ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money

3. ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority

4. ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing

5. ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources

6. ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities

7. provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees .

8. ensuring that members are adequately informed and understand the risk exposures taken on by an authority

9. ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above

10. Creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following): -

- Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;

- Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;

- Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;

- Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;

- Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.

Appendix 11 – CCLA – Diversified Income Fund

1. Performance

CCLA AUTHORISED CONTRACTUAL SCHEME
Prices & Dividend Yields

CCLA

	End of	Nov-18	Oct-18	Sep-18	Aug-18	Jul-18	Jun-18	May-18	Apr-18	Mar-18	Feb-18	Jan-18	Dec-17
Diversified Income Fund													
	Fund Size £m	129.69	129.76	128.76	107.89	98.58	89.04	89.07	83.30	76.90	76.40	75.00	73.83
Class 1	Price £	1.5449	1.5457	1.5641	1.5779	1.5579	1.5489	1.5495	1.5349	1.5087	1.5378	1.5451	1.5620
	Dividend on XD Date £			0.0120			0.0140			0.0120			0.0101
	Dividend - Last 12 Months £	0.0481	0.0481	0.0481	0.0482	0.0482	0.0482	0.0474	0.0474	0.0474	0.0513	0.0513	0.0513
	Dividend Yield on Price %	3.12	3.11	3.08	3.06	3.10	3.11	3.06	3.09	3.14	3.33	3.32	3.28
Class 2	Price £	1.4882	1.4890	1.5067	1.5205	1.5014	1.4926	1.4931	1.4794	1.4541	1.4823	1.4894	1.5057
	Dividend on XD Date £			0.0117			0.0134			0.0116			0.0098
	Dividend - Last 12 Months £	0.0465	0.0465	0.0465	0.0465	0.0465	0.0465	0.0458	0.0458	0.0458	0.0356	0.0356	0.0356
	Dividend Yield on Price %	3.13	3.12	3.09	3.06	3.10	3.12	3.07	3.10	3.15	3.11	3.09	3.06
Class 3	Price £	1.4966	1.4975	1.5152	1.5287	1.5095	1.5006	1.5010	1.4870	1.4616	1.4897	1.4969	1.5133
	Dividend on XD Date £			0.0117			0.0133			0.0114			0.0017
	Dividend - Last 12 Months £	0.0380	0.0380	0.0380	0.0264	0.0264	0.0264	0.0130	0.0130	0.0130	0.0017	0.0017	0.0017
	Dividend Yield on Price %*	3.06	3.06	3.02	2.98	3.02	3.04	2.64	2.67	2.71	**	**	**

Class 1 launch date: 02 December 2016
Class 2 launch date: 24 March 2017
Class 3 launch date: 01 December 2017

*Dividend Yield on Price % has been annualised.
**Dividend Yield on Price % will be calculated from 31 March 2018.

The units of the ACS and the income from them can fall as well as rise and an investor may not get back the amount originally invested. Past performance is no guarantee of future returns. The units are intended only for long-term investment and are not suitable for money liable to be spent in the near future. Units are realisable daily.

Source: CCLA

2. Background from Link Asset Services (HBC's Treasury Advisors)

3. The fund was set up at the back of 2016 and would only be suitable for long-term investment purposes. The fund is an Advanced Collective Scheme, which we think meets UCITs standards, so would be deemed revenue in structure.

4. Its primary objective is to return circa 3% through a diversified portfolio of assets. There is capital growth potential but it is not the fund's key focus.

They noted the following in June 2018

(i) Fixed Interest & Cash
   a. Cash is via their own MMF
   b. FI only in sterling
   c. Average credit rating of A so the fund will have exposure to "BBB" securities
   d. The manager currently has a cautious view on bonds…too expensive

(ii) Alternatives
   a. Identifying a wider universe of opportunities
   b. These may include student accommodation (long lease), aircraft leases (long lease), solar and wind farms (long lease), private equity funds, care homes / doctors' surgeries (long lease), property funds (but not CCLA one)
   c. Typical yields on these will be 6-8%

(iii) Equities

a. Focus on quality, not higher yielding options
b. For UK – focus on large companies with an international footprint
c. Currently, largest exposure is to US equities
d. Could hedge currency exposure, but would use forward transactions, not more complex derivatives
e. All subject to ERI (Ethical Reputation Index) standards

(iv) While this is a new fund, they have managed similar for other clients (mainly charities and churches) for some time.

(v) Income paid out quarterly at end of Feb, May, Aug, Nov

5. Any investor should check on the individual underlying equity holdings (potentially significant volatility) to see exactly what kind of exposures they are looking to include, particularly as cumulatively around 50% of the fund is in rather volatile assets, being equity and property based.

6. The other 50% of the fund is in income based products which are subject to interest rate risk. Previously, we have assumed that typical c10% cash holding provides for scope to take advantage of any new opportunities they spot.

7. The Key Investor information that CCLA has on the website provides some further points. No stand-alone derivatives, although they will manage FX exposure with efficient techniques. There will be no borrowing.

8. The minimum investment is £1m and the annual management charges are a net 60bps, consistent with other property fund management charges. The dilution levy charge is, however, much lower than property fund charges, which can be 5% on exit and entry (0-1.5% estimated in this case).

9. T+2 settlement provides reasonable liquidity and is similar to an ultra-short dated bond fund.

10. The fund is at present around £100m in size. The characteristics of these types of fund is strong diversification and a strong risk/return relationship.

11. The dividend yield typically of 3-3.5% would be similar to investment grade/ slightly lower than FTSE All-Share returns. The returns overall may be quite similar to a property fund, but its returns would be more capital based than property, which tends to give c4-5% from the funds we look at. They are committed to rising dividends on a nominal basis.

Appendix 12 CCLA Diversified Income Fund - Fact Sheet

CCLA

Diversified Income Fund Unit Class 2 - For local authorities and public sector organisations

Fact Sheet – 30 June 2018

Investment objective

To provide a balanced return from income and capital growth over time from a portfolio structured to control relative risk.

Investment policy

The portfolio will be actively managed and may invest in a wide range of potential assets. The control of relative risk will be an important influence on structure and strategy.

Suitability

The Fund is suitable for long term investors seeking a balanced return of income and capital growth for whom control of relative risk is important.

Who can invest?

Any local authority and public sector investor in England, Wales, Scotland and Northern Ireland. Investors should note that there is a minimum investment in the Fund of £1million.

Responsible investment policy

Information about the ethical and responsible policies to be followed by the Diversified Income Fund is available from the Investment Manager's website www.ccla.co.uk.

Income

The Fund distributes income on a quarterly basis. As at 30 June 2018 the dividend yield on price was 3.12%. This is based on the last 12 months' dividend of 4.65p.

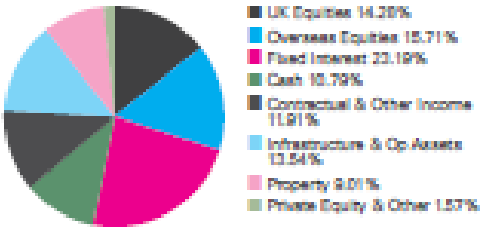
Fund update

The Fund has an actively managed, balanced portfolio diversified across a wide base of good-quality assets.

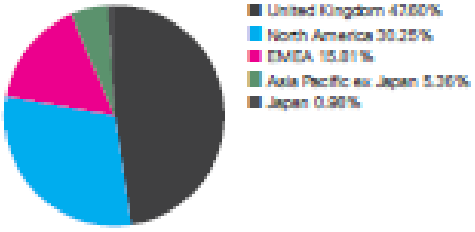
The domestic bond weighting is below that of the benchmark and there is a defensive bias to the securities held, reflected in a maturity profile which is significantly shorter than that on the benchmark. The equity holdings have a bias towards international exposure, both in terms of direct overseas investments and UK companies with a strong global presence. The focus is on robust finances and growth potential, independent of broad economic trends. The result is a relatively high weighting to sectors such as IT and a modest exposure to traditional income sectors such as energy and utilities. The Fund has a high allocation to non-traditional asset classes including infrastructure, alternative energy and contractual income sources such as leasing. Investments such as these make an important contribution to the Fund's income and help control risk by improving diversification.

Recent activity has included increasing the property weighting and introducing an exposure to short-dated US government bonds. In the current environment, these are seen as an attractive alternative to cash.

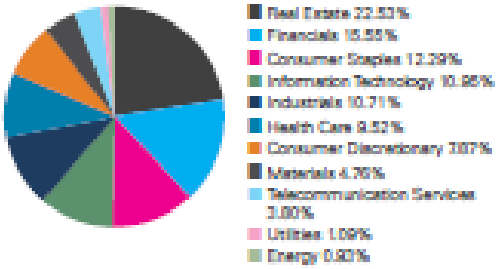
Asset allocation at 30 June 2018



Equity portfolio geographical breakdown at 30 June 2018



Equity portfolio sector breakdown at 30 June 2018



Discrete year total return performance (gross)

12 months to 30 June	2018
Diversified Income Fund - Unit Class 2	+2.24%
Comparator	+4.13%

Comparator – composite: from 24.03.17 MSCI UK IMI 20%, MSCI North America 6.67%, MSCI Europe ex UK 6.67%, MSCI Pacific 6.67%, Markit iBoxx £ Gilts 30% & Markit iBoxx £ Non-Gilts 30%. Source: CCLA. Past performance is not a reliable indicator of future results.

Most overweight companies relative to equity indices at 30 June 2018

F&c Uk Real Estate	5.76%	Accenture	1.61%
Hkt Trust and Hkt Ltd	2.11%	Informa	1.57%
Relx	1.64%	Prologis	1.56%
Pfizer	1.62%	Taiwan Semiconductor	1.49%
Microsoft	1.62%	Medtronic	1.45%

Key facts

Fund size	£89m
Number of holdings	170
Price	£1.49
Fund launch date	2 December 2016
Unit Class 2 launch date	24 March 2017
Minimum initial investment	£1m
Minimum subsequent investment	£25,000
Dealing	Daily*
Sedol number	BD568Q2
ISIN number	GB00BD568Q24
Dividend payment dates	End February, May, August & November
Annual management charge (taken 100% from capital)	0.60%

*The Dealing Deadline is normally 12 noon London time on a Dealing Day. The Valuation Point is normally 3pm on a Dealing Day.

Treasury Management Strategy (TMS) for 2019/20

1. The Local Government Act 2003 (the Act) and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

2. The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy; this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. There is also now the new requirement to produce a Capital Strategy – also for determination by full Council.

3. The Treasury Management strategy covers two remain areas:

   (i) Capital issues
   - the capital plans (in summarised form) and the prudential indicators;
   - the Minimum Revenue Provision (MRP) policy.

   (ii) 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.

4. 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.

5. The strategy for 2019/20 in respect of the following aspects of the treasury management function is based upon the Council officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor, Link Asset Services (previously Capita Asset Services).

Key Changes to the Strategy

6. The key changes from the previous year's strategy are:

   i. The Council has taken on additional borrowing in 2018/19 in respect of the Capital programme and the Income Strategy. The level of borrowing has risen significantly but remained within the operational and authorised boundaries.

The income generation plans of the Council are expected to involve considerable new borrowing again in 2019/20 and the years ahead. The borrowing limits proposed in the strategy are those previously agreed when determining the budget for 2018/19 (included the £50m for income generation) and allow very limited headroom to borrow for the current and forthcoming schemes within the Capital programme without reliance on the capital receipts from land and property disposals.

ii. The majority of the new borrowing in future years will be for Capital purposes, but there will inevitably continue to be a smaller requirement for loans that are revenue in nature e.g. loans to the housing company for running costs. Such monies cannot be borrowed from the Public Works Loan Board, and will be financed from existing Council reserves.

iii. The Council is required to make a Minimum Revenue Provision in respect of its borrowing – to ensure debt is repaid over an appropriate period. Where the Council is making significant investments in property, housing or other programmes the Council's MRP policy enables the Council to match the principal repayments made on loans arranged with a near equal MRP payment (an annuity methodology).

iv. Investment returns should increase in the next few years as the bank base rate increases, albeit marginally. The overall cash return may however decrease as the Council's reserves deminish.

v. The Council invested some of its existing reserves in a Property Fund – up to a limit of £2m by 31 March 2018. This strategy proposes to invest further monies up to £3m in another CCLA (Churches, Charities, and Local Authorities) Fund which is less exposed to property and is more liquid (available to be recalled at shorter notice and with less los of capital and interest). This is seen as important given the potential calls on reserves and the considerable uncertainty surrrounding the impact of Brexit.

Balanced Budget

7. It is a statutory requirement under the Local Government Finance Act 1992, for the Council to calculate its Council Tax requirement. In particular, Section 31 requires a local authority in calculating the Council Tax requirement for each financial year to include the revenue costs that flow from capital financing decisions. Thus any increases in costs (running costs & borrowing costs) from new capital projects must be limited to a level which is affordable within the projected income of the Council for the foreseeable future.

PRUDENTIAL AND TREASURY LIMITS FOR 2019/20 TO 2021/22

The Council's Capital Position (Prudential Indicators)

8. The Council's capital expenditure plans are the key driver of treasury management activity.

9. The prudential code requires the local authority to identify prudential indicators that enable members, officers and the public to make a meaningful judgement on

the Council's total exposure from borrowing and investment decisions. The indicators are required to cover both the Council's current position and the expected position assuming all planned investments in the forthcoming years are completed.

10. This part of the report is structured to update:

    The Council's capital expenditure plans;

    How these plans are being financed;

    The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and

    Reviewing the limits in place for borrowing activity.

