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Audit Committee Agenda

Wednesday, 22 January 2020 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

14 NOVEMBER 2019

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

66. APOLOGIES FOR ABSENCE

Councillor Charman sent apologies

67. DECLARATIONS OF INTEREST

None

68. MINUTES OF THE LAST MEETING

RESOLVED – (unanimously) that the minutes of the meeting held on 30 July 2019 be approved.

69. AUDIT FINDINGS REPORT- SEPTEMBER UPDATE

The Assistant Director, Financial Services and Revenues (Chief Finance Officer), presented a report from Grant Thornton our external auditors. Darren Wells of Grant Thornton LLP (engagement lead), attended the meeting also.

They have previously presented an initial Grant Thornton Audit Findings at the Audit Committee held on 30th July 2019. Grant Thornton have now concluded their external audit and provided an updated Audit Findings Report. The accounts were signed on 20th September 2019.

Councillors had questions concerning the net pension liability. There is a revaluation currently being undertaken with revised contributions payable from April 2020.The McCloud judgement was discussed.

In December 2018, the Court of Appeal ruled that transitional provisions implemented in changing the pension scheme had given rise to unlawful direct age discrimination to some workers. On 15 July 2019 the Government announced that they accept that the judgement applies to all main public service pension schemes.

The implications of this ruling are currently not clear as the tribunal must agree the next steps. It is not known exactly how this will affect Hastings Borough Council but it is likely to have financial implications.

Councillors asked about how pension funds were invested and whether any of these were high risk. Councillors were told that it was unlikely that this would happen as all pension funds have a long term agreed strategy which usually relies on long term stable investments. There is no awareness of a high risk strategy approach to local government pension schemes.

Councillors asked DW about his report and if there were difficulties changing from the old financial system software to the new one. The external auditor had made recommendations on how to improve the transitional phase.

RESOLVED- (unanimously)
To agree the revised Audit Findings report for Hastings Borough Council for the year ending 31 March 2019.

Reasons for the decision
Compliance with statutory requirements and good practice. The Council is accountable for the use of public money and continuously seeks to improve Value for Money.

70. STRATEGIC REGISTER

The Chief Auditor presented a report that informs Councillors of the current strategic risks identified for Hastings Borough Council and the measures put in place to avoid or mitigate those risks.

The Chief Auditor advised that next year new software will be used for the strategic and operational register (Smartsheet). This will help improve consistency between services and improve the tracking of tasks for completion.

The Chief Auditor advised that the report located on page 55 of the pack, target 8 potential risk should read;
'*Deterioration of the Council's priority infrastructure i.e. those that create tourism or public safety issues e.g. cliffs & sea front'*

Councillors asked questions and discussed various issues included the effects of climate change and reputational risk. They also raised that officers are getting better in identifying the difference between risk mitigation and avoidance but there were still opportunities for improvement.

RESOLVED- (unanimously)
To acknowledge the risks identified in the report and comment as appropriate.

Reasons for the decision
As part of the Corporate Risk Management Strategy agreed by Cabinet, the Strategic Risk Register is to be reviewed by the Audit Committee each year.

71. OPERATIONAL RISK REGISTER

The Chief Auditor presented a report to inform Councillors of the current operational risks identified for Hastings Borough Council and the measures put in place to avoid or mitigate those risks.

The Chief Auditor reported that there were a number of good practices officers have adopted that have resulted in the registers being updated regularly and discussed in departmental meetings.

Councillors asked if everything identified on the register was to happen whether the Council would be able to afford the costs. They were advised that this was very unlikely but if it did occur the Council would likely received additional support form national government under the Belwin Scheme.

RESOLVED- (unanimously)
To acknowledge the risks identified in the report and comment as appropriate.

Reasons for the decision
As part of the Corporate Risk Management Strategy agreed by Cabinet, the Operational Risk Register is to be reviewed by the Audit Committee each year.

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

None

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

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Report to: **Audit Committee**

Date of Meeting: **22 January 2020**

Report Title: **The Annual Audit Letter for Hastings Borough Council – Year ended 31 March 2019**

Report By: **Peter Grace, Assistant Director Financial Services & Revenues**

Purpose of Report

To inform the Audit Committee of the contents of the Annual Audit Letter for the Year ended 31 March 2019 which is a concise summary of the work carried out by External Audit (Grant Thornton).

Recommendation(s)

1. **To approve the Annual Audit Letter for Hastings Borough Council – Year ended 31 March 2019**

Reasons for Recommendations

The Annual Audit Letter is for all councillors and the public and will be posted to the council's website. It is of particular interest to those charges with governance.

Introduction

1. The Annual Audit Letter for Hastings Borough Council for the Year ended 31 March 2019 is one of External Audit's key outputs. It summarises the key findings arising from the work carried out by External Audit at Hastings Borough Council and its subsidiary (the group) for the year ended 31 March 2019.

2. The letter is intended to provide a commentary on the results of the external audit work to the group and external stakeholders and to highlight issues that Grant Thornton wish to draw to the attention of the general public.

3. The detailed letter can be found at appendix A.

4. We are expecting a senior manager, the Engagement Lead, from Grant Thornton to attend the meeting and present the report.

Timetable of Next Steps

5. Please include a list of key actions and the scheduled dates for these:

Action	Key milestone	Due date (provisional)	Responsible
Not applicable – this is an information report for the public	-	-	-

Wards Affected

None.

Implications

Relevant project tools applied? ~~Yes/No/~~N/A

Have you checked this report for plain English and readability? Yes/~~No~~

Climate change implications considered? ~~Yes~~/No

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

Equalities and Community Cohesiveness	
Crime and Fear of Crime (Section 17)	
Risk Management	✓
Environmental Issues	
Economic/Financial Implications	✓
Human Rights Act	
Organisational Consequences	
Local People's Views	
Anti-Poverty	

Additional Information

Appendix A - The Annual Audit Letter for Hastings Borough Council – Year ended 31 March 2019

Officer to Contact

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The Annual Audit Letter for Hastings Borough Council

Year ended 31 March 2019

January 2020

Contents

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Executive Summary

Purpose

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Hastings Borough Council (the Council) and its subsidiary (the group) for the year ended 31 March 2019.

This Letter is intended to provide a commentary on the results of our work to the group and external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this Letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'. We reported the detailed findings from our audit work to the Council's Audit Committee as those charged with governance in our Audit Findings Report on 30 July 2019 (updated report communicated to the Committee on 14 November 2019).

Respective responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

- give an opinion on the Council and group's financial statements (section two)
- assess the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Council and group's financial statements, we comply with International Standards on Auditing (UK) (ISAs) and other guidance issued by the NAO.

Our work

Materiality	We determined materiality for the audit of the group's financial statements to be £1,436,264, which is 2% of the group's gross revenue expenditure from the prior year audited accounts.
Financial Statements opinion	We gave an unqualified opinion on the group's financial statements on 20 September 2019.
Whole of Government Accounts (WGA)	We completed work on the Council's consolidation return following guidance issued by the NAO.
Use of statutory powers	We did not identify any matters which required us to exercise our additional statutory powers.
Value for Money arrangements	We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources. We reflected this in our audit report to the Council on 20 September 2019.
Certification of Grants	We also carry out work to certify the Council's Housing Benefit subsidy claim on behalf of the Department for Work and Pensions. Our work on this claim was finalised on the 29 November 2019 prior the Central Government deadline.
Certificate	We certified that we have completed the audit of the financial statements of Hastings Borough Council in accordance with the requirements of the Code of Audit Practice on 20 September 2019.

Executive Summary

Working with the Council

During the year we have delivered a number of successful outcomes with you:

- We made five recommendations for controls and systems improvements in our Action Plan as reported to the Audit Committee in November 2019. Implementation of these recommendations will be followed up with your finance team in the 2019/20 year;
- We highlighted a number of areas of the accounts where disclosures could be made clearer along with accounts adjustments for misclassifications/misstatements, which were also reported to the Audit Committee in November 2019;
- Sharing our insight – we provided regular Audit Committee updates covering best practice. We also share our thought leadership reports.

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Authority's staff.

Grant Thornton UK LLP
January 2020

Audit of the Financial Statements

Our audit approach

Materiality

In our audit of the group's financial statements, we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for the audit of the group financial statements to be £1,436,264, which is 2% of the group's gross revenue expenditure from the prior year audited accounts. We used this benchmark as, in our view, users of the group and Council's financial statements are most interested in where the group and Council has spent its revenue in the year.

We set a lower threshold of £71,812, above which we reported errors to the Audit Committee in our Audit Findings Report.

The scope of our audit

Our audit involves obtaining sufficient evidence about the amounts and disclosures in the financial statements to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error. This includes assessing whether:

- the accounting policies are appropriate, have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the remainder of the financial statements, the Narrative Report and Annual Governance Statement published alongside the financial statements to check they are consistent with our understanding of the Authority and with the financial statements included in the Annual Report on which we gave our opinion.

We carry out our audit in accordance with ISAs (UK) and the NAO Code of Audit Practice. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach was based on a thorough understanding of the group's business and is risk based.

We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

Audit of the Financial Statements

Significant Audit Risks

These are the significant risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Improper revenue recognition We considered the rebuttable presumed risk under ISA (UK) 240 that revenue may be misstated due to the improper recognition of revenue. We rebutted this presumed risk for revenue streams that are derived from Council Tax, Business Rates and Grants on the basis that they are income streams primarily derived from grants or formula based income from central government and tax payers and that opportunities to manipulate the recognition of these income streams is very limited. We did not deem it appropriate to rebut this presumed risk for fees, charges and other service income as we do not have cumulative audit testing knowledge of these revenues being your new auditor, and the adoption of new accounting standard, IFRS15 Revenue from Contracts with Customers, could materially affect recognition of this income. We therefore identified the occurrence and accuracy of these income streams and the existence of associated receivable balances as a significant risk of material misstatement.	As part of our audit work we : • evaluated the Council's accounting policy for recognition of income for appropriateness and compliance with LG Code of Practice; • updated our understanding of the system for accounting for income and evaluated the design of the associated controls; • reviewed and sample tested income to supporting evidence; • evaluated and challenged significant estimates and the judgments made by management, including those around the adoption of the new IFRS15.	Our audit work did not identify any issues in respect of revenue recognition.
Management override of controls Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities. The Council faces external scrutiny of its spending and this could potentially place management under undue pressure in terms of how they report performance. We therefore identified management override of control, in particular journals, management estimates and transactions outside the course of business as a significant risk, which was one of the most significant assessed risks of material misstatement.	As part of our audit work we : • evaluated the design effectiveness of management controls over journals; • analysed the journals listing and determined the criteria for selecting high risk unusual journals; • tested unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration; • gained an understanding of the accounting estimates and critical judgements made by management and considered their reasonableness with regard to corroborative evidence; • evaluated the rationale for any changes in accounting policies, estimates or significant unusual transactions.	Our audit work did not identify any issues in respect of revenue recognition.

Audit of the Financial Statements

Significant Audit Risks - continued

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Valuation of land and buildings The Council revalues its land and buildings on a five-yearly rolling basis to ensure the carrying value in the financial statements is not materially different from the current value or the fair value (for investment properties and surplus assets) at the financial statements date. This valuation is carried out by the Council's professional valuers. This valuation represents a significant estimate by management due to the size of the numbers involved and the sensitivity of this estimate to changes in key assumptions. Management need to ensure the carrying value in the Council financial statements is not materially different from the current value or the fair value (for investment properties and surplus assets) at the financial statements date, where a rolling programme is used. We therefore identified valuation of land and buildings, particularly revaluations and impairments, as a significant risk, which was one of the most significant assessed risks of material misstatement, and a key audit matter. **Valuation of Heritage Assets** Heritage assets were held at £15m at the 31 March 2018 balance sheet date. The Authority revalues heritage assets periodically based on market value as approximated by their insurance value. The insurance values are reviewed annually to ensure there have been no material changes, and where there are other indications of impairment their carrying amount will be reviewed. The valuations of heritage assets, particularly revaluations and impairments, was also considered a significant risk.	As part of our audit work we : • evaluated management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work; • evaluated the competence, capabilities and objectivity of the valuation expert; • wrote to the valuer to confirm the basis on which the valuation was carried out to ensure that the requirements of the Code are met; • challenged the information and assumptions used by the valuer to assess completeness and consistency with our understanding; • assessed how management challenged the valuations produced internally, by professional valuers and by independent property managing consultants to assure themselves that these represent the materially correct current value; • tested revaluations made during the year to see if they had been input correctly into the Council's asset register; • evaluated the assumptions made by management for any assets not revalued during the year and how management satisfied themselves that these are not materially different to current value.	During the year, £39.5 million of assets were revalued representing 34% of land and buildings held on the balance sheet at current or fair value. The remaining £75.6 million of assets held at current value were revalued in earlier years or acquired in the year. The Code of Practice allows a rolling programme of revaluation over a short period, but requires management to ensure assets not revalued in year are not materially misstated. Management did not prepare a working paper to address whether assets had been impaired during the year, and also did not specifically set out in detail their own assumptions and estimates of the potential movements in value for assets not revalued during the year. We developed our own point estimate of the movement in values using information of possible variations provided by our own auditor's expert, and we made further inquiries to the management's professional valuers. Through this work we were able to gain assurance that assets not revalued in the year were not materially misstated. **Heritage Assets:** These assets are not required to be revalued annually, but should be reviewed sufficiently regularly to ensure that valuations remain current. We reviewed the insurance valuations which are used as the basis for the estimation of the market value of heritage assets, and we challenged the basis of and assumptions underlying the valuation method for reasonableness. Our working around heritage assets did not identify any issues.