Prudential Indicator for Capital Expenditure

11. This table shows the revised estimates for capital expenditure for the current and next three financial years.

	Revised 2018/19 £'000s	**2019/20 £'000s**	**2020/21 £'000s**	**2021/22 £'000s**
Gross Capital Expenditure	26,261	18,961	7,347	3,736
Net Capital Expenditure	22,405	16,066	5,808	2,236
Financing from own resources	953	799	208	120
Borrowing Requirement	21,452	15,267	5,600	2,116

12. In terms of **net cost**, the 2018/19 programme has been revised to £22,405,000 from £28,691,000. The 2019/20 programme amounts to £16,066,000 (£18,961,000 Gross).

Capital Expenditure – Financing

13. The table above summarises the capital expenditure plans and how these plans are being financed – either by own resources e.g. Section 106, Capital receipts or through borrowing. New Capital schemes will generally be financed by borrowing, unless Capital receipts from the sale of assets are available.

14. The larger schemes in the capital programme which are expected to require financing in **2018/19** from borrowing are:-

    - Commercial property purchases estimated at £15m
    - Loans to Hastings Housing Company Ltd estimated at £5.7m
    - Temporary accommodation estimated at £640,000

15. The financing requirements for larger schemes in **2019/20** include:

- Loans to Hastings Housing Company Ltd estimated at £5m
- Commercial property purchases estimated at £4.7m (Stage Payment)
- Energy initiatives at £1.66m
- Street Cleaning Vehicles at £780,000
- York buildings at £602,000
- Country Park Interpretive centre at £266,000 (net)
- Housing – Temporary Accommodation at £1.86m

Impact on the prudential indicators

16. The treasury indicators for borrowing activity are the **Authorised Limit** and the **Operational Boundary** for external debt.

The **Authorised Limit**, which is a limit beyond which external debt is prohibited, needs to be set or revised by the full Council; it is a statutory duty under Section 3 (1) of the Local Government Act 2003 and supporting regulations. It reflects the level of borrowing which, while not desired, could be afforded in the short term. It is the expected maximum borrowing need with some headroom for unexpected movements.

Authorised limit	**2017/18 Estimate £**	**2018/19 Estimate £**	**2019/20 Estimate £**	**2020/21 Estimate £**
Debt	75,000,000	85,000,000	95,000,000	95,000,000
Other long term liabilities	5,000,000	5,000,000	5,000,000	5,000,000
Total	80,000,000	90,000,000	100,000,000	100,000,000

17. The **Operational Boundary** is the limit beyond which external debt is not normally expected to exceed.

Operational boundary	**2017/18 Estimate £**	**2018/19 Estimate £**	**2019/20 Estimate £**	**2020/21 Estimate £**
Debt	65,000,000	75,000,000	85,000,000	85,000,000
Other long term liabilities	5,000,000	5,000,000	5,000,000	5,000,000
Total	70,000,000	80,000,000	90,000,000	90,000,000

18. Essentially the Council is required to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future Council Tax levels is ‘acceptable’.

19. Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion in the Capital programme incorporate financing by both external borrowing as well as other forms of liability e.g. Credit arrangements (such as leases).

20. The Authorised Limit and operational boundary are to be set, on a rolling basis, for the forthcoming financial year and two successive financial years by full Council as part of this strategy.

21. **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.**

PROSPECTS FOR INTEREST RATES

22. The Council has appointed Link Asset Services (previously Capita Asset Services) as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates (Appendix 2 – Economic Review). The following table gives their view.

Link Asset Services Interest Rate View	Dec-18	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%	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	0.80%	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	0.90%	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	1.10%	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	2.00%	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%	2.50%	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%	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%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

23. 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 2018 to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth has been healthy since that meeting, but is expected to weaken somewhat during the last quarter of 2018.

24. At their November 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. The timing of the next increase in Bank Rate is very uncertain. Forecast to be in

May 2019 or December 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

25. 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.

26. Rising bond yields in the US have also caused some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure has been dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

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

28. 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.

BORROWING STRATEGY

29. The capital expenditure plans set out in the budget 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.

Current Portfolio Position

30. The Council's forecast debt position for 31 March 2019, if no further borrowing is taken for the rest of the financial year, as at 28 December 2019, amounted to £44.7m (SeeTable below).

Table 1 – Borrowing

Debt	1 April 2018 Principal	Rate	Maturity	01-Apr-19 Principal	Rate
PWLB Loan 1	£7,500,000	4.80%	2033	£7,500,000	4.80%
PWLB Loan 2			2016		
PWLB Loan 3	£0	1.63%	2018	£0	1.63%
PWLB Loan 4	£2,000,000	0.40% (*Variable)	2019		0.40% (*Variable)
PWLB Loan 5	£909,027	3.78%	2044	£909,027	3.78%
PWLB Loan 6	£1,788,235	3.78%	2044	£1,788,235	3.78%
PWLB Loan 7 (Annuity)	£243,901	1.66%	2026	£215,148	1.66%
PWLB Loan 8	£1,000,000	2.92%	2056	£1,000,000	2.92%
PWLB Loan 9	£1,000,000	3.08%	2046	£1,000,000	3.08%
PWLB Loan 10	£1,000,000	3.01%	2036	£1,000,000	3.01%
PWLB Loan 11	£1,000,000	2.30%	2026	£1,000,000	2.30%
PWLB Loan 12	£2,000,000	2.80%	2054	£2,000,000	2.80%
PWLB Loan 13	£1,000,000	2.42%	2028	£1,000,000	2.42%
PWLB Loan 14	£2,000,000	2.53%	2057	£2,000,000	2.53%
PWLB Loan 15	£2,000,000	2.50%	2059	£2,000,000	2.50%
PWLB Loan 16	£2,000,000	2.48%	2060	£2,000,000	2.48%
PWLB Loan 17 (Annuity)	£7,222,996		2057	£7,113,729	2.53%
PWLB Loan 18 (Annuity)	£8,350,000		2057	£8,232,535	2.72%
PWLB Loan 19			2028	£2,000,000	1.98%
PWLB Loan 20 (Annuity)			2058	£4,000,000	2.55%
Total Debt	**£41,014,159**	**3.15%**		**£44,758,674**	**3.03%**

The Council has loaned money to other organisations. As at 30 September 2018 three longer term loans are outstanding. Namely:

Table 2 – Loans to Other Organisations

3rd Party Organisations	Rate/ Return (%)	Start Date	End Date	Principal £	Term
Amicus /Optivo	3.78	04/09/2014	02/09/2044	1,788,235	Fixed
The Foreshore Trust	1.66	21/03/2016	20/03/2026	229,583	Annuity
The Source	2.43	17/12/2015	17/12/2025	19,304	Annuity
			Total	2,037,122	

31. A further loan has been agreed with Freedom Leisure in respect of the new climbing wall at Summerfields leisure Centre (as per the cabinet report of 8 April 2018). The loan agreement for some £134,037 is being finalised.

32. Borrowing from the PWLB was taken to fund the Amicus Horizon (now Optivo) loan (£1,788,235- maturity loan) and the loan to the Foreshore Trust (£300,000 originally borrowed – annuity loan); these correspond to PWLB loans in Table 1 above. The £25,000 loan to the Source is repayable over a 10 year period and is financed from HBC reserves.

Borrowing Limit – Capital Financing Requirement (CFR)

33. The first key control over the treasury activity is a prudential indicator to ensure that borrowing will only be for a capital purpose. The CFR (Capital Financing Requirement) 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 underlying borrowing need. Any capital expenditure which has not been funded from grants, revenue, reserves or capital receipts will increase the CFR.

34. The Council has at the time of writing some £46.7m of PWLB debt, with £2m of debt being repaid in January 2019, and should look to borrow up to the projected level of the CFR (£60.1m) by the end of March 2019 or risk exposure to interest rate movements .

35. There has been, not unexpectedly, a big impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow. The Capital Financing Requirement has increased significantly over the last 18 months. It is expected to reach some £78.6m by 2021/22 (based on the capital programme approvals to date).

36. As a key indicator the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement (CFR) in the preceding year plus the estimates of any additional CFR for 2018/19 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.

37. The Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

38. The total CFR can also be reduced by:

    (i) the application of additional capital financing resources (such as unapplied capital receipts); or

    (ii) charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

39. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and next two financial years.

40. The Council has been looking to be in a fully funded position given the projected future increases in borrowing rates. This means that the capital borrowing need (the Capital Financing Requirement), has been fully funded with loan debt. Previously cash supporting the Council's reserves, balances and flow has been used as a temporary measure to fund the Capital expenditure. This strategy had been considered prudent as borrowing costs are increasing. However there is a cost of doing this as investment returns are low compared to borrowing costs and counterparty risk is still an issue that needs to be considered.

41. The plans for income generation, which require substantial new borrowing by the Council in the future, play a part in the consideration as to when to borrow and the level of internal borrowing. Given the historically low interest rates and the ability of the Council to look at other investment opportunities which are providing higher returns than the cost of borrowing e.g. property acquisitions or property funds, there remains a much stronger case for minimising the level of internal funding in order to ensure a lower level of borrowing risk in the future.

42. The table below provides an estimate of the Council's Capital Financing Requirement (CFR) for the current and next 3 years. Please note the table below excludes the impact of leases (which have minimal impact at present <£10k).

CFR	2018/19 (Adj. Est)	2019/20 (Est)	2020/21 (Est)	2021/22 (Est)	2022/23 (Est)
	£	£	£	£	£
CFR-Opening	39,493,000	60,150,000	74,234,000	78,215,000	78,565,000
Less MRP	-795,000	-1,183,000	-1,619,000	-1,766,000	-1,866,000
Plus, New Borrowing	21,452,000	15,267,000	5,600,000	2,116,000	0
CFR Closing	60,150,000	74,234,000	78,215,000	78,565,000	76,699,000

43. The table below highlights the Council's projected gross borrowing position against the CFR (showing the level that is financed from internal borrowing).

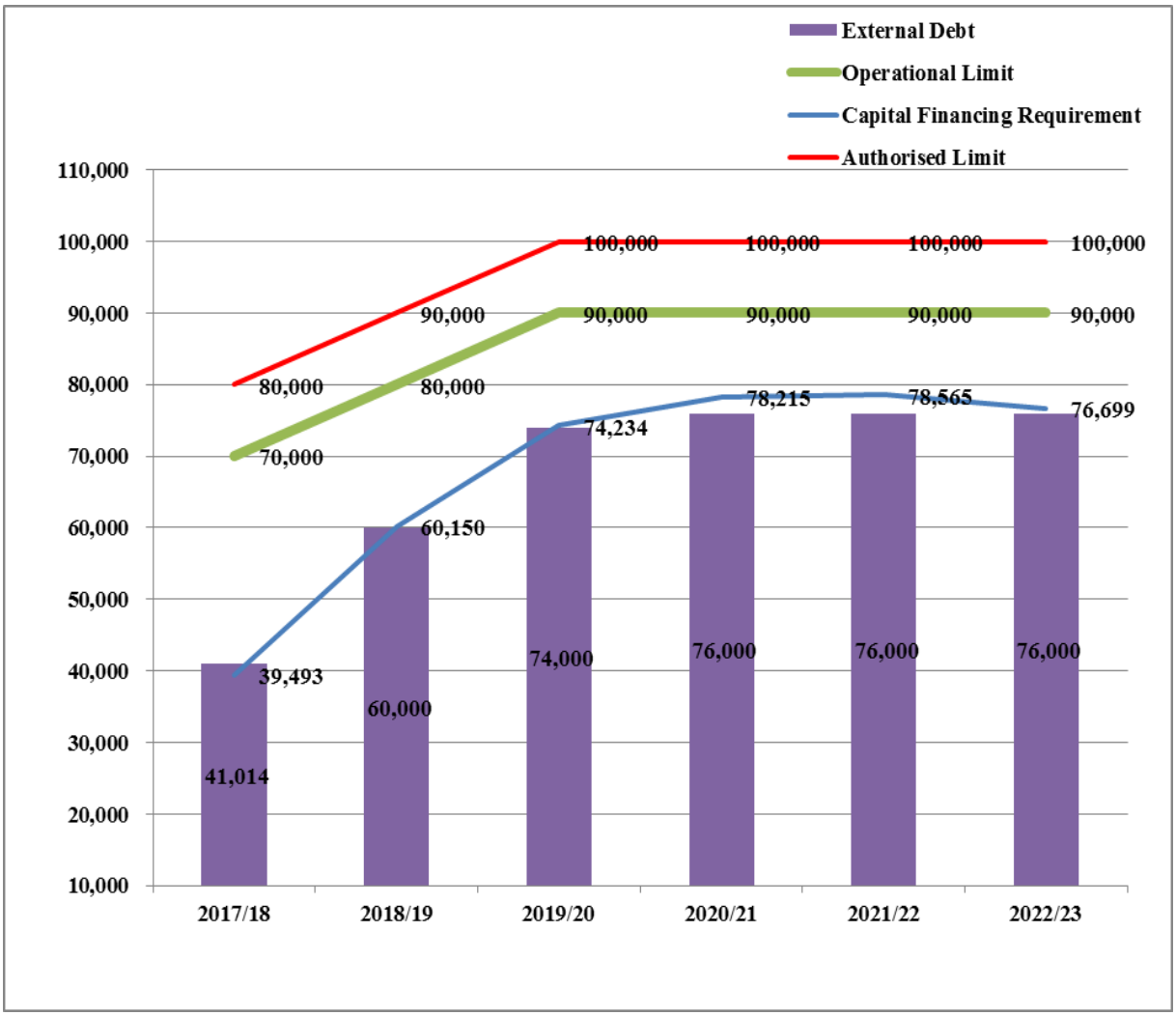
Table 3 Internal Borrowing	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Capital Financing Requirement	60,150,000	74,234,000	78,215,000	78,565,000
External Borrowing Est.	44,750,000	74,000,000	78,000,000	78,000,000
Net Internal Borrowing	15,300,000	234,000	215,000	565,000

44. The Council now has some £44.758m of PWLB debt, and could potentially borrow up to a level of £60.15m (estimated CFR at 31 March 2019). The £60.15 figure does take account of projected new capital spending in the remainder of this year which is expected to be funded by new borrowing.