Audit of the Financial Statements

Significant Audit Risks - continued

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Valuation of pension fund net liability The Council's pension fund net liability, as reflected in its balance sheet as the net defined benefit liability, represents a significant estimate in the financial statements. The pension fund net liability is considered a significant estimate due to the size of the numbers involved (£41.6 million in the Council's unaudited balance sheet at the 31 March 2019, adjusted to £46 million after audit adjustments) and the sensitivity of the estimate to changes in key assumptions. We therefore identified valuation of the Council's pension fund net liability as a significant risk, which was one of the most significant assessed risks of material misstatement.	Our work included: • documenting an understanding of the process and controls put in place by management to ensure the Council's pension fund net liability is not materially misstated and evaluating the design of the associated controls; • evaluating the instructions and accuracy/completeness of information issued to the management expert (actuary – Hymans Robertson) for this estimate and the scope of the actuary's work; • assessing the competence, capabilities and objectivity of the actuary who carried out the pension fund valuation; • testing the consistency of the pension fund asset and liability and disclosures in the notes to the core financial statements with the actuarial report from the actuary; • undertaking procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performing additional focussed audit procedures suggested within the report; and • obtaining assurances from the auditor of East Sussex Pension Fund as to the controls surrounding the validity and accuracy of membership data; contributions data and benefits data sent to the actuary by the pension fund and the fund assets valuation in the pension fund financial statements. During the year two legal cases were heard impacting on pensions and their accounting. The McCloud case relates to the Court of Appeal ruling that there was age discrimination in certain public sector pension schemes where there were transitional protections given to scheme members. And the guaranteed minimum pension (GMP) case relates to the High Court ruling that GMPs must be equalised between men and women and that past underpayments must be corrected. These two potential liabilities were considered immaterial by management and not included in the pension liability. We assessed the reasonableness of this judgement.	We concluded that - management's actuarial expert was clearly competent, capable and objective; - the actuarial method of calculating the estimate, including the roll forward approach, and assumptions adopted, was reasonable except for the point highlighted below; - the information used to the actuary was complete and accurate; and - the disclosure of the estimate in the financial statements was considered adequate. We carried out analytical procedures to conclude on whether the Council's share of LGPS pension assets and liabilities was reasonable and this resulted in highlighting a material difference in the estimated return on pension fund assets as at the financial year end used by the actuary to provide an early estimate for inclusion in the accounts, and the actual return. The Council requested from the actuary an updated actuarial estimate to include the actual year end return on pension fund assets. The revised actuary report also included the additional liability for the impact of the McCloud ruling. Management agreed this material difference required adjustment in the authority accounts. These two issues meant the estimate of the net pension fund liability increased by £4.4m, which increased the Council's Cost of Services by £548k, and increased Other Comprehensive Income and Expenditure by £3.9m. We agreed that the GMP potential liability could be estimated to a reasonable degree of accuracy, and our own recalculation agreed that the amount was immaterial.

Audit of the Financial Statements

Audit opinion
We gave an unqualified opinion on the group's financial statements on 20 September 2019.

Preparation of the financial statements
The Council presented us with draft financial statements in accordance with the national deadline.

During the audit we found that there were not clear working papers to support each note in the accounts, and that sub-systems through which significant volumes of transactions in the accounts are recorded, such as Council Tax and Business Rates income and Housing Benefits expenditure, were not supported by clear reconciliations to provide assurance of the completeness and accuracy of accounting in the general ledger for transactions in these sub-systems. We have recommended the Council strengthens its working papers in a number of specific areas.

Issues arising from the audit of the financial statements
We reported the key issues from our audit to the Authority's Audit Committee on 30 July 2019, and subsequently updated the Committee with an additional report on completion of outstanding audit work on 14 November 2019.

All significant issues from our audit have been summarised on pages 3-8 of this report.

Annual Governance Statement and Narrative Report
We are required to review the Council's Annual Governance Statement and Narrative Report. It published them on its website in the Statement of Accounts in line with the national deadlines.

Both documents were prepared in line with the CIPFA Code and relevant supporting guidance. We confirmed that both documents were consistent with the financial statements prepared by the Council and with our knowledge of the Council.

Whole of Government Accounts (WGA)
We carried out work on the Council's Data Collection Tool in line with instructions provided by the NAO . We issued an assurance statement which confirmed the Council was below the audit threshold.

Certificate of closure of the audit
We certified that we have completed the audit of the financial statements of Hastings Borough Council in accordance with the requirements of the Code of Audit Practice on 20 September 2019.

Value for Money conclusion

Background

We carried out our review in accordance with the NAO Code of Audit Practice, following the guidance issued by the NAO in November 2017 which specified the criterion for auditors to evaluate:

In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.

Key findings

Our first step in carrying out our work was to perform a risk assessment and identify the risks where we concentrated our work.

The risks we identified and the work we performed are set out overleaf.

Overall Value for Money conclusion

We are satisfied through the work documented below, that in all significant respects the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2019.

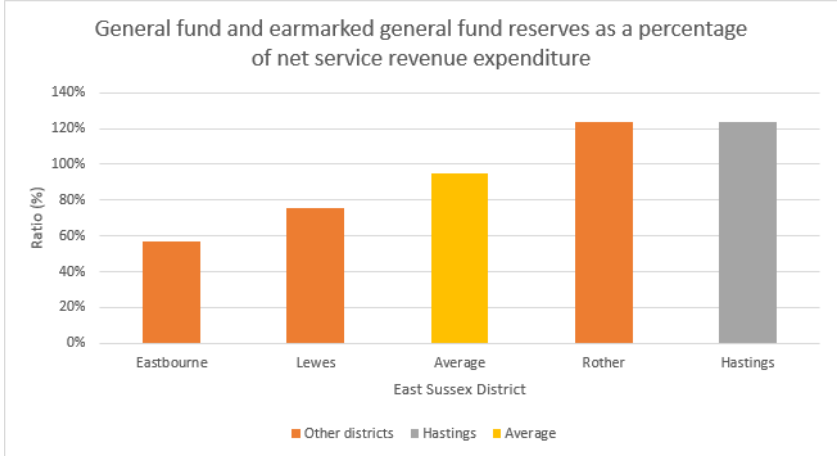
Value for Money conclusion

Risks identified in our audit plan	Findings and conclusions
Medium term financial sustainability The Council had deficit results on its provision of services for the 2016/17 and 2017/18 years. These were relatively small deficits which could be alleviated through use of reserves. At 31 March 2018 the usable reserves stood at £21.7m, a level which is considered by the Council to be sufficient to ensure the ongoing sustainability of the organisation. You are responding to funding challenges in a variety of ways, through identifying efficiencies & new sources of funding, working with partners, and engaging in service redesign. For the 2018/19 year, Council set a budget for a £1.7m deficit for the 2018/19 year, and the Medium Term Financial Strategy set out expectations of funding gaps of between £2-3m for each of the subsequent 3 years before use of reserves. There are savings and income generation plans in place which will mitigate some of the impact, but the expected results will entail significant use of the Council's current usable reserves which will be difficult to replenish. Savings plans are inherently uncertain and risky and these could put overall budget achievement in doubt. There is currently no reasonable estimate that can be made for the impact of the 2020/21 Fair Funding Review and potential changes to Business Rate retention. For these reasons we cited medium term financial sustainability as a risk that the Council could fail to achieve Economy, Efficiency, and Effectiveness in use of its resources in 2018/19 and beyond.	**Financial performance 2018/19** During the 2018/19 year the Council set a revised budget in early February 2019 to acknowledge and plan for the additional spending pressures being experienced at that point in the year. The Council, like most others, experienced a significant increase in pressure on demand led budgets, and at the year end delivered a General Fund outturn deficit of £681k, a positive variance against the revised budget of £747k. In the year the Council slightly increased its usable reserves (across General Reserve and Earmarked Reserves) by some £650k. Priority Income and Efficiency Review (PIER) savings schemes in the year have under achieved by £161k against a budgeted savings total of £703k. Delivering PIER savings to address budget gaps going forwards will be a particular challenge for the authority. Particularly in the context of having re-set the budget at quite a late stage in the current financial year, the Council will have to make sure that structural demand pressures manifesting as budget overspends, and PIER savings schemes which may not be achievable are adequately factored into the MTFS in future years as recurrent increases in costs, and reductions in anticipated savings/increases in service income. These will need to be mitigated through service transformation, or through the identification of alternative PIER efficiency savings. **Financial planning (MTFS) 2019/20 to 2023/24** The Council's Medium Term Financial Strategy (MTFS) is the key financial planning document which sets out the financial implications of its corporate strategy over 5 years. We reviewed the method for building the MTFS and in particular the robustness and realism underlying key assumptions, the PIER savings plans which are included and any areas where significant new/increased areas of revenue have been included. The MTFS, much like the 2019/20 budget, starts from a baseline of the previous year budget adjusted for what is known in terms of cost and income variations from the actual outturn to set an "adjusted base" position. There is then an iterative process of layering on inflationary assumptions including staff pay increases, known and assumed increases in services pressures, reductions in grants and other revenues, any strategic driven spending commitments continued) and plans which would drive revenue increases. Once this is complete, for this Council as we would expect from our experience across the Local Government sector, this leaves a Budget Gap between the expected expenditure required to maintain services and investment, and the resources expected to be available. For 2019/20 this Budget Gap was closed by identified savings plans which management viewed as being achievable. However in the following three years there are predicted budget gaps of £2.436m in 2020/21, £1.791m in 2021/22 and £1.897k in 2022/23.

Value for Money conclusion (continued)

Risks identified in our audit plan	Findings and conclusions
Medium term financial sustainability (continued)	In our discussions with management we have been informed of forward looking development and regeneration plans. At the date of the 2018/19 audit, more work was required by the Council to address its future budget gaps. We will consider what progress the Council has made for the medium term financial sustainability as part of our 2019/20 work. **Fiscal Indicators and Reserves Levels** Each year your management assess the level of reserves they believe it is prudent for the Council to hold. Management base this on the following factors: (i) the cashflow working balance requirement; (ii) considerations of the level of available internal and external funds in the event of unexpected events or an emergency; (iii) The need to build up funds for known or potential liabilities (earmarked reserves); (iv) reserves put in place to assist in the transition to becoming a lower spending Council; (iii) having funds in place for investment. We compared the Council's proportion of reserves and level of reserves to a set of other similar sized councils. The Council's General Fund and Earmarked reserves total as a percentage of net service revenue expenditure for the 2018/19 year is 124% (chart 1). This compares favourably to other East Sussex and Kent districts with 4 Councils holding a higher percentage of reserves compared to net service revenue expenditure. The percentage for this indicator ranged from 27% to 267%. This demonstrates clearly there is no "correct" level of reserves to hold and it very much depends on local circumstances, risk analysis and risk appetite. We also note that management analysed reserve levels and risks using a range of CIPFA developed indicators, and benchmarked the Council against other authorities. This was reported in the February 2019 budget report to members. This showed the current level of reserves as a percentage of net expenditure was 135%, reducing to 91% by the end of the next financial year. Our view was that management have given reasonable consideration to whether the reserves provide a sufficient cushion to weather the on-going financial challenges that the Council faces over the medium term due to reductions in central government funding and forecast increases in demand for its core services. However, the Council only has finite reserves available and it is important that it continues to maintain appropriate budgetary controls. The financial outlook for local government is at its most uncertain for a generation. It is key that members recognise the current level of reserves provide a buffer for the uncertainties ahead and do not represent an easy way to resolve immediate budget pressures.

Value for Money conclusion (continued)

Risks identified in our audit plan	Findings and conclusions
Medium term financial sustainability (continued)	Chart 1 

A. Reports issued and fees

We confirm below our final reports issued and fees charged for the audit and provision of non-audit services.