45. The Council is now (1 January 2019) maintaining a very small under-borrowed position, but this is set to increase to some £15.3m if the Capital programme completes as forecast. In future years the capital borrowing need (the Capital Financing Requirement), is nearly fully funded with loan debt as against cash supporting the Council's reserves, balances and cash flow being used as a temporary measure. This strategy is seen as prudent when interest rates are forecast to increase. However there is a cost, given that investment returns are low and counterparty risk has been relatively high. New borrowing will continue to be taken if good rates are available in the absence of any meaningful Capital receipts being available to fund Capital expenditure.

46. Borrowing activity is constrained by prudential indicators particularly the CFR, and by the authorised limit. The Council's long term borrowing must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure.

47. **Table: External Debt, Authorised limits and CFR Projections**



48. **Borrowing – Overall Limits**

In determining what is a prudent level of borrowing, the Council needs to ensure that it would still be able to provide core services if its investments or income generating initiatives failed – at least in part. As a guide each £1m of new borrowing, financing an asset with a life of 40 years would currently cost the Council some 5.5 % p.a. (based on a maturity loan with a 3% interest rate) i.e. £55,000 p.a.. The Council if investing money in property based assets as against other ventures would have assets to sell if necessary – thus reducing overall risk.

49. In taking on significant levels of additional debt the Council has to ensure that it can afford to do so. It also needs to ensure that it has an affordable exit strategy in the event that expected returns are not realised. Where property is concerned there is normally an asset to dispose of and such schemes are not therefore at the higher end of the risk spectrum. In arriving at the original figure of an additional £50m on the borrowing limit, it was, and still remains the position, that the Council currently has sufficient reserves to ensure that it could dispose of

assets in a reasonable period and not be forced into an immediate fire sale. In the event that property values fell by say 20% the Council would not be forced to sell assets providing the rental streams were secure.

50. **Borrowing – Certainty Rate**

The Council again registered for the PWLB certainty rate earlier in the year which has given a 20 basis point reduction in the average rate of borrowing. The Council will look to do so again for 2019/20 and thereafter if it remains available.

51. **Borrowing – Change of Sentiment**

In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. The Chief Finance Officer, in conjunction with the treasury advisors, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

a. if it were felt that there was a significant risk of a sharp FALL in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered

b. if it were felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still relatively cheap.

52. **Borrowing – Timing**

The general aim of this treasury management strategy is to minimise the costs of borrowing in both the short and longer term. In the short term it can consider avoiding new borrowing and using cash balances to finance new borrowing. However to minimise longer term costs it needs to borrow when rates are a historically low levels. The timing of new borrowing is therefore important to minimise the overall costs to the Council.

53. Given that rates look set to increase and given an increased borrowing requirement relating to Capital programme it is recommended that new borrowing is taken rather than use internal balances for long life assets. Likewise, given that the Council is increasingly using its reserves these need to be readily available and not subjected to unnecessary risk or exposure.

Summary

54. New borrowing has been taken over the last 18 months, to not only take advantage of the historically low rates, but to ensure that the Council's own reserves are cash backed should restrictions be placed on the amount and levels

of borrowing that authorities can undertake (particularly from the PWLB) and a balanced view will continue to be taken.

55. The plans for income generation require further substantial new borrowing by the Council. The plans play a large part in the consideration as to when to borrow and the level of internal borrowing. Given the historically low interest rates and the ability of the Council to look at other investment opportunities which are providing higher returns than the cost of borrowing e.g. property funds, there has been a much stronger case for reducing the level of internal funding in order to ensure a lower level of borrowing risk in the future.

56. The cheapest borrowing will be internal borrowing by running down cash balances and foregoing interest earned at historically low rates. However, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration has been given to weighing the short term advantage of internal borrowing against the potential increase in long term costs as rates rise. As such additional new borrowing has been, and will continue to be, taken.

57. The use of PWLB variable rate loans for up to 10 years will still be considered as they can be repaid early without early redemption premiums. They can also be converted into longer dated fixed rate debt should it be considered prudent to do so.

58. The use of fixed rate market loans will also be considered should rates be below PWLB rates for the equivalent maturity period.

59. The use of either PWLB maturity or annuity loans will be considered in order to minimise annual borrowing costs.

Policy on borrowing in advance of need

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 considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

61. In determining whether borrowing will be undertaken in advance of need the Council will:

    a. ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need.
    b. ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered.
    c. evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.
    d. consider the merits and demerits of alternative forms of funding.
    e. consider the appropriate funding period.
    f. consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the

consequent increase in exposure to counterparty risk, and the level of such risks given the controls in place to minimise them.

Debt Rescheduling

62. The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt, which has now been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that PWLB to PWLB debt restructuring is now much less attractive than it was before both of these events. In particular, consideration would have to be given to the large premiums which would be incurred by prematurely repaying existing PWLB loans and it is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing.

63. The Council also keeps under review the potential for making premature debt repayments in order to reduce borrowing costs as well as reducing counterparty risk by reducing investment balances. However, the cost of the early repayment premiums that would be incurred and the increase in risk exposure to significantly higher interest rates for new borrowing, continue to make this option unattractive. When last reviewed on the 27 September 2017 the early repayment cost of the £7.5m PWLB loan, maturing in 2033, would amount to £3,177,343. No debt rescheduling is being contemplated at present.

64. The reasons for any rescheduling to take place will include:

    a. the generation of cash savings and / or discounted cash flow savings,

    b. helping to fulfil the strategy outlined above

    c. enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Minimum Revenue Provision (MRP)

65. Appendix 1 of this report provides the detail on what the MRP is and the basis of the calculation. Basically, authorities are required each year to set aside some of their revenues as provision for debt repayment. Unlike depreciation which is reversed out of the accounts, this provision has a direct impact on the Council Tax requirement. The provision is in respect of capital expenditure that is financed by borrowing or credit arrangements e.g. leases.

66. The Council is required to make a “Prudent Provision” which basically ensures that revenue monies are set aside to repay the debt over the useful life of the asset acquired i.e. the Minimum Revenue Provision (MRP). This can be achieved by equal annual instalments (current practice) or an annuity method – annual payments gradually increasing over the life of the asset. Where an annuity loan is taken, the Council’s policy (Appendix 1) was amended last year to reflect the matching, as far as possible, of the MRP with the actual principal repaid (within each debt repayment).

67. The MRP for 2018/19 is estimated at £1,116,000 (the statutory charge to revenue that remains within the accounts).

ANNUAL INVESTMENT STRATEGY

Investment Policy

68. The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the CIPFA TM Code"). The Council's investment priorities will be security first, portfolio liquidity second, and then return.

69. 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.

70. 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 achieve this consideration 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.

71. 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.

72. Investment instruments identified for use in the financial year are listed in an attached Appendix under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.

73. The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

74. In accordance with guidance from the MHCLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agency.

Creditworthiness Policy

75. This Council uses the creditworthiness service provided by Link Asset Services - the potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications. This service has been progressively enhanced over the last couple

of years and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moody's and Standard and Poor's, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays: -

- credit watches and credit outlooks from credit rating agencies
- Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

76. 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 code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments and are therefore referred to as durational bands. This is a service which the Council would not be able to replicate using in house resources.

77. The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Link Asset service's weekly credit list of worldwide potential counterparties. The Council will therefore use counterparties within the following durational bands: -

- Purple 2 years (but HBC will only invest for up to 1 year – except Property Fund and Diversified Income Fund)
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100days
- No Colour not to be used

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

79. Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of 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.

80. This Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties as Moody's tend to be more aggressive in giving low ratings than the other two agencies. This would therefore be unworkable and leave the Council with few

banks on its approved lending list. The Link creditworthiness service does though, use ratings from all three agencies, but by using a risk based scoring system, does not give undue weighting to just one agency's ratings.

81. The Council is alerted to the changes to credit ratings of all three agencies through its use of the Link creditworthiness service. These are monitored on a daily basis with lists updated weekly by Link Asset Services.

82. Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on government support for banks and the credit ratings of that government support.

83. The Council only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 6. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy. The maximum investment in any non UK country is not to exceed £10m.

Investment Strategy

84. The table below provides a snapshot of the investments and deposits held mid year (on 30 September 2018). The level of investments can fluctuate significantly on a day to day basis, given the level of funding received, precept payments, grants payable and receivable, salaries and wages, etc.

Table – Investments and Deposits

Counterparty	Rate/ Return	Start Date	End Date	Principal	Term
Australia & NZ BCG Ltd	0.90%	29/08/2018	29/11/2018	5,000,000	Fixed
Birmingham City Council	1.05%	30/08/2018	28/08/2019	3,000,000	Fixed
Blackpool Borough Council	0.80%	28/09/2018	28/01/2019	2,000,000	Fixed
Blaenau Gwent CBC	0.50%	25/06/2018	03/10/2018	2,000,000	Fixed
DBS Bank Ltd London	0.77%	18/09/2018	18/10/2018	3,000,000	Fixed
Eastleigh Borough Council	0.65%	24/08/2018	25/02/2019	5,000,000	Fixed
London Borough of Harrow	0.75%	10/09/2018	10/04/2019	2,000,000	Fixed
Barclays Corporate	0.40%			2,998,426	Call
NAT West	0.05%			1,720	Call
Santander	0.40%			505	Call
			Total	**25,000,651**	

85. Priority is given to security and liquidity of investments in order to reduce counterparty risk to the maximum possible extent.

86. The Council has various limits depending upon the credit rating e.g. £5m with any one institution with a minimum short term rating of F+, and a long term rating of A+ or above, supported by a red (6 month) rating by Capita Asset Services. The

£5m limit generally represents a level of up to 25% of the investment portfolio with any one institution or group at any one time. It is also necessary, at times, to invest sums of this size in order to attract the larger institutions which have the higher credit ratings.

87. The Eurozone and Brexit have led to a number of downgrades to banks' credit ratings, making it increasingly difficult to spread investments across a number of institutions. The Chief Finance Officer has the authority to amend the limits on a daily basis if necessary to ensure that monies can be placed with appropriate institutions.

Investment Strategy – Property Fund

88. It was agreed in February 2017 that the option for diversification of some of the investments into a property fund be undertaken with CCLA in the sum of £2m. The investment being in respect of the Council's reserves that are not required for a period of at least 5 years in order that any fall in values and entry costs into such funds can be covered. The £2m was invested in April 2017 and the performance is detailed below:

CCLA - LA's Property Prices and Dividend yields							
End of	Dec-18	Sep-18	Jun-18	Mar-18	Dec-17	Sep-17	Apr-17
Offer Price p	329.35	324.17	324.10	322.40	319.44	314.48	307.19
Net Asset Value p	308.53	303.67	303.61	302.01	299.24	294.60	287.77
Bid Price p	303.75	298.97	298.90	297.33	294.60	290.03	283.31
Dividend* on XD Date p	3.32	3.17	3.28	3.21	3.38	3.34	
Dividend* - Last 12 Months p	12.98	13.04	13.64	13.70	13.71	13.13	13.19
Dividend Yield on NAV %	4.21	4.29	4.49	4.54	4.58	4.46	4.58
Fund Size £m	1,099.0	1,047.8	1,027.7	976.3	930.8	836.2	710.2

89. The dividend yield is around 4.9% on the net asset value, which results in quarterly cash dividends of around £21,000. Full year dividends are estimated at around £84,000 (£63,614 as at 31 December 2018).

Table Showing Capital Value Increases since April 2017

Units (651,063)	Dec-18	Sep-18	Jun-18	Mar-18	Dec-17	Sep-17	Apr-17
Mid Market Price(£)	2,008,724.67	1,977,083.01	1,976,692.37	1,966,275.37	1,948,240.92	1,918,031.60	1,873,564.00
Bid Price (£)	1,977,603.86	1,946,483.05	1,946,027.31	1,935,805.62	1,918,031.60	1,888,278.02	1,844,526.59

90. The Capital value increased by some 4.95% per annum between April 2017 and March 2018 and that trend is currently continuing. It is important that this is continued to be viewed as a longer term investment (5 years plus), albeit the original Capital value is now projected to be recovered by April 2019.

Investment Strategy – Diversified Income Fund (CCLA)

91. The Council's reserves are diminishing and given uncertainties around Brexit and the implications, either way, over the next few years, the Council needs to ensure that it has cash available when required. The Council invested £2m last financial year in the CCLA Property Fund which has been very successful to date, but will have taken some 2 years to recover the original Capital value of the investment made.

92. It is recommended that the Council invests up to £3m in a more diversified fund that returns just above 3% which although a lower return than the Property Fund, has much lower entry and exit costs but still achieves more than if invested solely as cash. In terms of the complete fund, 75% of it could be liquidated within 2 days if necessary – unlike the existing Property Fund.

93. Investing in the fund would still be viewed as a long term investment, would provide a higher rate of return than current cash investments, and provide a more diversified investment income stream. The additional interest earned, estimated at some £60,000 p.a. is included in the 2019/20 budget.

94. Due diligence on CCLA (Churches, Charities and Local Authorities) has been undertaken previously and is owned by its investors. Currently there are 28 authorities and 2 charity clients investing £126m in this fund with more in the pipeline. More details on the fund are included in Appendix 11 and the fact sheet is included in Appendix 12.

Investment Strategy – View on Interest Rates

95. Investment returns have started to increase in 2018/19 and are expected to be on a gently rising trend over the next few years.

Investment Return Expectations.

96. 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%

97. The Council will look to report on the actual return achieved on its cash investments, both in terms of percentage and actual cash. It will look to report separately on different categories of cash investments e.g. Property Fund. It will use the London Interbank Bid Rate (3 month rate) as a comparator.

Investment Strategy – Income Generation

98. The income generation proposals that the Council is looking at require substantial investments to be made by the Council and will necessitate new borrowing. The levels of new borrowing that the Council can afford to take on board for new commercial property purchases and development, housing and energy schemes, etc, will be dependent upon the individual proposals and credit worthiness of the counterparties involved. Due to the timescales within which some property purchasing and disposal decisions have to be made the Council's existing governance arrangements and delegated authorities have been revised e.g. establishment of Income Generation Board.

99. The additional risks that the Council is taking on need to be considered in the context of the totality of risk that the Council faces e.g. Pier claim, rates revaluation, robustness of income streams, economic downturns, etc. Where there is more risk and volatility in income streams the Council will need to ensure that it maintains sufficient reserves to ensure the Council's ability to deliver key services is not jeopardised.

100. The income generation proposals require revenue loans to be provided to Council owned companies. Such funding is not be available from the Public Works Loan Board, and is therefore from existing Council reserves and balances. The rates of interest that are charged to the company (s) are determined at the time of the advance and need to comply with state aid rules where thresholds are exceeded – a market rate being payable.

Accounting Implications

101. International Financial reporting Standard Number 9 (IFRS 9) – This is an important consideration when assessing any investments now and will encompass the 2018/19 Accounting Code of Practice proposals for financial assets.

102. Expected Credit Loss Model – Whilst this should not be material for normal treasury investments, longer dated service investments, loans to third parties or loans to subsidiaries may be more problematic;

103. As the code is currently structured, equity related to the "commercialism" agenda, property funds, equity funds and similar, are likely to be classified as Fair Value through the Profit and Loss (FVPL). It is understood some funds are suggesting the election to Fair Value through Comprehensive Income (FVCI) applies to property funds as it would be deemed to be an equity investment. In late 2018 the government have confirmed there will be a statutory override to FVPL for these types of investment for a period of 5 years.

End of Year Investment Report

104. At the end of the financial year, officers will report to Council on its investment activity as part of its Annual Treasury Report (to be presented by no later than 30 September).

Policy on Use of External Service Providers

105. The Council uses Link Asset Services (Capita Asset Services previously) as its external treasury management advisors. There is currently value in employing external providers of treasury management services in order to acquire access to credit worthiness information and specialist advice.

106. **Training**

The CIPFA Code requires the responsible officer (Chief Financial 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 was provided in November on Joint Ventures. In terms of Treasury management in general, training has been undertaken by members on an annual basis to date and further training is being arranged for all members prior to full Council on 20 February 2019.

The training needs of treasury management officers are periodically reviewed.

107. **MiFID II (Markets in Financial Instruments Directive)**

In brief, this directive requires the Council to distinguish itself as either a retail or professional client. In order to qualify for professional status the Council is required to show that it has more than £10m in investments, invests regularly (more than 10 times a quarter), as well as having appropriately trained and experienced staff.

108. To date only two counterparties have required us to complete the forms in order to maintain the existing professional status. The directive became law on 1 January 2018.

109. The two parties to date are Link Asset Services and CCLA. A schedule of such counterparties will be maintained, as per the requirements of the Code, should the list expand further.

Scheme of Delegation

110. Please see Appendix 9.

Role of the Section 151 Officer

111. Please see Appendix 10.

APPENDIX 1

Minimum Revenue Provision – An Introduction

1. What is a Minimum Revenue Provision?
Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. It would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred therefore such expenditure is spread over several years in order to try to match the years over which such assets benefit the local community through their useful life. The manner of spreading these costs is through an annual Minimum Revenue Provision, which was previously determined under Regulation, and will in future be determined under Guidance.

2. Statutory duty
Statutory Instrument 2008 no. 414 s4 lays down that:

"A local authority shall determine for the current financial year an amount of minimum revenue provision that it considers to be prudent."

The above is a substitution for the previous requirement to comply with regulation 28 in S.I. 2003 no. 3146 (as amended).

There is no requirement to charge MRP where the Capital Financing Requirement is nil or negative at the end of the preceding financial year.

3. Government Guidance
Along with the above duty, the Government issued guidance which came into force on 31st March 2008 which requires that a Statement on the Council's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which the provision will relate.

The Council is legally obliged to "have regard" to the guidance, which is intended to enable a more flexible approach to assessing the amount of annual provision than was required under the previous statutory requirements. The guidance offers four main options under which MRP could be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The requirement to 'have regard' to the guidance therefore means that: -

Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent.

It is the responsibility of each authority to decide upon the most appropriate method of making a prudent provision, after having had regard to the guidance.

Option 1: Regulatory Method
Under the previous MRP regulations, MRP was set at a uniform rate of 4% of the adjusted CFR (i.e. adjusted for "Adjustment A") on a reducing balance method (which in effect meant that MRP charges would stretch into infinity). This historic approach must continue for all capital expenditure incurred in years before the start of this new approach. It may also be used for new capital expenditure up to the amount which is deemed to be supported through the SCE annual allocation.

Option 2: Capital Financing Requirement Method
This is a variation on option 1 which is based upon a charge of 4% of the aggregate CFR without any adjustment for Adjustment A, or certain other factors which were brought into account under the previous statutory MRP calculation. The CFR is the measure of an authority's outstanding debt liability as depicted by their balance sheet.

Option 3: Asset Life Method.
This method may be applied to most new capital expenditure, including where desired that which may alternatively continue to be treated under options 1 or 2.

Under this option, it is intended that MRP should be spread over the estimated useful life of either an asset created, or other purpose of the expenditure. There are two useful advantages of this option: -
Longer life assets e.g. freehold land can be charged over a longer period than would arise under options 1 and 2.
No MRP charges need to be made until the financial year after that in which an item of capital expenditure is fully incurred and, in the case of a new asset, comes into service use (this is often referred to as being an 'MRP holiday'). This is not available under options 1 and 2.

There are two methods of calculating charges under option 3:
equal instalment method – equal annual instalments,
annuity method – annual payments gradually increase during the life of the asset.

Option 4: Depreciation Method
Under this option, MRP charges are to be linked to the useful life of each type of asset using the standard accounting rules for depreciation (but with some exceptions) i.e. this is a more complex approach than option 3.

The same conditions apply regarding the date of completion of the new expenditure as apply under option 3.

Minimum Revenue Provision Policy Statement 2018/19

The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2008/9 , and will assess the MRP for 2018/19 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

A major proportion of the MRP for 2018/19 relates to the more historic debt liability that will continue to be charged at the rate of 4%, in accordance with option 1 of the guidance. Certain expenditure reflected within the debt liability at 31st March 2018 will under delegated powers be subject to MRP under option 3, which will be charged over

a period which is reasonably commensurate with the estimated useful life applicable to the nature of expenditure, using the equal annual instalment method. For example, capital expenditure on a new building, or on the refurbishment or enhancement of a building, will be related to the estimated life of that building.

Estimated life periods will be determined under delegated powers – subject to the limitations of the government's investment requirements (2018). To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

The Council participates in LAMS using the cash backed option. The mortgage lenders require a 5 year deposit from the local authority to match the 5 year life of the indemnity. The deposit placed with the mortgage lender provides an integral part of the mortgage lending, and is treated as capital expenditure and a loan to a third party. The Capital Financing Requirement (CFR) will increase by the amount of the total indemnity. The deposit is due to be returned in full at maturity, with interest paid either annually or on maturity. Once the deposit matures and funds are returned to the local authority, the returned funds are classed as a capital receipt, and the CFR will reduce accordingly. As this is a temporary (5 year) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application. The LAMS scheme should be ending in early 2018, but it is possible if there is outstanding debt that it extends into 2018/19 and hence this paragraph is retained within the policy.

Repayments included in finance leases are applied as MRP. It should also be noted that the Council will not make any MRP in regards of the loans to Optivo (previously Amicus Horizon) in respect of the Coastal Space scheme. Optivo will meet the costs of the loan (Principal and Interest). Likewise for any loan to the Foreshore Trust - as the interest and principal repayments to be made by the Council will be funded in full from the sums payable by the Trust no separate MRP will be made by the Council.

The Council is seeking to generate additional income from capital Investments. The Council will look to make a prudent provision for the repayment of debt over the expected life of the asset. In doing so, where an annuity loan is taken or may be taken at some stage in the future to finance the purchase the MRP made will reflect as far as possible the principal element of the actual loan repayments (rather than accruals). The interest rate to be calculated at the outset being determined by the Chief Finance Officer.

APPENDIX 2 Interest Rate Forecasts

The data below shows Sectors forecast

Link Asset Services Interest rate forecast – Dec 2018 – March 2021

Bank Rate	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	**0.75%**	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%
Capital Economics	**0.75%**	0.75%	0.75%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%	-

5yr PWLB Rate	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	**1.76%**	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
Capital Economics	**1.76%**	1.95%	2.03%	2.15%	2.40%	2.65%	2.70%	2.75%	2.80%	2.85%	-

10yr PWLB Rate	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	**2.18%**	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%
Capital Economics	**2.18%**	2.30%	2.43%	2.55%	2.80%	3.05%	3.05%	3.05%	3.05%	3.05%	-

25yr PWLB Rate	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	**2.80%**	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%
Capital Economics	**2.80%**	2.83%	2.96%	3.08%	3.33%	3.58%	3.53%	3.48%	3.43%	3.38%	-

50yr PWLB Rate	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	**2.68%**	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%
Capital Economics	**2.68%**	2.65%	2.78%	2.90%	3.15%	3.40%	3.40%	3.40%	3.40%	3.40%	-

Link Asset Services Interest Rate View	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
Bank Rate	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%
3 Month LIBID	0.68%	0.80%	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%
6 Month LIBID	0.78%	0.90%	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%
12 Month LIBID	0.95%	1.10%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%

APPENDIX 3 Economic Review (Link Asset Services)

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, 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 which is likely to prompt central banks into a series of increases in central rates. The EU is probably about a year behind in a similar progression.

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 has already started in the US, and 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 now means that both asset categories are vulnerable to a sharp downward correction. 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.**

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. In addition, the European Central Bank has cut back its QE purchases substantially and is likely to end them completely by the end of 2018.

UK. The flow of positive economic statistics since the end of the first quarter this year 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; quarter 3 is expected to be robust at around +0.6% but quarter 4 is expected to weaken from that level.

At their November 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 has held back some spare capacity to provide a further fiscal stimulus if needed.

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 next year. 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. 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 2.4% in October. 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 inflation 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 September**,** 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 3.2%, (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 0.8%, 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. In particular, wage rates were increasing at 3.1% y/y in October and heading higher due to unemployment falling to a 49 year low of 3.7%. With CPI inflation over the target rate of 2% and on a rising trend towards 3%, the Fed increased rates another 0.25% in September to between 2.00% and 2.25%, this being the fourth increase in 2018. They also indicated that they expected to increase rates four more times by the end of 2019. The dilemma, however, is what to do when the temporary boost to consumption wanes, particularly as the recent imposition of tariffs on a number of countries' exports to the US,

(China in particular), could see a switch to US production of some of those goods, but at higher prices. Such a scenario would invariably make any easing of monetary policy harder for the Fed in the second half of 2019. However, a combination of an expected four increases in rates of 0.25% by the end of 2019, together with a waning of the boost to economic growth from the fiscal stimulus in 2018, could combine to depress growth below its potential rate, i.e. monetary policy may prove to be too aggressive and lead to the Fed having to start on cutting rates. The Fed has also been unwinding its previous quantitative easing purchases of debt by gradually increasing the amount of monthly maturing debt that it has not been reinvesting.

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. The results of the mid-term elections are not expected to have a material effect on the economy.

Eurozone. Growth was 0.4% in quarters 1 and 2 but fell back to 0.2% in quarter 3, though this is 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 has indicated it is likely to end all further purchases in December 2018. Inflationary pressures are starting to build gently so it is expected that the ECB will start to increase rates towards the end of 2019.

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 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. At the time of writing, the EU has rejected the proposed Italian budget and has demanded cuts in government spending which the Italian government has refused. 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 actions of the Italian government and consequently, Italian bond yields have risen sharply – 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. 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, 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.

- **Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU while **Italy,** this year, has 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. In October 2018, we have seen a sharp fall in equity markets but this has been limited, as yet. 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.

APPENDIX 4 Prudential Indicators

The Council's Capital expenditure plans are the key driver of treasury management activity. The output of the Capital expenditure plans (detailed in the budget) is reflected in the prudential indicators below.

TREASURY MANAGEMENT PRUDENTIAL INDICATORS	2017/18*	2018/19	2019/20	2020/21	2021/22
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt					
Borrowing	£75,000	£85,000	£95,000	£95,000	£95,000
other long term liabilities	£5,000	£5,000	£5,000	£5,000	£5,000
TOTAL	£80,000	£90,000	£100,000	£100,000	£100,000
Operational Boundary for external debt -					
borrowing	£65,000	£75,000	£85,000	£85,000	£85,000
other long term liabilities	£5,000	£5,000	£5,000	£5,000	£5,000
TOTAL	£70,000	£80,000	£90,000	£90,000	£90,000

2017/18* - proposed revision to authorised boundary from £70m to £80m. Operational boundary unaltered.