Reports issued

Report	Date issued
Audit Plan	14 March 2019
Audit Findings Report	30 July 2019
Annual Audit Letter	14 January 2020

Fees

	Planned £	Actual fees £	2017/18 fees £
Statutory audit	35,742	46,742	46,418
Housing Benefit Grant Certification	10,500	TBC	8,844
Total fees	46,242	TBC	55,262

Audit fee variation

As outlined in our audit plan, the 2018-19 scale fee published by PSAA of £35,742 assumes that the scope of the audit does not significantly change. There are a number of areas where the scope of the audit has changed, which has led to additional work. These are set out in the adjacent table.

Non- audit services

- For the purposes of our audit we made enquiries of all Grant Thornton UK LLP teams providing services to the group. The table above summarises all non-audit services which were identified.
- We have considered whether non-audit services might be perceived as a threat to our independence as the group's auditor and have ensured that appropriate safeguards are put in place.

The above non-audit services are consistent with the group's policy on the allotment of non-audit work to your auditor.

Area	Reason	Fee variance
Assessing the impact of the McCloud ruling	The Government's transitional arrangements for pensions were ruled discriminatory by the Court of Appeal last December. The Supreme Court refused the Government's application for permission to appeal this ruling. As part of our audit we have reviewed the actuarial assessment of the impact on the financial statements along with any audit reporting requirements.	1,600
Pensions – IAS 19	The Financial Reporting Council has highlighted that the quality of work by audit firms in respect of IAS 19 needs to improve across local government audits. Accordingly, we have increased the level of scope and coverage in respect of IAS 19 this year to reflect this.	2,300
PPE Valuation – work of experts	As above, the Financial Reporting Council has highlighted that auditors need to improve the quality of work on PPE valuations across the sector. We have increased the volume and scope of our audit work to reflect this.	2,500
New ledger system	The Council moved to a new ERP ledger system from April 2018. The working papers provided as evidence for the correct migration of the system were of a poor quality. This meant our testing of the migration took much more time for the audit team than we would have anticipated.	2,200
Oher factors increasing audit input	During the audit we found there were not clear working papers to support each note in the accounts, and that sub-systems such as Council Tax and Business Rates income and Housing Benefits expenditure, were not supported by clear reconciliations to provide assurance of the completeness and accuracy of accounting in the general ledger for transactions in these sub-systems. Group accounts were prepared for the first time in 2018/19.	£2,400
Total		11,000

Fee variations are subject to PSAA approval.

Our commitment to our local government clients

- Senior level investment
- Local presence enhancing our responsiveness, agility and flexibility.
- High quality audit delivery
- Collaborative working across the public sector
- Wider connections across the public sector economy, including with health and other local government bodies
- Investment in Health and Wellbeing, Social Value and the Vibrant Economy
- Sharing of best practice and our thought leadership.
- Invitations to training events locally and regionally – bespoke training for emerging issues
- Further investment in data analytics and informatics to keep our knowledge of the areas up to date and to assist in designing a fully tailored audit approach

Our relationship with our clients– why are we best placed?

- We work closely with our clients to ensure that we understand their financial challenges, performance and future strategy.
- We deliver robust, pragmatic and timely financial statements and Value for Money audits
- We have an open, two way dialogue with clients that support improvements in arrangements and the audit process
- Feedback meetings tell us that our clients are pleased with the service we deliver. We are not complacent and will continue to improve further
- Our locally based, experienced teams have a commitment to both our clients and the wider public sector
- We are a Firm that specialises in Local Government, Health and Social Care, and Cross Sector working, with over 25 Key Audit Partners, the most public sector specialist Engagement Leads of any firm
- We have strong relationships with CIPFA, SOLCAE, the Society of Treasurers, the Association of Directors of Adult Social Care and others.

New opportunities and challenges for your community

The Local Government economy

Local authorities face unprecedented challenges including:

- Financial Sustainability – addressing funding gaps and balancing needs against resources
- Service Sustainability – Adult Social Care funding gaps and pressure on Education, Housing, Transport
- Transformation – new models of delivery, greater emphasis on partnerships, more focus on economic development
- Technology – cyber security and risk management

At a wider level, the political environment remains complex:

- The government continues its negotiation with the EU over Brexit, and future arrangements remain uncertain.
- We will consider your arrangements for managing and reporting your financial resources as part of our work in reaching our Value for Money conclusion.
- We will keep you informed of changes to the financial reporting requirements for 2018/19 through on-going discussions and invitations to our technical update workshops.

Delivering real value through:

- Early advice on technical accounting issues, providing certainty of accounting treatments, future financial planning implications and resulting in draft statements that are 'right first time'
- Knowledge and expertise in all matters local government, including local objections and challenge, where we have an unrivalled depth of expertise.
- Early engagement on issues, especially on ADMs, housing delivery changes, Children services and Adult Social Care restructuring, partnership working with the NHS, inter authority agreements, governance and financial reporting
- Implementation of our recommendations have resulted in demonstrable improvements in your underlying arrangements, for example accounting for unique assets, financial management, reporting and governance, and tax implications for the Cornwall Council companies
- Robust but pragmatic challenge – seeking early liaison on issues, and having the difficult conversations early to ensure a 'no surprises' approach – always doing the right thing
- Providing regional training and networking opportunities for your teams on technical accounting issues and developments and changes to Annual Reporting requirements
- An efficient audit approach, providing tangible benefits, such as releasing finance staff earlier and prompt resolution of issues.

Grant Thornton in Local Government

Our client base and delivery

- We are the largest supplier of external audit services to local government
- We audit over 150 local government clients
- We signed 95% of our local government opinions in 2017/18 by 31 July
- In our latest independent client service review, we consistently score 9/10 or above. Clients value our strong interaction, our local knowledge and wealth of expertise.

Our connections

- We are well connected to MHCLG, the NAO and key local government networks
- We work with CIPFA, Think Tanks and legal firms to develop workshops and good practice
- We have a strong presence across all parts of local government including blue light services
- We provide thought leadership, seminars and training to support our clients and to provide solutions

Our people

- We have over 25 engagement leads accredited by ICAEW, and over 250 public sector specialists
- We provide technical and personal development training
- We employ over 80 Public Sector trainee accountants

Our quality

- Our audit approach complies with the NAO's Code of Audit Practice, and International Standards on Auditing
- We are fully compliant with ethical standards
- Your audit team has passed all quality inspections including QAD and AQRT

Our technical support

- We have specialist leads for Public Sector Audit quality and technical
- We provide national technical guidance on emerging auditing, financial reporting and ethical areas
- Specialist audit software is used to deliver maximum efficiencies

Agenda Item 5

Report to: **Audit Committee**

Date of Meeting: **22 January 2020**

Report Title: **Audit Progress Report and Sector Update**

Report By: **Peter Grace, Assistant Director Financial Services & Revenues**

Purpose of Report

To inform the Audit Committee of External Audit progress in delivering their responsibilities and providing a Sector Update.

Recommendation(s)

1. **That the report be noted**

Reasons for Recommendations

As a communication channel for Grant Thornton to inform the Committee on progress in delivering their responsibilities as our External Auditor and to provide a summary of emerging national issues and developments that are relevant to us as a local authority.

Introduction

1. This is a new type of report received from External Auditors that the Committee will have seen for the first time.

2. It summarises progress as at January 2020 including the status on each of the key external audit deliverables.

3. The second part of the report provides a sector update, specifically;

   MHCLG – Independent probe into local government audit

   National Audit Office – Code of Audit Practice

   Financial Reporting Council – Summary of key developments for 2019/20 annual reports.

   What is the future for local audit?

   Grant Thornton's Sustainable Growth Index Report

   Institute for Fiscal Studies – English local government funding: trends and challenges in 2019 and beyond

4. The detailed report can be found at appendix A.

5. We are expecting a senior manager, the Engagement Lead, from Grant Thornton to attend the meeting and present the report.

Timetable of Next Steps

6. Please include a list of key actions and the scheduled dates for these:

Action	Key milestone	Due date (provisional)	Responsible
Not applicable – this is an information report only	-	-	-

Wards Affected

None.

Implications

Relevant project tools applied? ~~Yes/No/~~N/A

Have you checked this report for plain English and readability? Yes/~~No~~

Climate change implications considered? ~~Yes~~/No

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

Equalities and Community Cohesiveness	
Crime and Fear of Crime (Section 17)	
Risk Management	✓
Environmental Issues	
Economic/Financial Implications	✓
Human Rights Act	
Organisational Consequences	
Local People's Views	
Anti-Poverty	

Additional Information

Appendix A – Audit Progress Report and Sector Update

Officer to Contact

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Grant Thornton

An instinct for growth™

Audit Progress Report and Sector Update

Hastings Borough Council
Year ending 31 March 2020

January 2020

Contents

Introduction

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This paper provides the Audit Committee with a report on progress in delivering our responsibilities as your external auditors.

The paper also includes:

- a summary of emerging national issues and developments that may be relevant to you as a local authority; and
- includes a number of challenge questions in respect of these emerging issues which the Committee may wish to consider (these are a tool to use, if helpful, rather than formal questions requiring responses for audit purposes)

Members of the Audit Committee can find further useful material on our website, where we have a section dedicated to our work in the public sector. Here you can download copies of our publications www.grantthornton.co.uk ..

If you would like further information on any items in this briefing, or would like to register with Grant Thornton to receive regular email updates on issues that are of interest to you, please contact either your Engagement Lead or Engagement Manager.

Progress at January 2020

2019/20

All of our work is complete in respect of 2018/19 (see our Annual Audit Letter also presented to this meeting). We completed the certification of the Housing Benefit claim on 29 November 2019. The claim was certified with amendments. We reported errors identified from follow up testing to the Department of Works and Pensions.

2019/20

We begun our planning for 2019/20 financial year end audit in November 2019. We have:

- continued to have regular discussions with management to inform our risk assessment for the 2019/20 financial and value for money audits
- reviewed committee papers including the latest financial and operational performance reports
- considered any reports from regulators regarding your operational effectiveness
- started our initial value for money risk assessment to determine our approach.

Our 2019/20 Audit Plan will be presented at the March 2020 Audit Committee meeting.

Our interim audit has commenced in January 2020 and includes: :

- updating our review of the Council's control environment and financial systems
- review of Internal Audit reports on key financial systems
- early work on emerging accounting issues including Minimum Revenue Provisions, application of IFRS 16 Leases
- early substantive testing involves testing a portion (pro rata share) of the population early
- detailed review of significant value for money risks as set out in the Audit Plan.

We will report our work in the Audit Findings Report in July 2020. The NAO is consulting on a new Code of Audit Practice from 2020 which proposes to make significant changes to Value for Money work. Please see page 8 for more details.

Audit fees

During 2017, PSAA awarded contracts for audit for a five-year period beginning on 1 April 2018. 2019/20 is the second year of that contract. Since that time, there have been a number of developments within the accounting and audit profession. Across all sectors and firms, the Financial Reporting Council (FRC) has set out its expectation of improved financial reporting from organisations and the need for auditors to demonstrate increased scepticism and challenge and to undertake additional and more robust testing.

Our work in the Local Government sector in 2018/19 has highlighted areas where financial reporting, in particular, property, plant and equipment and pensions, needs to improve. There is also an increase in the complexity of Local Government financial transactions and financial reporting. This combined with the FRC requirement that all Local Government audits are at or above the "few improvements needed" (2A) rating means that additional audit work is required.

We are currently reviewing the impact of these changes on both the cost and timing of audits. We will discuss this with your s151 Officer including any proposed variations to the Scale Fee set by PSAA Limited, before communicating fully with the Audit Committee.

As a firm, we are absolutely committed to meeting the expectations of the FRC with regard to audit quality and local government financial reporting.

Other areas

Meetings

We met with Finance Officers in November 2019 and January 2020 as part of audit planning for 2019/20. We continue to be in discussions with finance staff regarding emerging developments and to ensure the audit process is smooth and effective.

Events

We provide a range of workshops, along with network events for members and publications to support the Council. Your officers will be invited to our Financial Reporting Workshop in February, which will help to ensure that members of your Finance Team are up to date with the latest financial reporting requirements for local authority accounts.

Audit Deliverables

2018/19 Deliverables	Planned Date	Status
Annual Audit Letter This letter communicates the key issues arising from our work.	January 2020	Complete

2019/20 Deliverables	Planned Date	Status
Fee Letter Confirming PSAA scale fee for 2019/20.	April 2019	issued
Accounts Audit Plan We are required to issue a detailed accounts audit plan to the Audit Committee setting out our proposed approach in order to give an opinion on the Council's 2019-20 financial statements.	January 2020	Not yet due
Interim Audit Findings We will report to you the findings from our interim audit and our initial value for money risk assessment within our Progress Report.	March 2020	Not yet due
Audit Findings Report The Audit Findings Report will be reported to the July Audit Committee.	July 2020	Not yet due
Auditors Report This is the opinion on your financial statement, annual governance statement and value for money conclusion.	July 2020	Not yet due
Annual Audit Letter This letter communicates the key issues arising from our work.	August 2020	Not yet due

Sector Update

Councils continue to try to achieve greater efficiency in the delivery of public services, whilst facing the challenges to address rising demand, ongoing budget pressures and social inequality.

Our sector update provides you with an up to date summary of emerging national issues and developments to support you. We cover areas which may have an impact on your organisation, the wider local government sector and the public sector as a whole. Links are provided to the detailed report/briefing to allow you to delve further and find out more.

Our public sector team at Grant Thornton also undertake research on service and technical issues. We will bring you the latest research publications in this update. We also include areas of potential interest to start conversations within the organisation and with audit committee members, as well as any accounting and regulatory updates.

- **Grant Thornton Publications**
- **Insights from local government sector specialists**
- **Reports of interest**
- **Accounting and regulatory updates**

More information can be found on our dedicated public sector and local government sections on the Grant Thornton website by clicking on the logos below:

Public Sector

Local government

MHCLG – Independent probe into local government audit

In July, the then Communities secretary, James Brokenshire, announced the government is to examine local authority financial reporting and auditing.

At the CIPFA conference he told delegates the independent review will be headed up by Sir Tony Redmond, a former CIPFA president.

The government was "working towards improving its approach to local government oversight and support", Brokenshire promised.

"A robust local audit system is absolutely pivotal to work on oversight, not just because it reinforces confidence in financial reporting but because it reinforces service delivery and, ultimately, our faith in local democracy," he said.

"There are potentially far-reaching consequences when audits aren't carried out properly and fail to detect significant problems."

The review will look at the quality of local authority audits and whether they are highlighting when an organisation is in financial trouble early enough.

It will also look at whether the public has lost faith in auditors and whether the current audit arrangements for councils are still "fit for purpose".

On the appointment of Redmond, CIPFA chief executive Rob Whiteman said: "Tony Redmond is uniquely placed to lead this vital review, which will be critical for determining future regulatory requirements.

"Local audit is crucial in providing assurance and accountability to the public, while helping to prevent financial and governance failure."

He added: "This work will allow us to identify what is needed to make local audit as robust as possible, and how the audit function can meet the assurance needs, both now and in the future, of the sector as a whole."

Ministry of Housing, Communities & Local Government

In the question and answer session following his speech, Brokenshire said he was not looking to bring back the Audit Commission, which appointed auditors to local bodies and was abolished in 2015. MHCLG note that auditing of local authorities was then taken over by the private, voluntary and not-for-profit sectors.

He explained he was "open minded", but believed the Audit Commission was "of its time".

Local authorities in England are responsible for 22% of total UK public sector expenditure so their accounts "must be of the highest level of transparency and quality", the Ministry of Housing, Local Government and Communities said. The review will also look at how local authorities publish their annual accounts and if the financial reporting system is robust enough.

Redmond, who has also been a local authority treasurer and chief executive, is expected to report to the communities secretary with his initial recommendations in December 2019, with a final report published in March 2020. Redmond has also worked as a local government boundary commissioner and held the post of local government ombudsman.

The terms of reference focus on whether there is an "expectation gap" between the purpose of external audit and what it is currently delivering. It will examine the performance of local authority audit, judged according to the criteria of economy, effectiveness and efficiency.

Other key areas of the review include whether:

1) audit recommendations are effective in helping councils to improve financial management
2) auditors are using their reporting powers appropriately
3) councils are responding to auditors appropriately
4) Financial savings from local audit reforms have been realised
5) There has been an increase in audit providers
6) Auditors are properly responding to questions or objections by local taxpayers
7) Council accounts report financial performance in a way that is transparent and open to local press scrutiny

National Audit Office – Code of Audit Practice

The Code of Audit Practice sets out what local auditors of relevant local public bodies are required to do to fulfill their statutory responsibilities under the Local Audit and Accountability Act 2014. 'Relevant authorities' are set out in Schedule 2 of the Act and include local councils, fire authorities, police and NHS bodies.

Local auditors must comply with the Code of Audit Practice.

Consultation – New Code of Audit Practice from 2020

Schedule 6 of the Act requires that the Code be reviewed, and revisions considered at least every five years. The current Code came into force on 1 April 2015, and the maximum five-year lifespan of the Code means it now needs to be reviewed and a new Code laid in Parliament in time for it to come in to force no later than 1 April 2020.

In order to determine what changes might be appropriate, the NAO is consulting on potential changes to the Code in two stages:

Stage 1 involves engagement with key stakeholders and public consultation on the issues that are considered to be relevant to the development of the Code.

This stage of the consultation is now closed. The NAO received a total of 41 responses to the consultation which included positive feedback on the two-stage approach to developing the Code that has been adopted. The NAO state that they have considered carefully the views of respondents in respect of the points drawn out from the Issues paper and this will inform the development of the draft Code. A summary of the responses received to the questions set out in the Issues paper can be found below.

Local audit in England Code of Audit Practice – Consultation Response (pdf – 256KB)

Stage 2 of the consultation involves consulting on the draft text of the new Code. To support stage 2, the NAO has published a consultation document, which highlights the key changes to each chapter of the draft Code. The most significant changes are in relation to the Value for Money arrangements. Rather than require auditors to focus on delivering an overall, binary, conclusion about whether or not proper arrangements were in place during the previous financial year, the draft Code requires auditors to issue a commentary on each of the criteria. This will allow auditors to tailor their commentaries to local circumstances. The Code proposes three specific criteria:

a) Financial sustainability: how the body plans and manages its resources to ensure it can continue to deliver its services;

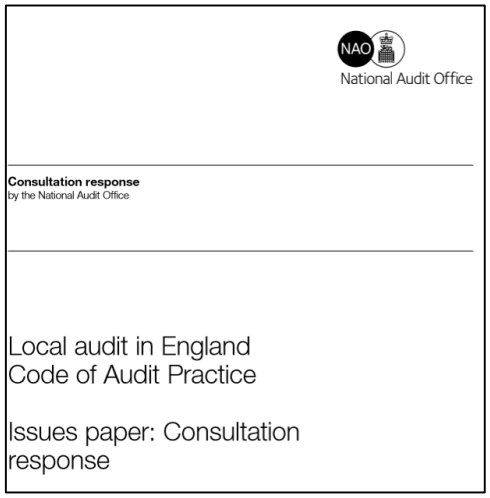
b) Governance: how the body ensures that it makes informed decisions and properly manages its risks; and

c) Improving economy, efficiency and effectiveness: how the body uses information about its costs and performance to improve the way it manages and delivers its services.

The consultation document and a copy of the draft Code can be found on the NAO website. The consultation closed on 22 November 2019. The new Code will apply from audits of local bodies' 2020-21 financial statements onwards.

Link to NAO webpage for the Code consultation:

https://www.nao.org.uk/code-audit-practice/code-of-audit-practice-consultation/


NAO
National Audit Office

Consultation response
by the National Audit Office

Local audit in England
Code of Audit Practice

Issues paper: Consultation response

Financial Reporting Council – Summary of key developments for 2019/20 annual reports

On 30 October the Financial Reporting Council (FRC) wrote an Open Letter to Company Audit Committee Chairs. Some of the points are relevant to local authorities.

The reporting environment

The FRC notes that, "In times of uncertainty, whether created by political events, general economic conditions or operational challenges, investors look for greater transparency in corporate reports to inform their decision-making. We expect companies to consider carefully the detail provided in those areas of their reports which are exposed to heightened levels of risk; for example, descriptions of how they have approached going concern considerations, the impact of Brexit and all areas of material estimation uncertainty." These issues equally affect local authorities, and the Statement of Accounts or Annual Report should provide readers with sufficient appropriate information on these topics.

Critical judgements and estimates

The FRC wrote "More companies this year made a clear distinction between the critical judgements they make in preparing their accounts from those that involve the making of estimates and which lead to different disclosure requirements. However, some provided insufficient disclosures to explain this area of their reporting where a particular judgement had significant impact on their reporting; for example, whether a specific investment was a joint venture or a subsidiary requiring consolidation. We will continue to have a key focus on the adequacy of disclosures supporting transparent reporting of estimation uncertainties. An understanding of their sensitivity to changing assumptions is of critical value to investors, giving them clearer insight into the possible future changes in balance sheet values and which can inform their investment decisions." Critical judgements and estimates also form a crucial part of local authority statements of account, with the distinction often blurred.

IFRS 16 Leases

The FRC letter notes "IFRS 16 is effective for periods beginning on or after 1 January 2019. We recently conducted a thematic review looking at how companies reported on their adoption of the new standard in their June 2019 interim accounts. In advance of our detailed findings which will be published shortly, I set out what we expect to see by way of disclosures in the forthcoming accounts, drawing on the results of our work.

• Clear explanation of the key judgements made in response to the new reporting requirements;

• Effective communication of the impact on profit and loss, addressing any lack of comparability with the prior year;

• Clear identification of practical expedients used on transition and accounting policy choices; and

• Well explained reconciliation, where necessary, of operating lease commitments under IAS 17, 'Leases', the previous standard and lease liabilities under IFRS 16."

The implementation of IFRS is delayed until 1 April 2020 in the public sector when it will replace IAS 17 Leases and the three interpretations that supported its application. Authorities will need information and processes in place to enable them to comply with the requirements. They will need to make disclosures in the 2019/20 accounts about the impact of IFRS 16 in accordance with IAS 8/ Code 3.3.4.3 requirements for disclosure about standards which are issued but are not yet effective.

What is the future for local audit?

Paul Dossett, Head of local government at Grant Thornton, has written in the Municipal Journal "Audit has been a hot topic of debate this year and local audit is no exception. With a review into the quality of local audit now ongoing, it's critical that part of this work looks at the overarching governance and management of the audit regime. We believe there is a strong need for new oversight arrangements if the local audit regime is to remain sustainable and effective in the future."

Paul goes on to write "Local (local authority and NHS) audit has been a key part of the oversight regime for public services for more than a century. The National Audit Office (NAO) has exercised this role in central government for several generations and their reporting to Parliament via the Public Accounts Committee is a key part of the public spending accountability framework.

Local audit got a significant boost with the creation of the Audit Commission in 1983 which provided a coordinated, high profile focus on local government and (from 1990) NHS spending and performance at a local level. Through undertaking value for money reviews and maintaining a tight focus on the generational governance challenges, such as rate capping in the 1980s and service governance failings in the 1990s, the Commission provided a robust market management function for the local audit regime. Local audit fees, appointments, scope, quality and relevant support for auditors all fell within their ambit.

However, the Commission was ultimately deemed, among other things, to be too expensive and was abolished in 2010, as part of the Coalition Government's austerity saving plans. While the regime was not perfect, and the sector had acknowledged that reform of the Commission was needed, complete abolition was not the answer.

Since then, there has been no body with complete oversight of the local audit regime and how it interacts with local public services. The Ministry of Housing, Communities and Local Government; Department of Health; NHS; NAO; Local Government Association (LGA); Public Sector Audit Appointments Ltd (PSAA); the Financial Reporting Council (FRC); the Chartered Institute of Public Finance & Accountancy (CIPFA), audit firms and the audited bodies themselves all have an important role to play but, sometimes, the pursuit of individual organisational objectives has resulted in sub-optimal and even conflicting outcomes for the regime overall.

These various bodies have pursued separate objectives in areas such as audit fee reduction, scope of work, compliance with commercial practice, earlier reporting deadlines and mirroring commercial accounting conventions – to name just a few.

This has resulted in a regime that no stakeholder is wholly satisfied with and one that does not ensure local audit is providing a sufficiently robust and holistic oversight of public spending.

To help provide a more cohesive and co-ordinated approach within the sector, we believe that new oversight arrangements should be introduced. These would have ultimate responsibility for ensuring the sustainability of the local audit regime and that its component parts – including the Audit Code, regulation, market management and fees – interact in an optimal way. While these arrangements do not need to be another Audit Commission, we need to have a strategic approach to addressing the financial sustainability challenges facing local government and the NHS, the benchmarking of performance and the investigation of governance failings.