Interest Rate Exposures	2018/19	2019/20	2020/21
	Upper	Upper	Upper
Limits on fixed interest rates based on **net** debt	100%	100%	100%
Limits on variable interest rates based on **net** debt	100%	100%	100%
Limits on fixed interest rates:			
· Debt only	100%	100%	100%
· Investments only	100%	100%	100%
Limits on variable interest rates			
· Debt only	30%	30%	30%
· Investments only	100%	100%	100%

Maturity Structure of fixed interest rate borrowing 2018/19			
		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 to 20 years		0%	100%
20 years to 30 years		0%	100%
30 years to 40 years		0%	100%
40 years to 50 years		0%	100%

Maturity Structure of variable interest rate borrowing 2018/19			
		lower	Upper
Under 12 Months		0%	30%
12 months to 2 years		0%	30%
2 years to 5 years		0%	30%
5 years to 10 years		0%	30%
10 years to 20 years		0%	10%
20 years to 30 years		0%	10%
30 years to 40 years		0%	10%
40 years to 50 years		0%	10%

Affordability prudential indicator - Ratio of financing costs to net revenue stream

This indicator assesses the affordability of the capital investment plans. It provides an indication of the impact of the capital investment plans on the Council's overall finances 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.

Prudential Indicator: Financing Cost to Net Revenue Stream	2017/18 Actual	2018/19 Rev.Est	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Financing Costs	£'000	£'000	£'000	£'000	£'000
1. Interest Charged to General Fund	925	1,366	1,983	2,296	2,394
2. Interest Payable under Finance Leases and any other long term liabilities	-	-	-	-	-
3. Gains and losses on the repurchase or early settlement of borrowing credited or charged to the amount met from government grants and local taxpayers	-19		0	0	0
4. Interest and Investment Income	-305	-366	-553	-834	-1,062
5. Amounts payable or receiveable in respect of financial derivatives	-	-	-	-	-
6. MRP, VRP	717	795	1,183	1,610	1,766
6. Depreciation/Impairment that are charged to the amount to be met from government grants and local taxpayers	-	-	-	-	-
Total	1,318	1,795	2,613	3,072	3,098
Net Revenue Stream					
Amount to be met from government grants and local taxpayers	13,373	13,459	13,421	13,182	13,477
Ratio					
Financing Cost to Net Revenue Stream	**10%**	**13%**	**19%**	**23%**	**23%**

This prudential indicator shows that the ratio of financing costs to the net revenue stream is increasing. This is not unexpected given that the Council has an income generation strategy that has identified an additional £50m of Capital expenditure over the period 2017/18 to 2020/21. The above ratio does not take into account the income that will be generated from the energy initiatives and commercial property acquisitions.

Other Prudential Indicators

Internal Borrowing and Gearing ratios for the authority are included in the Capital Strategy. Additional prudential indicators will be developed as the forward capital plans of the authority are developed.

APPENDIX 5 Specified and Non-Specified Investments

Specified Investments:

The idea of specified investments is to identify investments offering high security and high liquidity. All these investments should be in sterling and with a maturity of up to a maximum of one year.

Schedule A

	Security / Minimum Credit Rating	Maximum Maturity Period
Local authorities	N/A	1 year
DMADF – UK Government	N/A	1 year
Money market funds (CNAV, LVAV,VNAV)	AAA	Liquid
Term deposits with banks and building societies	Blue Orange Red Green No Colour	Up to 1 year Up to 1 year Up to 6 months Up to 3 months Not for use
Certificates of deposits (CDs) issued by credit rated deposit takers (banks and building societies)	Blue Orange Red Green No Colour	Up to 1 year Up to 1 year Up to 6 months Up to 3 months Not for use
UK Government Gilts	UK sovereign rating	12 months
UK Government Treasury Bills	UK sovereign rating	12 months

Non-Specified Investments

These are any investments which do not meet the specified investment criteria. The aim is to ensure that proper procedures are in place for undertaking risk assessments of investments made for longer periods or with bodies which do not have a “high” credit rating. As far as this Council is concerned the risks are in relation to the value of the investments, which may rise, or fall, rather than deficient credit rating.

There is no intention to invest in Non-Specified Investments, other than those Property Funds where there are no Capital accounting implications, without taking specialist advice first. The limits on Investments in Property Funds will be agreed as part of this Treasury Management Strategy and Investment Policy. For clarity any increase in the level of the investment would need Council approval.

Schedule B

Investment	Security / Minimum credit rating	(A) Why use it? (B) Associated risks
Property Funds	*The use of these instruments can be deemed capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using. Appropriate due diligence will also be undertaken before investment of this type is undertaken.*	
UK Government Gilts with maturities in excess of 1 year Custodial arrangement required prior to purchase	Government backed	(A) (i) Excellent credit quality. (ii) Very liquid. (iii) if held to maturity, known yield (rate of return) per annum – aids forward planning. (iv) If traded, potential for capital gain through appreciation in value (i.e. sold before maturity) (v) No currency risk. (B) (i) 'Market or interest rate risk': Yield subject to movement during life of sovereign bond which could negatively impact on price of the bond i.e. potential for capital loss.

APPENDIX 6 Approved Countries for Investments

The list is based on those countries which have sovereign ratings of AA- or higher (the lowest rating shown from Fitch, Moody's and S&P) and also have banks operating in sterling markets which have credit ratings of green or above in the Link Asset Services credit worthiness service.

Countries that meet our criteria 1, 2, 3, 4 (at 29.12.2018)

1. AAA
   - Australia
   - Canada
   - Denmark
   - Germany
   - Netherlands
   - Singapore
   - Sweden
   - Switzerland
   - U.S.A.

2. AA+
   - Finland

3. AA
   - Abu Dhabi (UAE)
   - France
   - U.K.

4. AA-
   - Belgium
   - Qatar

Examples of Countries that do not meet our criteria:

Japan
Kuwait
Greece
Spain

APPENDIX 7 Treasury Management Policy Statement

The Council defines the policies and objectives of its treasury management activities as:

"The management of the organisation'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".

This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management."

APPENDIX 8 Key Principles and Clauses formally adopted

The Code identifies three key principles:

Key Principle 1

Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities

Key Principle 2

Their policies and practices should make clear that the effective management and control of risk are the prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and portfolio liquidity when investing treasury management funds.

Key Principle 3

They should acknowledge that the pursuit of value for money in treasury management and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

Clauses formally adopted

1. This organisation will create and maintain, as the cornerstones for effective treasury management:

- a Treasury Management Policy Statement, stating the policies, objectives and approach to risk management of its treasury management activities

- suitable Treasury Management Practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The content of the policy statement and TMP's will follow the recommendations contained in Sections 6 and & of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the Codes key principles.

2. This organisation (i.e. full board/council) will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid- year review and an annual report after its close, in the form prescribed in its TMPs.

3. This council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury decisions to the Chief Financial Officer, who will act in accordance with the organisations policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

4. This Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

APPENDIX 9 Treasury Management Scheme of Delegation

(i) Full Council

1. Approval of the Treasury Management Strategy - prior to the new financial year
2. Approval of the Investment Strategy - prior to the new financial year
3. Approval of the MRP Policy - prior to the start of the new financial year
4. Approval of any amendments required to the Strategy during the year
5. Receipt of a Midyear report on the Treasury Management Strategy, to include consideration of any recommendations of the Cabinet or Audit Committee arising from any concerns since the original approval.

(ii) Cabinet

1. Developing and determining the Treasury Management strategy, Investment Strategy and MRP policy and recommending them to full Council - prior to the start of the new financial year.
2. Receipt of a midyear report on the Treasury Management Strategy and any concerns since the original approval and making recommendations to Council as appropriate.
3. Receiving, and reviewing reports on treasury management policies, practices, activities, and performance reports (based on quarterly reporting).
4. Approval of/amendments to the organisation’s adopted clauses, treasury management policy statement;
5. budget consideration and approval;
6. approval of the division of responsibilities;

(iii) Audit Committee

1. Scrutinising the Council's Treasury Management Strategy, Investment Strategy and MRP policy, Treasury Management Policy Statement and Treasury Management Practices and making recommendations to Cabinet and Council as appropriate.

2. Receiving and reviewing monitoring reports (based on quarterly reporting) and making recommendations as appropriate.

APPENDIX 10 The Treasury Management Role of the Section 151 Officer

Chief Finance Officer (S151 Officer) responsibilities

- recommending clauses, treasury management policy for approval, detemining Treasury Management Practices, 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.

Additional Responsibilities following new Codes of Practice/ Investment Guidance

The above list of specific responsibilities of the S151 officer in the 2017 Treasury Management Code has not changed. However, implicit in the changes in both the Prudential and the Treasury Management Codes, is a major extension of the functions of this role, especially in respect of non-financial investments, (which CIPFA has defined as being part of treasury management). Namely:-

1. preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe (say 20+ years – to be determined in accordance with local priorities. Please also note that CIPFA has provided advice that it recognises that it may be too late in the current budget round for 2018/19 for many local authorities to produce a capital strategy this year.)

2. ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money

3. ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority

4. ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing

5. ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources

6. ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities

7. provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees .

8. ensuring that members are adequately informed and understand the risk exposures taken on by an authority

9. ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above

10. Creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following): -

- Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;

- Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;

- Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;

- Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;

- Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.

Appendix 11 – CCLA – Diversified Income Fund

1. Performance

CCLA AUTHORISED CONTRACTUAL SCHEME
Prices & Dividend Yields

CCLA

	End of	Nov-18	Oct-18	Sep-18	Aug-18	Jul-18	Jun-18	May-18	Apr-18	Mar-18	Feb-18	Jan-18	Dec-17
Diversified Income Fund													
	Fund Size £m	129.69	129.76	128.76	107.89	98.58	89.04	89.07	83.30	76.90	76.40	75.00	73.83
Class 1	Price £	1.5449	1.5457	1.5641	1.5779	1.5579	1.5489	1.5495	1.5349	1.5087	1.5378	1.5451	1.5620
	Dividend on XD Date £			0.0120			0.0140			0.0120			0.0101
	Dividend - Last 12 Months £	0.0481	0.0481	0.0481	0.0482	0.0482	0.0482	0.0474	0.0474	0.0474	0.0513	0.0513	0.0513
	Dividend Yield on Price %	3.12	3.11	3.08	3.06	3.10	3.11	3.06	3.09	3.14	3.33	3.32	3.28
Class 2	Price £	1.4882	1.4890	1.5067	1.5205	1.5014	1.4926	1.4931	1.4794	1.4541	1.4823	1.4894	1.5057
	Dividend on XD Date £			0.0117			0.0134			0.0116			0.0098
	Dividend - Last 12 Months £	0.0465	0.0465	0.0465	0.0465	0.0465	0.0465	0.0458	0.0458	0.0458	0.0356	0.0356	0.0356
	Dividend Yield on Price %	3.13	3.12	3.09	3.06	3.10	3.12	3.07	3.10	3.15	3.11	3.09	3.06
Class 3	Price £	1.4966	1.4975	1.5152	1.5287	1.5095	1.5006	1.5010	1.4870	1.4616	1.4897	1.4969	1.5133
	Dividend on XD Date £			0.0117			0.0133			0.0114			0.0017
	Dividend - Last 12 Months £	0.0380	0.0380	0.0380	0.0264	0.0264	0.0264	0.0130	0.0130	0.0130	0.0017	0.0017	0.0017
	Dividend Yield on Price %*	3.06	3.06	3.02	2.98	3.02	3.04	2.64	2.67	2.71	**	**	**

Class 1 launch date: 02 December 2016
Class 2 launch date: 24 March 2017
Class 3 launch date: 01 December 2017

*Dividend Yield on Price % has been annualised.
**Dividend Yield on Price % will be calculated from 31 March 2018.

The units of the ACS and the income from them can fall as well as rise and an investor may not get back the amount originally invested. Past performance is no guarantee of future returns. The units are intended only for long-term investment and are not suitable for money liable to be spent in the near future. Units are realisable daily.

Source: CCLA

2. Background from Link Asset Services (HBC's Treasury Advisors)

3. The fund was set up at the back of 2016 and would only be suitable for long-term investment purposes. The fund is an Advanced Collective Scheme, which we think meets UCITs standards, so would be deemed revenue in structure.

4. Its primary objective is to return circa 3% through a diversified portfolio of assets. There is capital growth potential but it is not the fund's key focus.

They noted the following in June 2018

(i) Fixed Interest & Cash
   a. Cash is via their own MMF
   b. FI only in sterling
   c. Average credit rating of A so the fund will have exposure to "BBB" securities
   d. The manager currently has a cautious view on bonds…too expensive

(ii) Alternatives
   a. Identifying a wider universe of opportunities
   b. These may include student accommodation (long lease), aircraft leases (long lease), solar and wind farms (long lease), private equity funds, care homes / doctors' surgeries (long lease), property funds (but not CCLA one)
   c. Typical yields on these will be 6-8%

(iii) Equities

a. Focus on quality, not higher yielding options
b. For UK – focus on large companies with an international footprint
c. Currently, largest exposure is to US equities
d. Could hedge currency exposure, but would use forward transactions, not more complex derivatives
e. All subject to ERI (Ethical Reputation Index) standards

(iv) While this is a new fund, they have managed similar for other clients (mainly charities and churches) for some time.

(v) Income paid out quarterly at end of Feb, May, Aug, Nov

5. Any investor should check on the individual underlying equity holdings (potentially significant volatility) to see exactly what kind of exposures they are looking to include, particularly as cumulatively around 50% of the fund is in rather volatile assets, being equity and property based.

6. The other 50% of the fund is in income based products which are subject to interest rate risk. Previously, we have assumed that typical c10% cash holding provides for scope to take advantage of any new opportunities they spot.

7. The Key Investor information that CCLA has on the website provides some further points. No stand-alone derivatives, although they will manage FX exposure with efficient techniques. There will be no borrowing.

8. The minimum investment is £1m and the annual management charges are a net 60bps, consistent with other property fund management charges. The dilution levy charge is, however, much lower than property fund charges, which can be 5% on exit and entry (0-1.5% estimated in this case).