There are a number of possible solutions including:

1) The creation of a new arm's length agency with a specific remit for overseeing and joining up local audit. It would provide a framework to ensure the sustainability of the regime, covering fees, appointments, and audit quality. The body would also help to create a consistent voice to government and relevant public sector stakeholders on key issues arising from the regime. Such a body would need its own governance structure drawn from the public sector and wider business community; and

2) Extending the current remit of the NAO. Give it total oversight of the local audit regime and, in effect, establish a local audit version of the NAO, with all the attendant powers exercised in respect of local audit. In this context, there would be a need to create appropriate governance for the various sectors, similar to the Public Accounts Committee.

While the detail of the new arrangements would be up for debate, it's clear that a new type of oversight body, with ultimate responsibility for the key elements of local audit, is needed. It would help to provide much-needed cohesion across the sector and between its core stakeholders.

The online article is available here:

https://www.themj.co.uk/What-is-the-future-for-audit/214769

Grant Thornton's Sustainable Growth Index Report

Grant Thornton has launched the Sustainable Growth Index (formerly the Vibrant Economy Index) – now in its third year. The Sustainable Growth Index seeks to define and measure the components that create successful places. Our aim in establishing the Index was to create a tool to help frame future discussions between all interested parties, stimulate action and drive change locally. We have undergone a process of updating the data for English Local Authorities on our online, interactive tool, and have produced an updated report on what the data means. All information is available now on our online hub, where you can read the new report and our regional analyses.

The Sustainable Growth Index provides an independent, data-led scorecard for each local area that provides:

• businesses with a framework to understand their local economy and the issues that will affect investment decisions both within the business and externally, a tool to support their work with local enterprise partnerships, as well as help inform their strategic purpose and CSR plans in light of their impact on the local social and economic environment

• policy-makers and place-shapers with an overview of the strengths, opportunities and challenges of individual places as well as the dynamic between different areas

• Citizens with an accessible insight into how their place is doing, so that they can contribute to shaping local discussions about what is important to them

The Index shows the 'tip of the iceberg' of data sets and analysis our public services advisory team can provide our private sector clients who are considering future locations in the UK, or wanting to understand the external drivers behind why some locations perform better than others.

Our study looks at over 50 indicators to evaluate all the facets of a place and where they excel or need to improve.

Our index is divided into six baskets. These are:

1 Prosperity

2 Dynamism and opportunity

3 Inclusion and equality

4 Health, wellbeing and happiness

5 Resilience and sustainability

6 Community trust and belonging

This year's index confirms that cities have a consistent imbalance between high scores related to prosperity, dynamism and opportunity, and low scores for health, wellbeing, happiness inclusion and equality. Disparity between the richest and poorest in these areas represents a considerable challenge for those places.

Inclusion and equality remains a challenge for both highly urban and highly rural places and coastal areas, particularly along the east coast from the North East to Essex and Kent, face the most significant challenges in relation to these measures and generally rank below average.

Creating sustainable growth matters and to achieve this national policy makers and local authorities need to do seven things:

1 Ensure that decisions are made on the basis of robust local evidence.

2 Focus on the transformational trends as well as the local enablers

3 Align investment decisions to support the creation of sustainable growth

4 Align new funding to support the creation of sustainable growth

5 Provide space for innovation and new approaches

6 Focus on place over organisation

7 Take a longer-term view

The online report is available here:

https://www.grantthornton.co.uk/en/insights/sustainable-growth-index-how-does-your-place-score/

Institute for Fiscal Studies – English local government funding: trends and challenges in 2019 and beyond

The Institute for Fiscal Studies (IFS) has found "The 2010s have been a decade of major financial change for English local government. Not only have funding levels – and hence what councils can spend on local services – fallen significantly; major reforms to the funding system have seen an increasing emphasis on using funding to provide financial incentives for development via initiatives such as the Business Rates Retention Scheme (BRRS) and the New Homes Bonus (NHB)."

The IFS goes on to report "Looking ahead, increases in council tax and additional grant funding from central government mean a boost to funding next year – but what about the longer term, especially given plans for further changes to the funding system, including an expansion of the BRRS in 2021–22?

This report, the first of what we hope will be an annual series of reports providing an up-to-date analysis of local government, does three things in this context. First, it looks in detail at councils' revenues and spending, focusing on the trends and choices taken over the last decade. Second, it looks at the outlook for local government funding both in the short and longer term. And third, it looks at the impact of the BRRS and NHB on different councils' funding so far, to see whether there are lessons to guide reforms to these policies.

The report focuses on those revenue sources and spending areas over which county, district and single-tier councils exercise real control. We therefore exclude spending on police, fire and rescue, national park and education services and the revenues specifically for these services. When looking at trends over time, we also exclude spending on and revenues specifically for public health, and make some adjustments to social care spending to make figures more comparable across years. Public health was only devolved to councils in 2013–14, and the way social care spending is organised has also changed, with councils receiving a growing pot of money from the NHS to help fund services."

The IFS reports a number of key facts and figures, including

1) Cuts to funding from central government have led to a 17% fall in councils' spending on local public services since 2009–10 – equal to 23% or nearly £300 per person.
2) Local government has become increasingly reliant on local taxes for revenues.
3) Councils' spending is increasingly focused on social care services – now 57% of all service budgets.

The IFS report is available on their website below:

https://www.ifs.org.uk/publications/14563

Institute for Fiscal Studies

English local government funding: trends and challenges in 2019 and beyond

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Agenda Item 6

Agenda Item No:

Report to: **Audit Committee**

Date of Meeting: **22 January 2020**

Report Title: **Treasury Management Mid-Year Report 2019-20**

Report By: **Peter Grace**
Chief Finance Officer

Purpose of Report

This report advises the Audit Committee 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 2019.

Recommendation

Audit Committee 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 2019). It is a requirement of the Code of Practice that the Mid-year review is considered by Cabinet and full Council.

.

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 2019/20 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 2019/20;
- A review of the Council's borrowing strategy for 2019/20;
- A review of any debt rescheduling undertaken during 2019/20;
- A review of compliance with Treasury and Prudential Limits for 2019/20.

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.

8. 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.

9. The Cabinet considered a similar report at their meeting on 6 January 2020.

Economic Update

10. **UK.** Brexit. 2019 has been a year of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on 31 October 2019, with or without a deal. However, MPs blocked leaving on that date and the EU agreed an extension to 31 January 2020.

11. In late October, MPs approved an outline of a Brexit deal to enable the UK to leave the EU on 31 January; however at the time of writing the general election on 12 December 2019 provides considerable uncertainty as to whether this will occur. Should it proceed a trade deal will need to be negotiated by the end of the transition period in December 2020.

12. While the Bank of England went through the routine of producing another quarterly Inflation Report, (now renamed the Monetary Policy Report), on 7 November, it is very questionable how much all the writing and numbers are worth when faced with the uncertainties of where the UK will be after the general election. The Bank made a change in their Brexit assumptions to now include a deal being eventually passed.

13. Possibly the biggest message that is worth taking note of from the Monetary Policy Report, was an increase in concerns among MPC members around weak global economic growth and the potential for Brexit uncertainties to become entrenched and so delay UK economic recovery. Consequently, the MPC voted 7-2 to maintain Bank Rate at 0.75% but two members were sufficiently concerned to vote for an immediate Bank Rate cut to 0.5%.

14. The MPC warned that if global growth does not pick up or Brexit uncertainties intensify, then a rate cut was now more likely. Conversely, if risks do recede, then a more rapid recovery of growth will require gradual and limited rate rises. The speed of

recovery will depend on the extent to which uncertainty dissipates over the final terms for trade between the UK and EU and by how much global growth rates pick up. The Bank revised its inflation forecasts down – to 1.25% in 2019, 1.5% in 2020, and 2.0% in 2021; hence the MPC views inflation as causing little concern in the near future.

15. If economic growth were to weaken considerably, the MPC has relatively little room to make a big impact with Bank Rate still only at 0.75%. It would therefore, probably suggest that it would be up to the Chancellor to provide help to support growth by way of a fiscal boost by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy. The Government has already made moves in this direction and both of the largest parties have made significant promises in their election manifestos to increase government spending.

16. The Chancellor has also amended the fiscal rules in November to allow for an increase in government expenditure. In addition, it has to be borne in mind that even if the post-election Parliament agrees the deal on 31 January 2020, the current transition period for negotiating the details of the terms of a trade deal with the EU only runs until 31 December 2020. This could prove to be an unrealistically short timetable for such major negotiations which leaves open two possibilities; one the need for an extension of negotiations, probably two years, or a no deal Brexit in December 2020.

17. As for inflation itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell again in October to 1.5%. It is likely to remain close to or under 2% over the next two years and so it does not pose any immediate concern to the MPC at the current time. However, if there was a no deal Brexit, inflation could rise towards 4%, primarily because of imported inflation on the back of a weakening pound.

18. With regard to the labour market, growth in numbers employed has been quite resilient through 2019 until the three months to September where it fell by 58,000. However, this was about half of what had been expected. The unemployment rate fell back again to a 44 year low of 3.8% on the Independent Labour Organisation measure in September, despite the fall in numbers employed, due to numbers leaving the work force.

19. Wage inflation has been edging down from a high point of 3.9% in July to 3.8% in August and now 3.6% in September, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 1.9%. As 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. The other message from the fall in wage growth is that employers are beginning to find it easier to hire suitable staff, indicating that supply pressure in the labour market is easing.

Interest rate forecasts

20. The Council's treasury advisor, Link Asset Services, has provided the following forecast. This forecast includes the increase in margin over gilt yields of 100bps

introduced on 9 October 2019 in respect of the PWLB.

Interest rate Forecasts – December 2019 to March 2022

Link Asset Services Interest Rate View	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	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60
5yr PWLB Rate	2.30	2.50	2.60	2.70	2.70	2.80	2.90	3.00	3.00	3.10
10yr PWLB Rate	2.60	2.80	2.90	3.00	3.00	3.10	3.20	3.30	3.30	3.40
25yr PWLB Rate	3.30	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00
50yr PWLB Rate	3.20	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90

21. The above forecasts have been based on an assumption that there is some sort of agreed deal on Brexit at some point in time. Given the current level of uncertainties, this is a huge assumption and so forecasts may need to be materially reassessed in the light of events over the next few weeks or months.

The Council's Treasury Position – 30 September 2019

Borrowing

22. The Council's debt and investment position at the 30 September 2019 was as follows

Table 1 – Borrowing

Debt	1 April 2019 Principal	Rate	Maturity	30 Sept 2019 Principal	Rate
PWLB	£7,500,000	4.80%	2033	£7,500,000	4.80%
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)	£215,148	1.66%	2026	£200,592	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)	£7,113,729	2.53%	2057	£7,058,607	2.53%
PWLB (Annuity)	£8,232,534	2.72%	2057	£8,172,600	2.72%
PWLB	£2,000,000	1.98%	2028	£2,000,000	1.98%
PWLB (Annuity)	£4,000,000	2.55%	2058	£3,970,946	2.55%
PWLB (Annuity)	£2,500,000	2.56%	2059	£2,481,883	2.56%
PWLB (Annuity)	£4,410,000	2.56%	2069	£4,388,015	2.56%
PWLB (Annuity)	£9,400,000	2.54%	2059	£9,331,568	2.54%
PWLB (Annuity)	-	-	2069	£4,800,000	1.83%
Total Debt	**£61,068,673**	**2.90%**		**£65,601,473**	**2.82%**

23. At the 30 September 2019 the Council had debt amounting to £65.6m (PWLB debt).

24. 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.

25. 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.

26. 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.

27. 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).

28. The Council's 2019/20 MRP Policy was approved as part of the Treasury Management Strategy Report for 2019/20 by Council in February 2019.

29. 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	2018/19 Actual £000's	2019/20 Estimate £000's
Opening balance	39,493	58,094
Add unfinanced capital expenditure	19,396	15,662
Less MRP	(795)	(1,184)
Closing balance	**58,094**	**72,572**

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

31. 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 2019/20 plus the expected changes to the CFR over 2020/21 and 2021/22 from financing the capital programme. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2019/20.

Table 3 Internal Borrowing	2018/19 Actual £000's	2019/20 Estimate As at 30/11/19 £000's
Capital Financing Requirement	58,094	72,572
External Borrowing	61,069	65,601
Net Internal Borrowing	**(2,975)**	**6,971**

32. 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 2019-20

33. The table below provides a snapshot of the investments and deposits held on 30 September 2019. 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
Landesbank - Helaba	1.14%	30/01/2019	30/01/2020	**5,000,000**	Fixed
Australia & NZ BGC Ltd	0.98%	03/06/2019	03/12/2019	**5,000,000**	Fixed
DBS Bank	0.79%	04/07/2019	04/10/2019	**5,000,000**	Fixed
Credit Agricole	0.79%	03/09/2019	03/03/2020	**5,000,000**	Fixed
Goldman Sachs	0.92%	11/09/2019	11/03/2020	**5,000,000**	Fixed
Barclays Corporate	0.40%			**1,999,995**	Call
NAT West	0.05%			**6,147**	Call
			Total	**27,006,142**	

34. As at 30 September 2019 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	£200,592	Annuity
The Source	2.43%	17/12/2015	16/12/2024	£18,123	Annuity
			Total	**£2,006,950**	

35. 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.

36. The overall investment performance for the first 6 months of 2019/20 provided an average return of 0.91% (2018/19 0.78%).

37. The total interest receivable for the first 6 months is £120,348 (2018/19 £82,944) These figures exclude the interest receivable in respect of the three loans to other organisations and income from the Property Fund investment.

Loans to Hastings Housing Company Ltd

38. Hastings Housing Company has two loans outstanding with the council, a revenue loan and a capital loan. The rate chargeable on the revenue loan is calculated monthly and stood at 4.84% at the end of September 2019. The Capital loan rate is based on the rate prevailing at the time of the advance and is fixed for the period of

the loan. The value of the revenue loan was £94,000 and for the capital loan £5,492,000 at the end of September. The interest rates are determined in accordance with EU rules. The company expects to be able to repay the revenue loan in full at the year end. Currently the debt costs incurred by the Council in making advances to the housing company are covered by the interest repayments.

The Council's Capital Position (Prudential Indicators)

39. 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

40. This table shows the revised estimates for capital expenditure for 2019/20.

Table 6 Capital Expenditure (Net) by Service	2019/20 Original Estimate (net) £'000	2019/20 Revised Estimate (net) £'000
Corporate Resources	5,492	6,986
Operational Services	11,164	8,676
Total Capital Expenditure	**16,656**	**15,662**

Capital Expenditure – Financing

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

42. The larger schemes in the capital programme which are expected to require financing in 2019/20 from borrowing are:-

(1) Commercial property purchases estimated at £6.09m

(2) Loans to Hastings Housing Company Ltd estimated at £4.3m

(3) Temporary accommodation estimated at £2.3m

(4) DSO Vehicles and depot works at £1.08m

(5) Conversion of 12/13 York buildings at £654,000

(6) Country Park Visitors Centre estimated at £308,000

Impact on the prudential indicators

43. The Capital Financing Requirement has increased significantly over the last 18 months. It is expected to reach some £96m by April 2021. The position at 30 November 2019 is shown in Table 3 above, and highlights that there would be an underlying financing requirement of some £6.9m by the year end if no further borrowing is undertaken in 2019/20.

Compliance with the limits in place for borrowing activity.

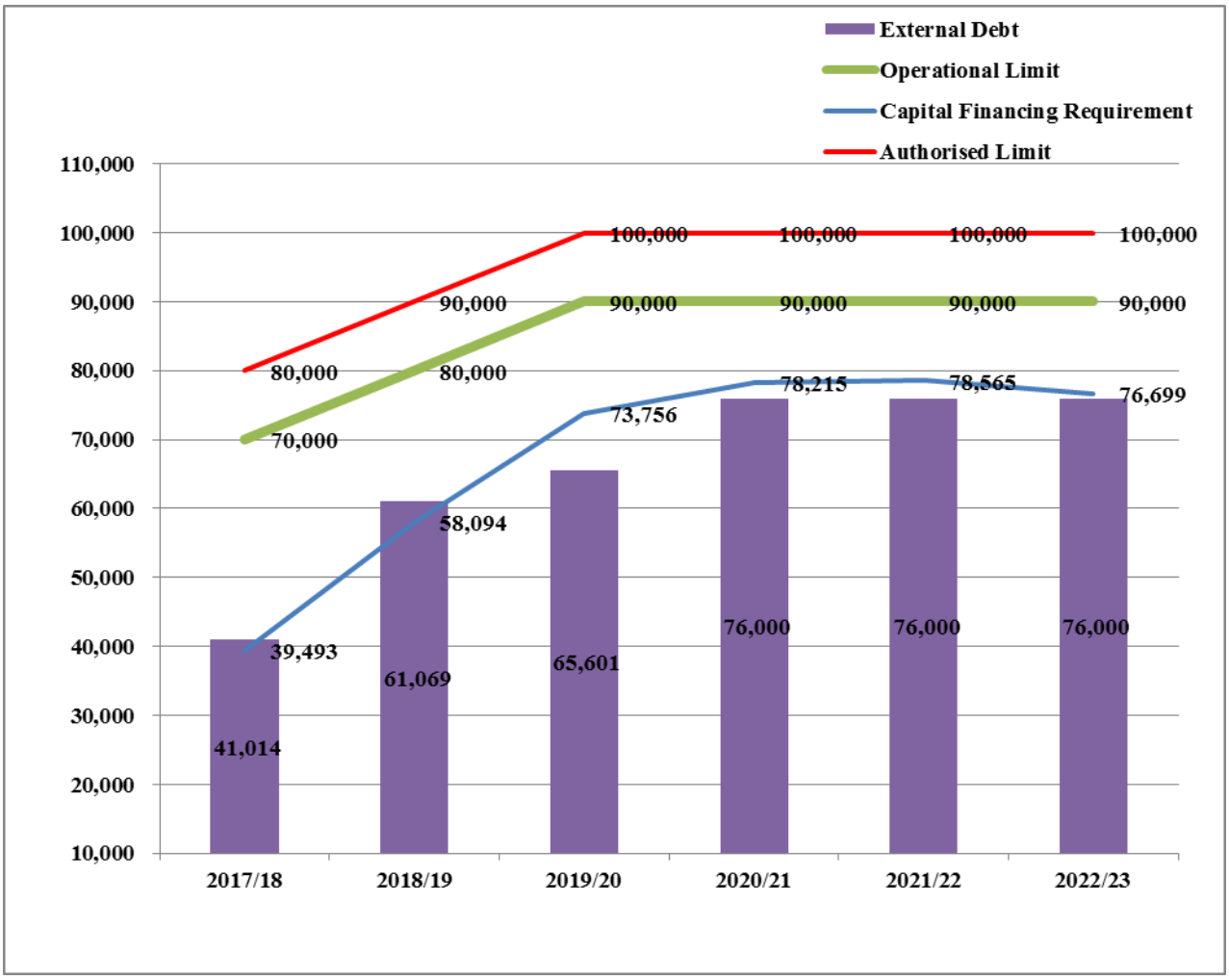
44. The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2019/20 and next two financial years.

45. 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.

46. The current operational and authorised boundaries are as follows. They will need to be revised for 2020/21 and beyond given planned expenditure. Revised limits will be considered when determining the Treasury management Strategy for 2020/21 in February 2020 (A full Council decision).

Table 7	**2019/20**	**2020/21**	**2021/22**
TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£'000	£'000	£'000
Authorised Limit for external debt -			
borrowing	£95,000	£95,000	£95,000
other long term liabilities	£5,000	£5,000	£5,000
TOTAL	£100,000	£100,000	£100,000
Operational Boundary for external debt -			
borrowing	£85,000	£85,000	£85,000
other long term liabilities	£ 5,000	£ 5,000	£ 5,000
TOTAL	£90,000	£90,000	£90,000

Graph: Estimated CFR/ Debt and Debt boundaries at year end



Borrowing Strategy

47. The Council now has some £65.6m of PWLB debt, and could potentially borrow up to a level of £73.7m (estimated CFR at 31 March 2020). This figure does not take account of any new capital spending in future years which could potentially be funded by new borrowing.

48. The interest rate forecasts from the Council's treasury advisers identify that it is unlikely that the base rate will increase until later in 2020. 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.

49. 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. This strategy was well founded given the 1% increase in borrowing rates from the PWLB in October 2019.

50. The Council's corporate plans 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.

51. On 9 October 2019 the PWLB announced it was increasing rates on new loans by 100bps (1%) with immediate effect. At the time this increased the cost of a 40 year annuity loan from 1.88% to 2.88%, an increase of 53% in the rate of interest payable. Despite the increase interest rates still remain at historically low levels. However the council will now consider other sources of borrowing when making financing decisions to ensure loans are obtained at the most advantageous rates possible.

Debt Rescheduling

52. 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 two years ago.

Investment Strategy

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

54. 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.

55. 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.

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

Property Fund

57. 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	Sep-19	Jun-19	Mar-19	Dec-18	Sep-18	Jun-18	Mar-18	Dec-17	Sep-17	Apr-17
Offer Price p	324.35	327.66	327.40	329.35	324.17	324.10	322.40	319.44	314.48	307.19
Net Asset Value p	303.84	306.94	306.70	308.53	303.67	303.61	302.01	299.24	294.60	287.77
Bid Price p	299.13	302.19	301.95	303.75	298.97	298.90	297.33	294.60	290.03	283.31
Dividend* on XD Date p	3.45	3.15	3.31	3.32	3.17	3.28	3.21	3.38	3.34	
Dividend* - Last 12 Months p	13.22	12.94	13.08	12.98	13.04	13.64	13.70	13.71	13.13	13.19
Dividend Yield on NAV %	4.35	4.22	4.26	4.21	4.29	4.49	4.54	4.58	4.46	4.58
Fund Size £m	1,173.1	1,178.2	1,127.1	1,099.0	1,047.8	1,027.7	976.3	930.8	836.2	710.2

58. The dividend yield is around 4.4% on the net asset value, which results in quarterly cash dividends of around £22,000. Full year dividends are estimated at around £86,000.

Property Fund Capital Value

Units (651,063)	Sep-19	Jun-19	Mar-19	Dec-18	Sep-18	Jun-18	Mar-18	Dec-17	Sep-17	Apr-17
Mid Market Price(£)	1,978,190	1,998,373	1,996,810	2,008,725	1,977,083	1,976,692	1,966,275	1,948,241	1,918,032	1,873,564
Bid Price (£)	1,947,525	1,967,447	1,965,885	1,977,604	1,946,483	1,946,027	1,935,806	1,918,032	1,888,278	1,844,527

59. The Capital value has increased by some 5.58% between April 2017 and September 2019 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.

Diversified Income Fund

60. It was agreed in February 2019 that a sum of £3m would be made available for further diversification of the Council's investments. £1m was invested on 26 July 2019 and a further £2m investment was made on 24 September 2019 into the CCLA Diversified Income Fund. Anticipated returns were around 3% with the added advantage of much higher liquidity than the property fund.

61. The capital value has already recovered from the initial investment where charges are effectively deducted, and was valued at £2,999,815 at the end of November 2019. Dividend yield is 3.17% for November (3.2% October). It should be remembered that this is a long term investment and prices can go up and down.

Compliance with Treasury Limits

62. 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

63. The Council's 2019/20 budget estimated a 0.75% return on investments. With the Bank Base Rate remaining unchanged since August 2018 interest rates on investments have not changed significantly. The Council's actual average rate of return to 30 September was slightly better than budgeted at 0.91% (excluding Property Fund and other loans made).

Future Changes

64. 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 was agreed by full council in February 2019 and will be reviewed and updated annually.

65. The 2020/21 Treasury Management Strategy suite of reports will be considered by the Audit Committee on the 22 January 2020 and thereafter considered by Cabinet and then by full Council on 19 February 2020 in conjunction with the budget papers.

Risk Management

66. 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. 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.

67. 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.

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

69. To date the strategy of externalising debt has been successful, particularly in the light of the sudden PWLB rate increase in October 2019. The investments made in the Property Fund (CCLA) and the Diversified Investment Fund (CCLA), totalling £5m are currently showing good returns. The risks currently faced in achieving a sustainable Council budget mean that no further long term investments can be made.

Timetable of Next Steps

70. Please include a list of key actions and the scheduled dates for these:

Action	Key milestone	Due date (provisional)	Responsible
Review and revise Annual Treasury Management Strategy	Setting of 2020/21 Budget	February 2020	Chief Finance Officer
Treasury Management Outturn Report to Cabinet	Close of 2019/20 accounts	July 2020	Chief Finance Officer

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

Area(s) Affected

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

Implications

Relevant project tools applied? Yes

Have you checked this report for plain English and readability? Yes. This has been done as far as possible considering the complex financial issues involved. Flesch-Kincaid grade level 34.4.

Climate change implications considered? N/A

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

Appendix 1: Prudential Indicators

Officer to Contact

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Chief Finance Officer
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APPENDIX 1

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APPENDIX 1 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	1,184	1,628	1,775
6. Depreciation/Impairment that are charged to the amount to be met from government grants and local taxpayers	-	-	-	-	-
Total	1,318	1,795	2,614	3,090	3,107
Net Revenue Stream					
Amount to be met from government grants and local taxpayers	13,373	13,034	13,034	13,389	13,673
Ratio					
Financing Cost to Net Revenue Stream	**10%**	**14%**	**20%**	**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.