9. T+2 settlement provides reasonable liquidity and is similar to an ultra-short dated bond fund.

10. The fund is at present around £100m in size. The characteristics of these types of fund is strong diversification and a strong risk/return relationship.

11. The dividend yield typically of 3-3.5% would be similar to investment grade/ slightly lower than FTSE All-Share returns. The returns overall may be quite similar to a property fund, but its returns would be more capital based than property, which tends to give c4-5% from the funds we look at. They are committed to rising dividends on a nominal basis.

Appendix 12 CCLA Diversified Income Fund - Fact Sheet

CCLA

Diversified Income Fund Unit Class 2 - For local authorities and public sector organisations

Fact Sheet – 30 June 2018

Investment objective

To provide a balanced return from income and capital growth over time from a portfolio structured to control relative risk.

Investment policy

The portfolio will be actively managed and may invest in a wide range of potential assets. The control of relative risk will be an important influence on structure and strategy.

Suitability

The Fund is suitable for long term investors seeking a balanced return of income and capital growth for whom control of relative risk is important.

Who can invest?

Any local authority and public sector investor in England, Wales, Scotland and Northern Ireland. Investors should note that there is a minimum investment in the Fund of £1million.

Responsible investment policy

Information about the ethical and responsible policies to be followed by the Diversified Income Fund is available from the Investment Manager's website www.ccla.co.uk.

Income

The Fund distributes income on a quarterly basis. As at 30 June 2018 the dividend yield on price was 3.12%. This is based on the last 12 months' dividend of 4.65p.

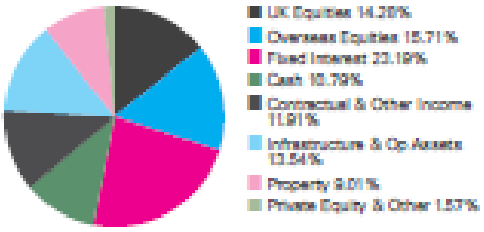
Fund update

The Fund has an actively managed, balanced portfolio diversified across a wide base of good-quality assets.

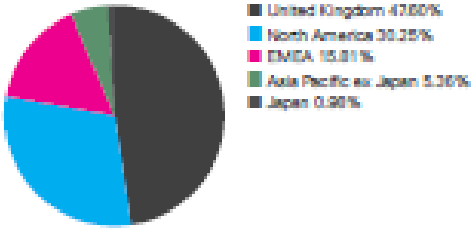
The domestic bond weighting is below that of the benchmark and there is a defensive bias to the securities held, reflected in a maturity profile which is significantly shorter than that on the benchmark. The equity holdings have a bias towards international exposure, both in terms of direct overseas investments and UK companies with a strong global presence. The focus is on robust finances and growth potential, independent of broad economic trends. The result is a relatively high weighting to sectors such as IT and a modest exposure to traditional income sectors such as energy and utilities. The Fund has a high allocation to non-traditional asset classes including infrastructure, alternative energy and contractual income sources such as leasing. Investments such as these make an important contribution to the Fund's income and help control risk by improving diversification.

Recent activity has included increasing the property weighting and introducing an exposure to short-dated US government bonds. In the current environment, these are seen as an attractive alternative to cash.

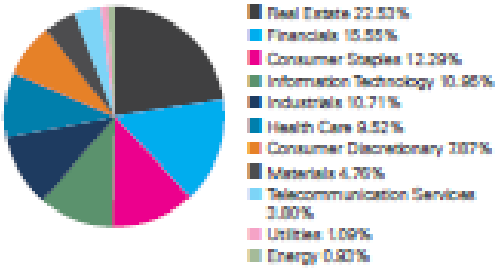
Asset allocation at 30 June 2018



Equity portfolio geographical breakdown at 30 June 2018



Equity portfolio sector breakdown at 30 June 2018



Discrete year total return performance (gross)

12 months to 30 June	2018
Diversified Income Fund - Unit Class 2	+2.24%
Comparator	+4.13%

Comparator – composite: from 24.03.17 MSCI UK IMI 20%, MSCI North America 6.67%, MSCI Europe ex UK 6.67%, MSCI Pacific 6.67%, Markit iBoxx £ Gilts 30% & Markit iBoxx £ Non-Gilts 30%. Source: CCLA. Past performance is not a reliable indicator of future results.

Most overweight companies relative to equity indices at 30 June 2018

F&c Uk Real Estate	5.76%	Accenture	1.61%
Hkt Trust and Hkt Ltd	2.11%	Informa	1.57%
Relx	1.64%	Prologis	1.56%
Pfizer	1.62%	Taiwan Semiconductor	1.49%
Microsoft	1.62%	Medtronic	1.45%

Key facts

Fund size	£89m
Number of holdings	170
Price	£1.49
Fund launch date	2 December 2016
Unit Class 2 launch date	24 March 2017
Minimum initial investment	£1m
Minimum subsequent investment	£25,000
Dealing	Daily*
Sedol number	BD568Q2
ISIN number	GB00BD568Q24
Dividend payment dates	End February, May, August & November
Annual management charge (taken 100% from capital)	0.60%

*The Dealing Deadline is normally 12 noon London time on a Dealing Day. The Valuation Point is normally 3pm on a Dealing Day.

Capital Strategy (2019-20)

Introduction

1. 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 seeks to 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

2. 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.

3. This capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the capital Strategy and the budget report. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset.

4. The capital strategy seeks to identify:

   - The corporate governance arrangements for these types of activities;
   - Service objectives relating to the Capital expenditure;
   - The expected income, costs and resulting contribution;
   - The debt related to the activity and the associated interest costs;
   - The payback period (MRP policy);
   - For non-loan type investments, the cost against the current market value;
   - The risks associated with each activity.

5. Where a physical asset is being bought, details of market research, advisers used, ongoing costs and investment requirements and any credit information will be disclosed, including the ability to sell the asset and realise the investment cash.

6. To demonstrate the proportionality between the treasury operations and the non-treasury operation, high-level comparators are identified.

7. The Capital strategy, and in particular the capital programme supports the Council's Corporate plan and is closely tied to the Medium Term Financial Strategy and the budget. The Capital Strategy is required to be compiled for a longer timeframe – generally 10 to 20 years although not specified.

8. The Council's future spending plans are evolving and as such the Capital Strategy and other strategies will need to be re-determined by full Council when the future plans are sufficiently robust. The report does detail the Council's borrowing commitments until 2061/62 that result from past and current capital programmes.

High Level Overview of how Capital Expenditure, Capital Financing and Treasury Management Activity Contribute to the Provision of Services

9. As detailed in the Council's Medium Term Financial Strategy (MTFS), the Council continues to face major reductions in government grants (see budget report elsewhere on the agenda). The Council seeks to use capital investment in the borough to not only achieve key corporate objectives but also to generate additional income in order to continue to provide services to its residents. The expenditure plans for the next three years are detailed below along with the expected outcomes.

Capital Expenditure 2019/20

10. The Council's Capital programme amounts to some £18.96m (£16m net of grants and contributions) in 2019/20.

The major areas of expenditure include

(i) Loans to the Council's housing company (£5m).
The outcomes being to assist in the provision of overall housing supply, whilst generating a surplus for the Council after borrowing and management costs of some 2% (net) i.e. some £20,000 per £1m borrowed. The surplus being used to support service provision to the residents of the borough.

(ii) Energy Initiatives – Solar Panels (£1.66m) & Ground Mounted Solar
In line with the strategic priority of a greener town the Council is installing roof mounted solar panels in order to supply the Council with its own energy, supplying energy to Council owned assets including commercial tenants and thus providing tenants with the option of a cheaper and greener energy supply. The potential ground mounted solar project in 2019/20 consists of a number of feasibility reports (£84,000). If positive then an investment of some £2.1m may result in 2020/21 providing cost savings and an income stream to the Council.

(iii) Commercial Property (311-323 Bexhill Road) (£4.7m)
In line with the strategic priority of economic and physical regeneration this is the Council's final instalment for the site, which is expected to be completed in the autumn of 2019. The completed units are expected to provide some 50 new jobs as well as secure new income and business rates for the Council, which in turn will help to sustain services within the borough.

(iv) Housing – Temporary Accommodation (£1.86m)
In line with the strategic priority of providing decent homes, the Council is seeking to acquire temporary accommodation, not only to secure accommodation in Hastings, but also to make savings on leasing costs.

(v) Priory Meadow Contribution to capital works (£126,000)
The Council owns 10% of the priory Meadow shopping centre. The money represents its share of the estimated capital investment costs for 2019/20. The Council receives 10% of the net income for the centre which provides a significant contribution towards meeting the service costs of the council.

(vi) Conversion of 12-13 York Buildings (£602,000)
In line with the strategic priority of providing decent homes, the Council is seeking to create 6 flats above the existing shop premises in this grade 2 listed property. The space has been unused for many years, there is a clear housing need, businesses face difficult trading conditions, and the Council can only contemplate such a regeneration project given its access to low borrowing rates. The costs of borrowing are expected to be covered by the future rental streams – but with no additional income stream for the Council.

(vii) Country Park Interpretive Centre (£662,000)
In line with the strategic priorities of a greener town, protecting and enhancing biodiversity, as well as a more attractive town, this new straw build project attracts 60% European funding. A new centre will benefit residents and visitors.

(viii) Playgrounds Upgrade (£92,000)
In line with the strategic objective of an attractive town, this is the continuation of a programme of upgrades, which carries on into 2020/21.

(ix) Direct Service Organisation (DSO) – (£1,036,000)
In line with the strategic objective of an attractive town the Council is providing the Street Cleaning service itself from July 2019. The Capital programme includes conversion building works as well as vehicle acquisition costs.

(x) Pelham Crescent – Building Works and Road (£296,000)
In line with the strategic priority of an attractive town, the council is working with property owners to restore the crescent and roadway. Much of the work is conditional on receipt of external grants and contributions, and works to the road may not be completed until 2021.

(xi) Priory St Multi Storey Car Park (£120,000)
In line with the strategic priorities of an attractive town and economic and physical regeneration, the Council needs to maintain the multi storey car park. This relatively small project will extend the useful life of the car park by some five years.

(xii) Sea Defences (£488,000 & £75,000 groyne refurbishment)
Preserving sea defences and the town is a key priority. This work is mostly 100% grant funded. The Council funds the groyne refurbishment works and sets aside £35,000 p.a. for this. In 2019/20 there is an additional carry forward of funds from prior years.

(xiii) Public Realm (£50,000)
In line with the strategic priorities of an attractive town, the Council sets aside £50,000 annually to seek to maintain the fabric of the town e.g. signposting, benches, seats, planters, highway and lighting improvements.

(xiv) Disabled Facility Grants (£1.5m (est) – all grant funding)
Property related grants for adapting homes. In 2018/19 the Council will receive funding approaching £1.9m. The figure for 2019/20 is as yet unknown.

(xv) Empty Homes (£100,000)
In line with the strategic priorities of creating decent homes and intervention where it is needed, the Council seeks to compulsory purchase properties that are long term empty, in order to bring much needed homes back into use.

Capital Expenditure 2020/21

11. The main areas of expenditure in 2020/21 are energy (£2.1m potentially for ground mounted solar), loans to Hastings Housing Company (£3.5m), Disabled Facility Grants (£1.5m), Playgrounds (£50,000), Public Realm (£50,000), Groyne refurbishment (£35,000), Empty Homes (£50,000)

Capital Expenditure 2021/22

12. The main areas of expenditure are currently energy generation (£2.116m), Public Realm (£50,000), Groyne Refurbishment (£35,000), Disabled Facility Grants (£1.5m).

Summarised Capital Expenditure and Funding (2018-19 (Revised) to 2021-22)

13. The table below shows a summary of the expenditure for the current and next three years, along with the projected borrowing requirements.

Table : Summarised Expenditure	Revised 2018/19 £'000s	2019/20 £'000s	2020/21 £'000s	2021/22 £'000s
Gross Capital Expenditure	26,261	18,961	7,347	3,736
Net Capital Expenditure	22,405	16,066	5,808	2,236
Financing from own resources	953	799	208	120
Borrowing Requirement	21,452	15,267	5,600	2,116

Financing the Capital Programme

14. The Council can invest in a capital programme so long as its capital spending plans are "affordable, prudent and sustainable".

15. The main sources of finance for capital projects are as follows:

- Capital receipts (from asset sales)
- Capital grants (e.g. Disabled Facilities Grant)
- External contributions (e.g. Section 106 developers' contributions)
- Earmarked Reserves
- Revenue contributions
- Borrowing including internal (Capital Financing Requirement).

16. Borrowing (or Capital Financing Requirement) makes up the most significant element. While the Council has sufficient cash and investment balances in the near term it is able to internally borrow but in the future will need to borrow externally in addition to the estimated £60m which will have been borrowed by 31 March 2019.

17. The Capital Financing Requirement is reduced over the life of individual assets by an annual contribution from revenue (Minimum Revenue Provision). Further information including borrowing forecasts, the provision for the repayment of debt, and borrowing limits are set out in the Treasury Management Strategy. The table below shows the projected indebtedness of the Council based on the current Capital programme and expected levels of capital receipts, grants and contributions.

Table: Capital Financing Requirement (CFR) less Minimum Revenue Provision (MRP)

CFR	2018/19 (Adj. Est)	2019/20 (Est)	2020/21 (Est)	2021/22 (Est)	2022/23 (Est)
	£	£	£	£	£
CFR-Opening	39,493,000	60,150,000	74,234,000	78,215,000	78,565,000
Less MRP	-795,000	-1,183,000	-1,619,000	-1,766,000	-1,866,000
Plus, New Borrowing	21,452,000	15,267,000	5,600,000	2,116,000	0
CFR Closing	60,150,000	74,234,000	78,215,000	78,565,000	76,699,000

18. The table highlights that by 2020/21 the level of debt will have increased to some £78.5m. This figure could be up to £4m higher if commercial property purchases, as per approvals granted in December 2018 complete.