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Agenda Item 7

Report To:	**Audit Committee**
Date of Meeting:	**22 January 2020**
Report Title:	**Treasury Management, Annual Investment Strategy and Capital Strategy 2020/21**
Report By:	**Peter Grace** **Assistant Director – Financial Services and Revenues (Chief Finance Officer)**
Key Decision:	**Yes**
Classification:	**Open**

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. This report also provides an update on performance to 31 December 2019.

The Council has some £64.55 million of debt (as at 1 January 2020), and investments which can fluctuate between £15m and £30m in the year. The level of debt is set to increase to some £104m by 2021/22 with a consequently increase in risks.

Recommendation(s)

The Audit Committee recommend 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. **The strategies listed be updated as necessary during 2020/21 in the light changing and emerging risks and the Council's evolving future expenditure plans.**

3. **The Financial rules and the Financial Operating Procedures of the Council are reviewed and revised as necessary to meet the requirements of the Code of Practice.**

4. **The Cabinet and full Council note that there is likely to be the use of Money Market Funds in 2020/21 – as already allowed for in the investment strategy.**

Reasons for Recommendations

1. 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.

2. The sums involved are significant and the assumptions made play an important part in determining the annual budget. The CIPFA Treasury Management 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.

3. The Council has the ability to diversify its investments and must consider carefully the level of risk against reward against a background of historically relatively 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. However over reliance on such income streams would involve taking unnecessary risks with the future of the Council and its ability to deliver statutory services.

4. The Council has the option of using Money Market funds within its Investment Policy already. These are on occasion providing higher rates of return than some straight deposit accounts and as such the use of these funds is likely to occur in the near future.

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. The Chief Finance Officer responsibilities were extended last year 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. These are included within the Appendices.

5. The Audit Committee considered the same report and strategies at its meeting on the 22 January 2020 and resolved to recommend the policies and strategies to Cabinet and full Council.

Borrowing / Borrowing Levels

Investment guidance

6. 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.

7. 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

The Primary Requirements of the Code

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

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

10. 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.

11. 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.

12. 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.

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

Reporting Arrangements

14. 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	Cabinet and Council	Mid-year

Year report		
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,

15. 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.

16. 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 2019-20

17. The performance for the first 9 months of 2019/20 provided an average return of 0.90%.This compares to 0.65% for the same period last year. The total interest receivable for the first 9 months is £182,603 (2018/19 £117,000). These figures exclude the interest receivable in respect of loans to other organisations, the Property Fund, Diversified Investment Fund (DIF) – See below.

Property Fund

18. 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-19	Sep-19	Jun-19	Mar-19	Dec-18	Dec-17	Apr-17
Offer Price p	322.7	324.35	327.66	327.4	329.35	319.44	307.19
Net Asset Value p	302.3	303.84	306.94	306.7	308.53	299.24	287.77
Bid Price p	297.61	299.13	302.19	301.95	303.75	294.60	283.31
Dividend* on XD Date p	3.19	3.45	3.15	3.31	3.32	3.38	
Dividend* - Last 12 Months p	13.1	13.22	12.94	13.08	12.98	13.71	13.19
Dividend Yield on NAV %	4.33	4.35	4.22	4.26	4.21	4.58	4.58
Fund Size £m	1200.1	1173.1	1178.2	1127.1	1,099.0	930.8	710.2

19. The dividend yield is around 4.3% on the net asset value. Dividends for the first 3 quarters of 2019/20 amount to some £63,650. Full year dividends are estimated at around £85,000 (December figures are provisional).

Property Fund Capital Value

Units (651,063)	Dec-19	Sep-19	Jun-19	Mar-19	Dec-18	Dec-17	Apr-17
Mid Market Price(£)	1,968,163	1,978,189.82	1,998,372.77	1,996,810.22	2,008,724.67	1,948,240.92	1,873,564.00
Bid Price (£)	1,937,629	1,947,524.75	1,967,447.28	1,965,884.73	1,977,603.86	1,918,031.60	1,844,526.59

20. The Capital value has increased by some 5.05% between April 2017 and December 2019 but continues to fluctuate as can be seen from the above table. 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.

Diversified Income Fund

21. It was agreed in February 2019 that a sum of £3m would be made available for further diversification of the Council's investments. £1m was invested on 26 July 2019 and a further £2m investment was made on 24 September 2019 into the CCLA Diversified Income Fund. Anticipated returns were around 3% with the added advantage of much higher liquidity than the property fund.

22. The capital value has already recovered from the initial investment where charges are effectively deducted, and was valued at £3,012,479 at the end of December 2019. Dividend yield (annual) on price is 3.15% for December (3.17% November). It should be remembered that this is a long term investment and prices can go up and down.

23. The Cabinet on 6 January 2020 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 recommendations for change were made.

Money Market Funds

24. The Council has the option of using Money Market funds within its Investment Policy already. These are on occasion providing higher rates of return than some straight deposit accounts currently being used on a daily basis. As such the use of these funds is likely to occur, once arrangements are in place. These funds remain highly rated and must meet the Council's existing creditworthiness criteria.

Capital Strategy

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

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

27. 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.

28. 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.

29. 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.

30. 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.

31. 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.

32. The Capital Strategy looks to cover a much longer planning period than the existing capital programme. The future expenditure plans continue to evolve. The capital strategy and all the prudential indicators and controls are attached for the known schemes. Borrowing limits will need to be determined by full Council based on affordability and risk in due course.

Risk Management

33. 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 seven years as and when these have been further developed by its advisers.

34. 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.

35. 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 in the autumn of 2020.

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

37. 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. NHS, rates claim, 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.

38. 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.

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

Economic/Financial Implications

40. The Council generally has investments in the year of between £15 million and £27 million at any one time, and is estimated to have longer term borrowings approaching £65m by the end of March 2020 (if no further external borrowing is undertaken). 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

41. 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.

42. 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.

43. 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.

44. 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

Please include a list of key actions and the scheduled dates for these:

Action	Key milestone	Due date (provisional)	Responsible
Update Treasury Management Practices, produce necessary schedules for full compliance with Codes of Practice	1 April 2020	Full implementation by 2020/21	Chief Finance Officer
Arrange Training for members/ officers	Year End & Mid-Year Review Report	July 2020	Chief Finance Officer

Wards Affected

None

Policy Implications

Reading Ease Score: 24.9
Reading Grade Level: 15.3%

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

Additional Information

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

Other Supporting Documents:-

CIPFA - Treasury Management Code of Practice (2017)
CIPFA - The Prudential Code (2017)
Budget Report - Cabinet 10 February 2020

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Treasury Management Strategy (TMS) for 2020/21

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 2020/21 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 2019/20 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 Capital expenditure plans of the Council are expected to involve considerable new borrowing again in 2020/21 and the years ahead. The borrowing limits proposed in the strategy are those previously agreed when determining the budget for 2019/20 plus increases in the borrowing 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 are uncretain over the next few years as the bank base rate fluctuates given the uncertainties around trade deals following Brexit. The overall cash returns are expected to decrease as the Council's reserves deminish.

v. The Council invested some £5m of its reserves in longer period investments e.g. property Fund, Diversified Investment fund. There are no proposals to invest for longer periods given the potential calls on reserves and the considerable uncertainty surrrounding the impact of Brexit and the impact on the economy and calls on Council services.

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 2020/21 TO 2022/23

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 2019/20 £'000s	**2020/21 £'000s**	**2021/22 £'000s**	**2022/23 £'000s**
Gross Capital Expenditure	18,461	26,100	19,122	1,882
Net Capital Expenditure	15,580	16,936	17,310	70
Financing from own resources	185	185	208	70
Borrowing Requirement	15,395	16,567	17,102	0

12. In terms of **net cost**, the 2019/20 programme has been revised to £15,580,000 from £16,656,000. The 2020/21 programme amounts to £16,936,000 (£26,100,000 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 **2019/20** from borrowing are:-

- Commercial property in Bexhill Rd (stage Payment at £4.741m
- Commercial Property in London Rd/ Shepherd Street at £1.35m
- Loans to Hastings Housing Company Ltd estimated at £4.3m
- Temporary accommodation estimated at £2.318m

- York Buildings at £654,000
- Street Cleaning Vehicles at £762,000
- Playgrounds Upgrade Programme at £124,000
- Country Park – Interpretive centre at £308,000

15. The financing requirements for larger schemes in **2020/21** include:

- Commercial property purchases estimated at £8.65m
- Churchfields Business centre at £3.265m
- Lacuna Place at £350,000
- Harold Place at £1.1m
- York buildings at £164,000
- Vehicles at £172,000
- Car Parks at £240,000
- Country Park Interpretive centre at £463,000
- Housing – Temporary Accommodation at £2.575m

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	**2018/19 Estimate £**	**2019/20 Estimate £**	**2020/21 Estimate £**	**2021/22 Estimate £**
Debt	85,000,000	95,000,000	110,000,000	110,000,000
Other long term liabilities	5,000,000	5,000,000	5,000,000	5,000,000
Total	90,000,000	100,000,000	115,000,000	115,000,000

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

Operational boundary	2018/19 Estimate £	2019/20 Estimate £	2020/21 Estimate £	2021/22 Estimate £
Debt	75,000,000	85,000,000	105,000,000	105,000,000
Other long term liabilities	5,000,000	5,000,000	5,000,000	5,000,000
Total	80,000,000	90,000,000	110,000,000	110,000,000

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 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-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.60	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.20	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.10	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00

23. The direction of UK interest rates remains unclear. Uncertainty is expected throughout the year as the detail of a trade deal will need to be negotiated by the current end of the Brexit transition period in December 2020, which the Prime Minister has pledged he will not extend. This could prove to be an unrealistically short timetable given the major negotiations required. Two possibilities could arise; one, the need for an extension of negotiations, possibly two years, or, a no deal Brexit in December 2020.

24. The economy may tread water in 2020, with low growth of about 1% until there is more certainty after the trade deal deadline is passed.

25. The Bank of England produced another quarterly Inflation Report, (now renamed the Monetary Policy Report), on 7 November 2019. The Bank made a change in their Brexit assumptions to now include a deal being eventually passed. Possibly the biggest message that was worth taking note of from the Monetary Policy Report, was an increase in concerns among MPC members around weak global economic growth and the potential for Brexit uncertainties to become entrenched and so delay UK economic recovery. Consequently, the MPC voted 7-2 to maintain Bank Rate at 0.75% but two members were sufficiently concerned to vote for an immediate Bank Rate cut to 0.5%. The MPC warned that if global growth does not pick up or Brexit uncertainties intensify, then a rate cut was now more likely. Conversely, if risks do recede, then a more rapid recovery of growth will require gradual and limited rate rises. The speed of recovery will depend on the extent to which uncertainty dissipates over the final terms for trade between the UK and EU and by how much global growth rates pick up. The Bank revised its inflation forecasts down – to 1.25% in 2019, 1.5% in 2020, and 2.0% in 2021; hence, the MPC views inflation as causing little concern in the near future. The MPC meeting of 19 December repeated the previous month's vote of 7-2 to keep Bank Rate on hold.

26. If economic growth were to weaken considerably, the MPC has relatively little room to make a big impact with Bank Rate still only at 0.75%. It would therefore, probably suggest that it would be up to the Chancellor to provide help to support growth by way of a fiscal boost by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy. The Government has already made moves in this direction and it made significant promises in its election manifesto to increase government spending by up to £20bn p.a., (this would add about 1% to GDP growth rates), by investing primarily in infrastructure. This is likely to be announced in the next Budget (March 2020). The Chancellor has also amended the fiscal rules in November to allow for an increase in government expenditure.

27. 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

28. 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

29. The Council's forecast debt position for 31 March 2020, if no further borrowing is taken for the rest of the financial year, as at 8 January 2020, amounted to £65.45m (SeeTable below).