Revenue Consequences of the Capital Programme on the General Fund

19. Not all projects provide savings or generate income but, aggregate, the capital programme is forecast to have a positive net benefit to the General Fund.

20. The majority of the Capital programme has a positive impact on the ongoing resources for the Council. The Schemes listed (i) to (v) in the Capital programme for 2019/20 all contribute a surplus to the General Fund. The income generation strategy projections are included in the main budget report.

21. Borrowing has long term revenue consequences. The table below shows the projected levels of debt up to 2061/62 as a result of the Council's current and past programmes. The debt is reduced by the MRP each year. The overall level of debt needs to be viewed against the overall Long Term Assets of the authority which stood at £141.89m as at 31 March 2018.

Table: Total Borrowing and Repayment Projections (2017-18 to 2061/62)

Financial Risk Management

22. The treasury management strategy outlines in some detail the economic environment and the risks that the Council faces in managing its investments and borrowing activities

23. A significant proportion of the Council's capital programme is likely to be financed by borrowing and this exposes the Council to the risk of changing interest rates and the ability to afford debt repayments.

24. Where borrowing finances commercial property the Council is increasingly dependent upon the income streams to finance the debt repayments. No matter how good the tenants, and how much of the debt is at fixed rates, there is a limit to the exposure that is acceptable without putting the Council at complete risk of being unable to provide key services in the event of a significant recession.

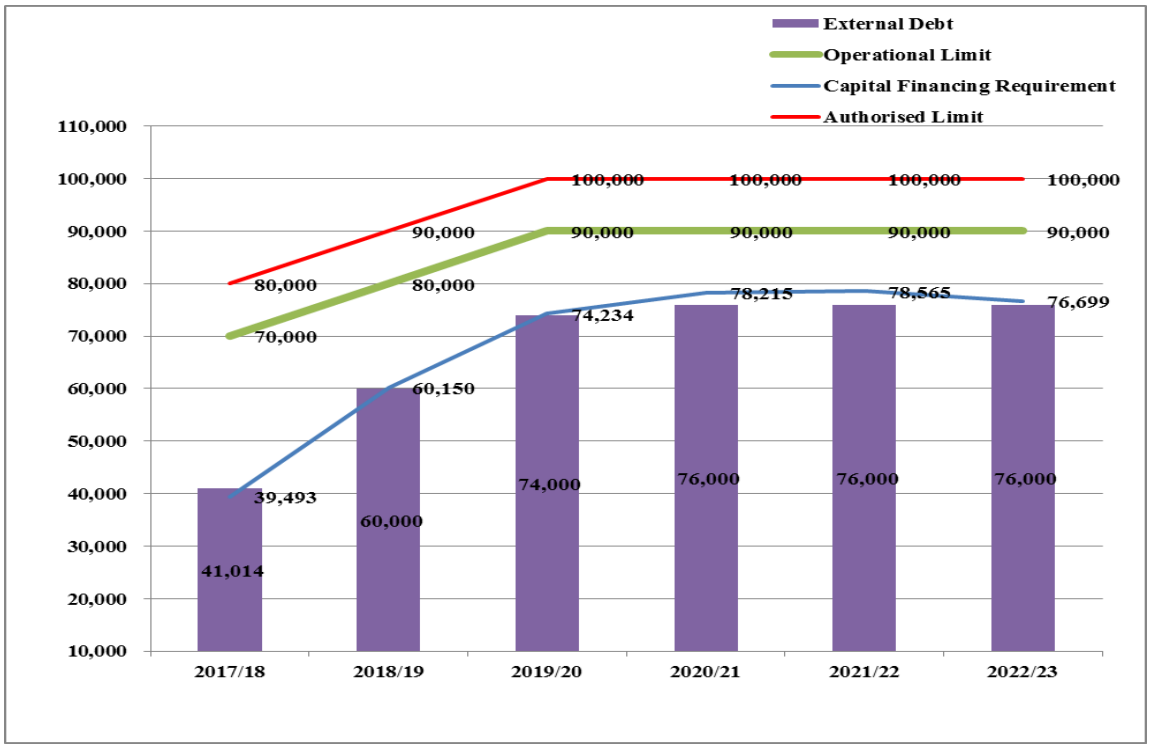
25. To arrive at an overall borrowing level (Authorised and Operational borrowing limits), the Council needs to take a considered view of its other potential liabilities, future borrowing requirements, guarantees and loans given, bad debts, claims against the Council , future funding, and security and diversity of the existing income streams.

26. Based on the existing Capital programme, by 2020/21annual interest on debt will amount to some £2.4m p.a. with capital repayments approaching £1.8m, offset by investment income of just over £1m. This represents 23% of the net revenue stream (amount met from government grants and local taxpayers).

27. The full Council determine the total limits on borrowing.

28. The graph below demonstrates the relationship between the various boundaries and limits and the actual borrowing undertaken to date or planned. The gap between the external debt and CFR also helps to illustrate the level of internal borrowing and potential interest rate exposure. The gap between the CFR and Operational Boundary/Authorised Limit highlights the potential scope/flexibility to borrow further, if the cashflow and treasury management position dictates.

Table: External Debt, Authorised limits and CFR Projections



29. In terms of cash backed investments, the Investment Policy provides strict guidance on the counterparties the Council is prepared to invest with and for what periods. The Council invested £2m in a property fund (CCLA) in April 2017 and may look to invest a further tranche of monies in a diversified investment fund in 2019/20.

30. In terms of asset backed investments and projects e.g. involving commercial property and housing, the business cases will look to identify the alternative options and uses of the premises should they become vacant. The Council increased the minimum level of reserves held in recognition of the fact that there will inevitably be void periods, and expenditure will be incurred in updating

properties from time to time in order to re-let them. Where the Housing Company is concerned it will need to retain sufficient working balances to re-let and refurbish properties. It is important that void periods are minimised and that properties acquired are not inherently defective.

31. Some projects such as the solar panel installations have some asset backed values, but the ability to meet the debt repayments from energy savings and sale of the surplus energy will remain a risk unless long term forward sale agreements are made. However such long term agreements come at the cost of not necessarily obtaining the maximum income. A balance of risk and reward needs to be achieved. Given the predicted trends in energy prices for the long term the business cases for energy generation look positive.

Loans and Guarantees

32. The Council is required to maintain a schedule of loans and guarantees to other organisations.

Table – Loans to Other Organisations

3rd Party Organisations	Rate/ Return (%)	Start Date	End Date	Principal O/S @ 30.9.2018 £	Term
Amicus /Optivo	3.78	04/09/2014	02/09/2044	1,788,235	Fixed
The Foreshore Trust	1.66	21/03/2016	20/03/2026	229,583	Annuity
The Source	2.43	17/12/2015	17/12/2025	19,304	Annuity
			Total	2,037,122	

33. In addition to these loans the Council is in the process of arranging a loan to Freedom Leisure who manage the Council's Summerfields Leisure centre in respect of a new climbing wall (some £134,000) as agreed by cabinet in April 2018.

34. The above table excludes the loans to Hastings Housing Company, which are of both a Capital nature (as per the capital programme) and of a revenue nature. The latter loans are made on a daily interest basis and reflect the net indebtedness of the company on any one day.

35. The Housing Service provides loans to individuals for rental deposits and the Council also provides a limited loan facility to staff for car loans, season tickets, and bicycle loans.

36. The Council has other liabilities that need to be considered when assessing the overall financial position of the Council e.g. potential legal claims, pension liabilities.

Reserves

37. The Council maintains reserves for specific purposes (earmarked reserves) and also a general reserve for unavoidable future liabilities. An absolute minimum level of reserves to be maintained has been set at £6m. The adequacy of the reserve levels are reviewed on a regular basis, and particularly when determining the budget.

38. The Council's General and earmarked reserves are set to fall further over the forthcoming 18 months. The balance at 1 April 2018 was some £18m. At the 31 March 2019 the projected balance is some £16.1m with the balance at the end of 2019/20 amounting to some £12.1m (excluding Clinical Commissioning Group and disabled facility grant monies).

39. The reduction in balances will result in less interest being earned on investments, greater short term borrowing to match cash flow requirements, along with the need to match future renewal and repair commitments to available resources. If general reserves are used to a significant level to finance emergency or non avoidable expenditure then future budget cuts (potentially in-year) will be required to restore reserves to minimum levels.

Risk Appetite & Prudential Indicators

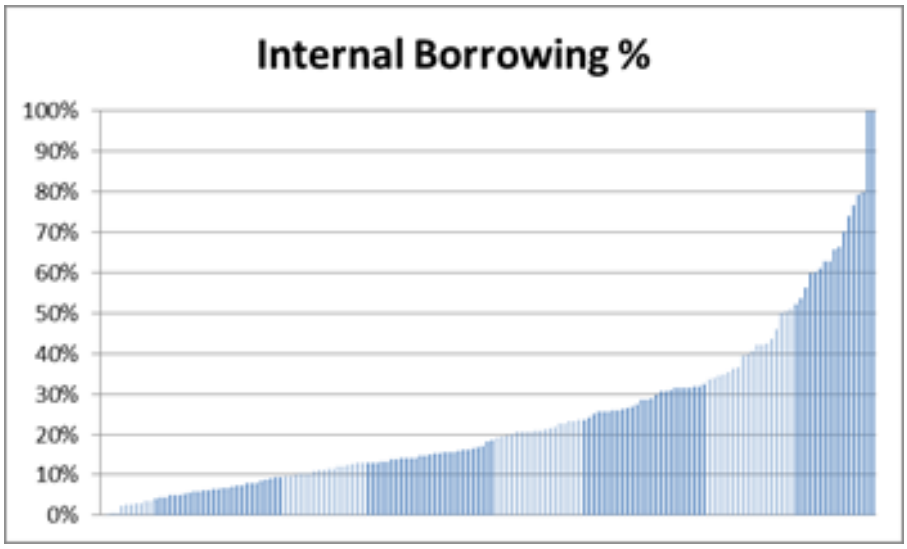
Internal Borrowing

40. When undertaking Capital projects or purchasing new assets, the Council has a number of options as to when and how to finance these. If there are no grants or revenue resources and no capital receipts the Council will finance by borrowing. If it delays the borrowing then it will be using its own monies (Internal borrowing - generally reserves) to temporarily to fund the assets.

41. If an authority has a large internal borrowing position, this will mean that reserves and balances have temporarily been used to support borrowing positions and therefore the reserves will not be backed by cash in the bank. This position

continues to work for many, but as reserves and balances are utilised in the years ahead and balances fall, this will reduce any ability to internally borrow and may bring forward the need to borrow externally (potentially at a time of high interest rates, or when there is limited ability to borrow externally).

Table showing levels of Internal borrowing in Councils (Link Asset Service's Client Base)



42. The Council's Treasury advisers have undertaken a review of client's balance sheets and the average level of internal borrowing is, from the above graph, just under 20%. The level will vary depending upon when an authority finances expenditure and when debt is refinanced.

43. For Hastings BC the Council has sought to achieve near full financing of the Capital programme over the last two years in order to take advantage of the historically low borrowing rates and avoid the risk of having to lock into high interest rates when it has no option but to borrow.

44. For 2019/20 the Council will seek to ensure the minimum cash balance is 60% of the year end reserve level with a minimum of £6m retained in cash i.e.40% maximum used for internal borrowing until such time as external borrowing is arranged.

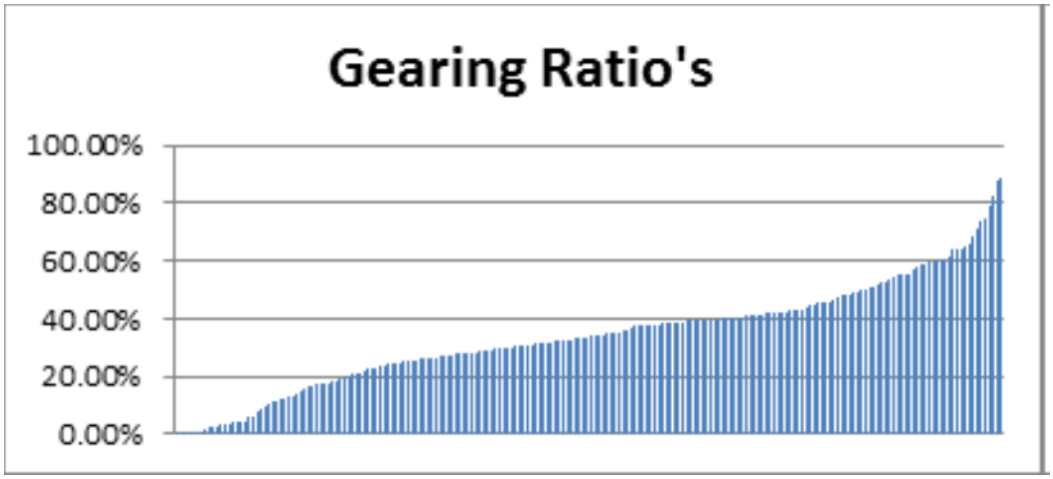
Gearing

45. Gearing has predominantly been a debt metric used by the private sector more than the public sector, but recent moves towards commercialism opportunities and investments means that borrowing is a much greater risk and gearing is an appropriate prudential indicator.

46. Based on Link Asset Services' analysis of balance sheet positions for 2017/18, gearing ratios for over 200 authorities averages out at around 35% when comparing **Capital Financing Requirements (CFR) to total Long-term Assets reported**.

47. Due to the nature of assets held, services provided and historical debt decisions, positions will vary across different types of authority.

Table showing Gearing ratios in Councils (Link Asset Service's Client Base)



48. Gearing provides an early indication of where debt levels are rising, relative to long-term assets held.

49. Despite some of the adverse publicity around local authority finances, it can be argued that gearing of 35%, on average, is not a bad position for the sector to be in, as in simple terms 65% of the costs of long-term assets have been paid for, with debt outstanding on the remaining 35%.

50. For Hastings, the gearing ratio of debt (CFR) to long term assets is set to increase from 28% in 2017/28 to 42% in 2020/21 (assuming no changes to asset valuations and Capital programme completed). When compared against the net assets of the authority the ratio increases to some 93%.

51. In the private sector gearing is generally calculated on net assets and a generally accepted norm is a ratio between 25% and 50%. The risk exposures are

generally deemed to be greater where a company has much of its borrowing at variable rates – which is the opposite to the Council's position.

52. **Table showing Future Projections of Gearing Ratios – based on Capital programme**

Gearing Calculations	Actual	Estimates					Operational Boundary
	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Capital Expenditure (net)		22,405	16,012	5,773	2,201	-	
New borrowing		21,452	15,267	5,600	2,116	-	
Net Assets	82,285	83,238	83,983	84,156	84,241	84,241	84,241
Long Term Assets	141,890	164,295	180,307	186,080	188,281	188,281	201,582
Capital Financing Requirement	39,493	60,150	74,234	78,215	78,565	76,699	90,000
RATIOS:							
Debt: Net Assets	**48%**	**72%**	**88%**	**93%**	**93%**	**91%**	**107%**
Debt: Long Term Assets	**28%**	**37%**	**41%**	**42%**	**42%**	**41%**	**45%**

53. The Council's position will move from being just below the average to just above it. If the Council borrowed at the limits to its current Operational boundary (£90m), then debt to long term assets ratio would rise to 45%.

54. At the end of the day, any outstanding debt comes back to affordability, prudence and sustainability principles which are at the heart of the Prudential Code and have been since its inception in 2004.

55. The Chartered Institute of Public Finance and Accountancy have issued a clear statement on the levels of debt that Councils in general are accumulating following the purchase of commercial assets in particular. Such borrowing must be proportionate to the size of the authority. Further detailed guidance was expected to be released before the end of 2018, and is awaited. The government have also advised that they are in discussions with the Treasury on lending to local authorities – resulting from the activities of a few.

56. Any new limitations on accessing PWLB monies could have significant implications for the Council.

Ratio of Financing Costs to Net Revenue Stream

57. Financing costs are the element of the budget which an authority is committed to, even before they have run a single service or incurred any other costs as they reflect the current costs of previous/planned capital financing decisions.

58. In Hasting's case the ratio of financing costs represents, 23%, of the Net Revenue Stream, which only leaves 77% of the revenue stream for all the other services to be provided. The higher the percentage, therefore, the less is left for running services.

59. If the Net Revenue Stream is reducing, as funding sources are reduced over time, then even though financing costs may be fixed through fixed-term loans and interest rate certainty, the ratio will potentially continue to climb leaving less available for front-line services and placing further pressures on budget positions.

60. However, the income the Council receives from rents and fees and charges decreases the net expenditure of the Council. The calculation of debt charges to "the amount to be met from Grant and Collection Fund" as a proxy for the "Net Revenue Stream" therefore has to be treated with considerable caution.

61. This leads back then to local decision making and the need/objectives behind capital investment. Business cases must identify ongoing revenue implications and hence affordability. The Treasury Management Strategy includes a prudential indicator that identifies the ratio of financing costs to Net Revenue Stream. This is a further way of ensuring that affordability, prudence and sustainability considerations are kept to the fore in treasury reporting.

Future Capital Expenditure – What is not yet included in the Capital Programme or within the Borrowing limits?

The Council's expenditure plans are evolving

Bexhill Road – lower tier site

62. The site having the potential for some 170 new homes. In October 2018 cabinet approved the progression of this project. Namely that the council enter into an agreement with Homes England to access the Local Authority Accelerated Construction fund to enable plans for flood remediation and other infrastructure measures to be undertaken.

63. The cabinet also agreed £25,000 be identified from general reserves to fund taxation and legal advice for setting up a joint venture.

64. A further report on funding requirements is to follow. The Council's contribution would, as a minimum, be the value of the remediated land but there may well be a call for development funding beyond this.

Industrial Units – Churchfields Estate (Sidney Little Road)

65. The Council has a substantial plot of undeveloped industrial land. There is potential to develop the site

    Plot 1 – 28 Starter Units
    Plot 2 – 35 Square foot factory
    Plot 3 – 3 to 8 factory units (flexible sizes)

66. The initial estimates identified construction costs for the 3 sites at some £9.3m. Given the current rentals chargeable in Hastings, the sites are not viable without external funding. Funding has been applied for in respect of the 28 starter unit site and a report will be presented to cabinet shortly. The outcome of the funding application should be known by April. There will be the opportunity to bid for further development funding thereafter.

Development Sites – HBC Land

67. The Council has a number of sites that are suitable for development and/or disposal. Namely,

- Harrow Lane - £27m construction costs (140 units)
- Mayfield E - £7.3m construction costs (38 units)
- Bexhill Road -Land rear of 419- 447 Bexhill Rd - £2.9m construction costs (16 units)
- Sandrock - (£2.2m (10 units) to £15.6m (81units) construction & site acquisition costs

68. If the Council sought to develop all these sites at the same time and did not phase the developments the borrowing requirement would be between £39.4m and £52.8m.

Bohemia

69. The Travel lodge site looks likely to progress to redevelopment, along with the construction of a significant number of new properties.

70. Whilst feasibility studies are ongoing, the major attraction for developing this area would be a new sports and leisure complex. Whilst it is not known whether this is financially viable the Council would have the option of funding this itself, in which case it could be looking for financing (borrowing) of up to an estimated £20m.

Commercial Property/ Housing/Energy Initiatives

71. The income generation strategy identified a £50m programme over a three period. £29m earmarked for commercial property, £15m for housing and £6m for energy initiatives (£2.116m of which is not earmarked). These figures are all included in the capital programme.

72. The income generation strategy approved in September 2017 is subject to review, with a report to Cabinet in early 2019/20.

Corporate Governance Arrangements – Project Approval Process

73. The Council has an ambitious Corporate Plan, and it remains important that the capital programme remains realistic in terms of resources and timescales to achieve the desired outcomes.

74. The Council has a number of project management procedures and tools in place for managing individual projects. Key is the project initiation stage, the approval process and thereafter effective performance monitoring and reporting. A business case is required in most instances, and/or a detailed report to cabinet/Council.

75. Major projects are likely to have impacts on other key services such as Legal, Finance and Estates teams depending upon the nature of the projects. External support is commissioned where there is insufficient capacity, knowledge, or expertise within the Council. Cabinet and the Overview and Scrutiny Committee receive quarterly updates on financial performance (including the capital programme).

76. The Council established an Income Generation Board to oversee Income generation activities and provide advice to Cabinet. The Board reviews strategy and progress and receives details of new proposals, such as:-

    (i) any proposed commercial property purchases where there is potential income generation.
    (ii) Energy Projects
    (iii) Housing
    (iv) Other e.g. lottery project

77. Commercial Property purchases are approved by Cabinet, with delegated authority normally provided thereafter to the Chief Finance Officer in consultation with the leader to negotiate the final terms. The Council's legal team, surveyors and Corporate Property Officer are all closely involved. The Council will normally employ the services of an agent to advise on the price and conduct negotiations. Necessary due diligence is conducted and externally specialist surveyors and advisors employed as necessary. The Council has had a large property portfolio for many years. More recently it has acquired a number of commercial sites within the borough as well as developing its own. As at 31 March 2018 the Council's Long term Assets were valued at some £140m whilst debt (CFR) amounted to some £39m.

78. In terms of Housing, the Council has set up its own housing company (Hastings housing company) which is wholly owned by the Council. It acquired its first property in March 2018. The company has its own set of procedures, which generally mirror the due diligence requirements of the Council. The Council lends money to the company at the EU prescribed market rates. The housing company produces annual accounts.

Repair and Renewal Programme

79. The Council has a comprehensive repair and renewal programme. There are elements of a reactive and recurring nature and a separate costed schedule for planned maintenance items (See budget). The Council contributes an annual sum of £508,000 to a reserve which funds the programme. In 2018/19 the expected spend amounts to £806,000 and in 2019/20 is estimated at £874,000. As a result of expenditure exceeding income the balance on the reserve is expected to fall to some £963,000 by the end of March 2020.

Information Technology Reserve

80. Like most Councils and businesses the Council is totally reliant on effective IT in order to deliver services. The Council is continuously improving systems and looks to streamline service provision wherever possible. Business continuity planning remains vital against the continuing systems attacks that are experienced, and it remains critical that systems and virus protection software remain updated.

81. Like the Repair and Renewal programme the costs of acquiring and the updating of systems does not fall uniformly in any one year and hence an annual contribution is made into an IT Reserve.

82. The Council contributes £214,000 p.a. into the fund. In 2018/19 the expenditure is estimated at £311,000 and in 2019/20 at £239,000 (Please see budget)

83. As a result of costs exceeding income the balance on the fund is expected to fall to £31,000 by the end of March 2020.

Knowledge, Skills and Training

84. In order to deliver the Capital Programme it is essential that the Council has access to the right knowledge and skills. The Council employs fully qualified and experienced staff such as solicitors, estate managers, surveyors and accountants.

85. The Council maintains a training budget, recognising that it remains critical to the organisation to have a well trained and motivated workforce. The Council provides on-line training courses, internal and external training, to enable staff to complete their Continuing Professional Development (CPD) requirements.

86. The Council seeks to ensure members have access to training opportunities in order for them to adequately undertake their governance role. Workshops and training events are held on a regular basis.

87. Where specialist knowledge is required the Council will obtain expert advice, particularly around property specialisms, taxation, and legal advice.

Summary

88. The Council, which has significant deprivation levels, understandably has an ambitious Corporate Plan. This is set against a background of severe funding reductions, and the need to provide good services to the many visitors, residents and businesses.

89. The Capital programme is heavily reliant on borrowing, and will continue to be so especially given that the Council is looking to develop its own land. The benefit of doing so is to ensure new homes are built and the profit generated remains within the borough.

90. The Council may well wish to progress the development of its own land rapidly following outline planning permission. Given the scale of the developments, the current risks to the economy the Council will need to determine a strategy for the development of these sites that takes accounts of the risks, the timing of other developments in the borough and whether or not some sites should be phased.

91. The Council's existing borrowing levels are not considered excessive. However a downturn in the economy with resultant loss of income would require the Council to make greater service cuts to balance the budget. With some £14m of income from fees and charges (including rents) a small reduction has significant implications if prolonged. Whilst the Council still has significant reserves these are predicted to fall rapidly as the Council is using these to fund the budget deficit.

92. The investments being made in Energy, Housing and Commercial Property are currently making, and will increasingly make, very significant contributions to the Council's budget and thus help to preserve services and jobs within the borough.

93. This Capital Strategy and the Treasury Management Strategy is likely to be reviewed and updated during the year, and put before full Council, as and when the Council's spending plans are developed further.

Consultation and Communication

94. The detailed Capital Programme is included within the Council's budget which is on the Budget Cabinet agenda. The programme supports the Council's Corporate Plan which is likewise on the same Budget Cabinet agenda.

95. The draft Corporate Plan and draft budget for 2019/20 are subject to public consultation from the 11 January 2019.

Equality Impact Assessment

96. Equality Impact assessments are considered as part of the business case when considering individual capital proposals.

Agenda Item 6

Report to: Audit Committee

Date of Meeting: 23 January 2019

Report Title: Chief Auditor's Summary Audit and Risk Report

Report By: Tom Davies
Chief Auditor

Purpose of Report

To inform the Audit Committee of the key findings from the Corporate Credit Card audit.

Recommendation(s)

1. **That the Audit Committee accepts the report.**

Reasons for Recommendations

To monitor levels of control within the organisation.

Summary report to Audit Committee

Corporate Credit Cards

Audit Conclusion

Overall Audit Assessment: A – Good

Most controls are in place and work effectively. Some improvements are recommended to ensure best practice and efficiency. Further changes are recommended in order to ensure policy compliance is introduced. Main audit concerns were the need for better policy guidance for the use of Corporate Credit Cards and the lack of expenditure monitoring records by cardholders.

Key Findings

Corporate Credit Card provisions were previously audited in 2015. At that time, seven corporate credit cards were in use with a total credit value of £11,000. Expenditure analysed for the 10-month period April 2014 to January 2015 was of £41,800.

Currently, Hastings Borough Council has an overall credit limit with Barclaycard of £17,500. There are 11 Corporate Credit Cards in use, with a total credit value of £17,500 and individual credit limits ranging from £1,000 to £2,500.

This audit has found a similar level of transactions (£40,189) for the same period as the previous audit (April 2017 to January 2018) and total expenditure amounting to £48,151 for the financial year 2017/18.

Controls would be enhanced with the introduction of a much revamped specific Corporate Credit Card policy that includes guidance on usage, security/expenditure controls and document retention.

Enhancing the existing guidance for cardholders on obtaining valid VAT invoices/receipts would ensure that VAT values are accurately recorded on the finance system.

Introducing more stringent checks and detailed records on the purpose of each credit card purchase would reduce the risk of unauthorised usage.

Management Response

The report and findings are agreed.

Wards Affected

None

Policy Implications

Please identify if this report contains any implications for the following:

Equalities and Community Cohesiveness	No
Crime and Fear of Crime (Section 17)	No
Risk Management	Yes
Environmental Issues	No
Economic/Financial Implications	Yes
Human Rights Act	No
Organisational Consequences	No
Local People's Views	No
Anti-Poverty	No

Additional Information

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