Table 1 – Borrowing

Debt	1 April 2019 Principal	Start Date	Maturity Date	31 Dec 2019 Principal	Rate
PWLB	£7,500,000	25/05/2007	01/02/2033	£7,500,000	4.80%
PWLB	£909,027	04/09/2014	02/09/2044	£909,027	3.78%
PWLB (Optivo)	£1,788,235	04/09/2014	02/09/2044	£1,788,235	3.78%
PWLB (FT) (Annuity)	£215,148	21/03/2016	20/03/2026	£200,592	1.66%
PWLB	£1,000,000	11/05/2016	11/05/2056	£1,000,000	2.92%
PWLB	£1,000,000	11/05/2016	11/05/2046	£1,000,000	3.08%
PWLB	£1,000,000	11/05/2016	09/05/2036	£1,000,000	3.01%
PWLB	£1,000,000	11/05/2016	11/05/2026	£1,000,000	2.30%
PWLB	£2,000,000	24/06/2016	24/06/2054	£2,000,000	2.80%
PWLB	£1,000,000	24/06/2016	23/06/2028	£1,000,000	2.42%
PWLB	£2,000,000	21/03/2017	21/03/2057	£2,000,000	2.53%
PWLB	£2,000,000	21/03/2017	19/09/2059	£2,000,000	2.50%
PWLB	£2,000,000	23/03/2017	23/03/2060	£2,000,000	2.48%
PWLB (Annuity)	£7,113,729	01/06/2017	01/06/2057	£7,002,787	2.53%
PWLB (Annuity)	£8,232,534	22/11/2017	22/11/2057	£8,111,852	2.72%
PWLB	£2,000,000	12/12/2018	12/06/2028	£2,000,000	1.98%
PWLB (Annuity)	£4,000,000	13/12/2018	13/12/2058	£3,941,522	2.55%
PWLB (Annuity)	£2,500,000	31/01/2019	31/01/2059	£2,481,883	2.56%
PWLB (Annuity)	£4,410,000	31/01/2019	31/01/2059	£4,388,015	2.56%
PWLB (Annuity)	£9,400,000	20/03/2019	20/03/2059	£9,331,568	2.54%
PWLB (Annuity)	-	02/09/2019	02/09/2069	£4,800,000	1.83%
Total Debt	**£61,068,673**			**£65,455,481**	**2.82%**

30. The Council has loaned money to other organisations. As at 30 September 2019 three longer term loans are outstanding. Namely:

Table 2 – Loans to Other Organisations

3rd Party Organisations	Rate/ Return (%)	Start Date	End Date	Principal Outstanding £	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	£185,915	Annuity
The Source	2.43%	17/12/2015	16/12/2024	£15,718	Annuity
			Total	**£1,989,868**	

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. The £25,000 loan to the Source is repayable over a 10 year period and is financed from HBC reserves.

32. The above table excludes the loans to the Hastings Housing Company. As at 30 September 2019 the value of the revenue loan was £94,000 and the Capital loan was £5.492m. The company expects to repay the revenue loan by 31 March 2020.

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 £65.455m of PWLB debt. To borrow for the remainder of the 2019/20 capital programme i.e. up to the projected level of the CFR (£73.6m) it would need to borrow a further £ 8.1m by the end of March 2020. The Capital Financing Requirement has increased significantly over the last few years. It is expected to reach some £103.7m by 2021/22 (based on the capital programme approvals to date).

35. 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 2019/20 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

36. 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.

37. 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).

38. 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.

39. To finance the future Capital programme will require substantial new borrowing by the Council. The key considerations are 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 has been a strong case for minimising the level of internal funding now in order to ensure a lower level of borrowing risk in the future. However, interest rates look set to remain low for a period of time (unless a trade deal is not negotiated following Brexit) and given the 1% increase in PWLB rates in October 2019 there is a stronger case now to not borrow externally until we really have to i.e. temporarily use existing resources. This is the strategy that is proposed for 2020/21 (as far as practical) and will save on borrowing costs and assist the Council's revenue account. There is only a limited ability to do this given the depletion of reserves, and funds already invested for longer periods.

40. 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	2019/20 (Rev Est)	2020/21 (Est)	2021/22 (Est)	2022/23 (Est)	2023/24 (Est)
	£	£	£	£	£
CFR-Opening	59,370,380	73,641,380	88,471,380	103,737,380	101,267,380
Less MRP	(1,176,038)	(1,623,844)	(1,883,773)	(2,424,943)	(2,434,520)
Plus, New Borrowing	15,395,000	16,567,000	17,102,000	0	0
CFR Closing	73,589,342	88,584,536	103,689,607	101,312,437	98,832,860

(Table excludes leasing element)

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

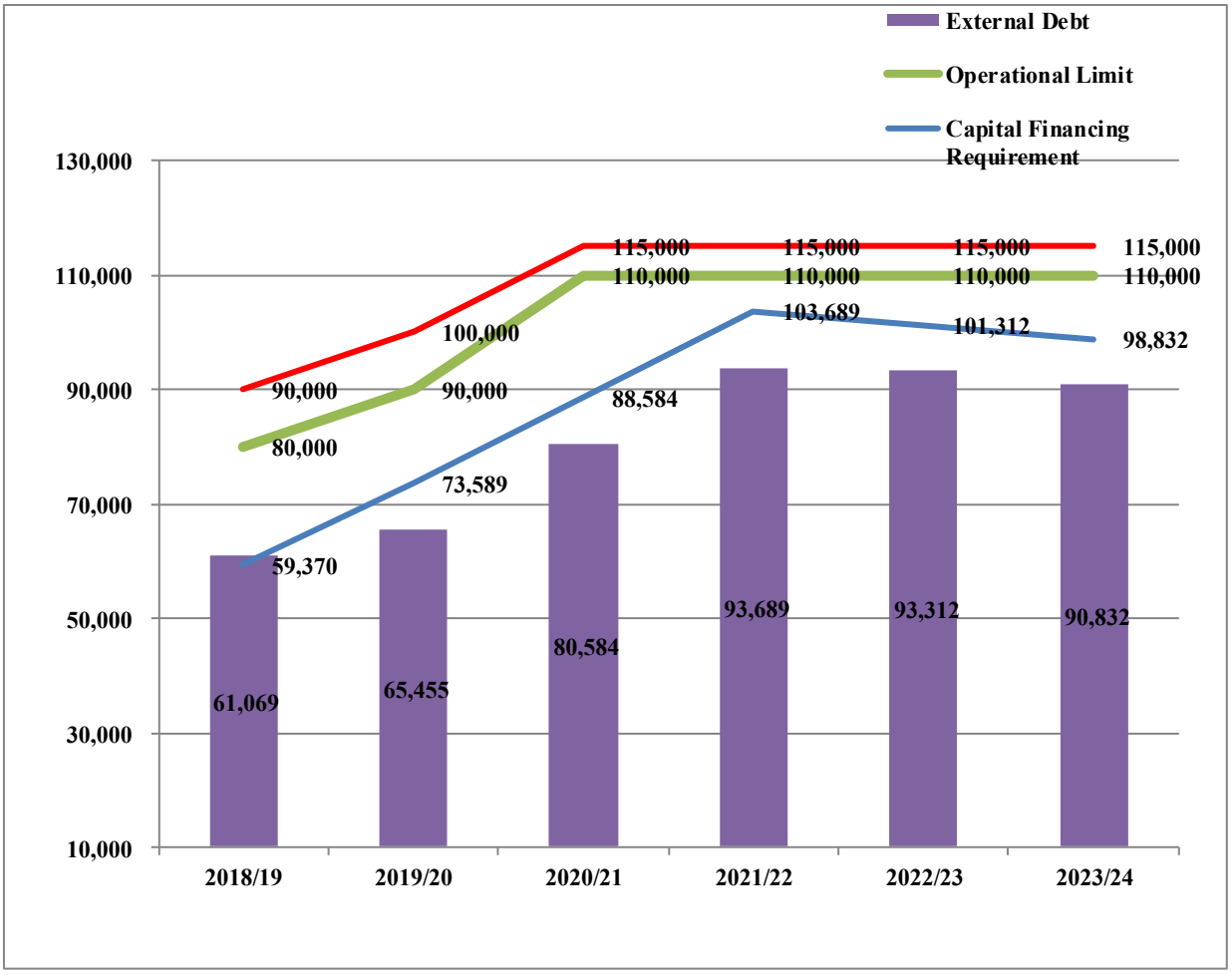
Table: Council's Projected Gross Borrowing Position Against The CFR

Internal Borrowing	2019/20 Actual £000's	2020/21 Estimate £000's	2021/22 Estimate £000's	2022/23 Estimate £000's
Capital Financing Requirement	73,589	88,584	103,689	101,312
External Borrowing	65,455	80,584	95,689	93,312
Net Internal Borrowing	**8,134**	**8,000**	**8,000**	**8,000**

42. The Council is now (8 January 2020) maintaining a small under-borrowed position, but this could increase to some £8.1m if the Capital programme completes as forecast and new loans are not taken.

43. 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.

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



45. **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 borrowing money for property based assets as against other ventures would have assets to sell if necessary – thus reducing overall risk.

46. 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. It is considered 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.

47. **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 2020/21 and thereafter if it remains available.

48. **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.

49. **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.

50. Given that rates look do not look set to increase it is recommended that new borrowing is only taken when necessary and internal balances are used to temporarily finance long life assets. Given that the Council is increasingly using its reserves these need to be readily available and not subjected to unnecessary risk or exposure.

Summary

51. New borrowing has been taken over the last 30 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. This strategy served the Council well given the unexpected 1% increase in PWLB rates in October 2019.

52. The capital expenditure plans 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. The Council has taken advantage of other investment opportunities which are providing higher returns than the cost of borrowing e.g. property funds. To date the Council has reduced the level of internal funding in order to ensure a lower level of borrowing risk in the future.

53. For the remainder of 2019/20 and 2020/21 the cheapest borrowing will be internal borrowing by running down cash balances and foregoing interest earned at historically low rates. However, the Council will not have sufficient balances to temporarily finance all the Capital expenditure. 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 when good opportunities arise.

54. 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.

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

56. 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.

57. In determining whether borrowing will be undertaken in advance 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.

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

58. 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.

59. 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.

60. 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)

61. 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.

62. 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).

63. The MRP for 2020/21 is estimated at £1,624,000 (the statutory charge to revenue that remains within the accounts).

ANNUAL INVESTMENT STRATEGY

Investment Policy

64. 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.

65. 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.

66. 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.

67. 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.

68. 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.

69. 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.

70. 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

71. 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

72. 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.

73. 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 100 days
- No Colour not to be used

74. 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.

75. 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.

76. 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.

77. 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.

78. 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.

79. 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

80. The table below provides a snapshot of the investments and deposits held at 31 December 2019. 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
Landesbank - Helaba	1.14%	30/01/2019	30/01/2020	**5,000,000**	Fixed
Credit Agricole	0.79%	03/09/2019	03/03/2020	**5,000,000**	Fixed
Goldman Sachs	0.92%	11/09/2019	11/03/2020	**5,000,000**	Fixed
Rotherham	0.90%	02/12/2019	02/06/2020	**5,000,000**	Fixed
Barclays Corporate	0.40%			**3,000,000**	Call
NAT West	0.05%			**6,147**	Call
			Total	**23,006,147**	

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

82. 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.

83. 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. The use of Money Market funds is now anticpated given the higher returns that are on offer – as against short term direct deposits.

Investment Strategy – Property Fund

84. 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:

Table: CCLA – LA's Property Prices and Dividend yields

End of	Dec-19	Sep-19	Jun-19	Mar-19	Dec-18	Dec-17	Apr-17
Offer Price p	322.7	324.35	327.66	327.4	329.35	319.44	307.19
Net Asset Value p	302.3	303.84	306.94	306.7	308.53	299.24	287.77
Bid Price p	297.61	299.13	302.19	301.95	303.75	294.60	283.31
Dividend* on XD Date p	3.19	3.45	3.15	3.31	3.32	3.38	
Dividend* - Last 12 Months p	13.1	13.22	12.94	13.08	12.98	13.71	13.19
Dividend Yield on NAV %	4.33	4.35	4.22	4.26	4.21	4.58	4.58
Fund Size £m	1200.1	1173.1	1178.2	1127.1	1,099.0	930.8	710.2

85. The dividend yield is around 4.3% on the net asset value. Dividends for the first 3 quarters of 2019/20 amount to some £63,650. Full year dividends for 2019/20 are estimated at around £85,000 (December figures are provisional) and the same performance is expected for 2020/21.

Table: CCLA - Property Fund Capital Value

Units (651,063)	Dec-19	Sep-19	Jun-19	Mar-19	Dec-18	Dec-17	Apr-17
Mid Market Price(£)	1,968,163	1,978,189.82	1,998,372.77	1,996,810.22	2,008,724.67	1,948,240.92	1,873,564.00
Bid Price (£)	1,937,629	1,947,524.75	1,967,447.28	1,965,884.73	1,977,603.86	1,918,031.60	1,844,526.59

86. The Capital value has increased by some 5.05% between April 2017 and December 2019 but continues to fluctuate as can be seen from the above table. 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.

Diversified Income Fund

87. It was agreed in February 2019 that a sum of £3m would be made available for further diversification of the Council's investments. £1m was invested on 26 July 2019 and a further £2m investment was made on 24 September 2019 into the CCLA Diversified Income Fund. Anticipated returns were around 3% with the added advantage of much higher liquidity than the property fund.

The capital value has already recovered from the initial investment where charges are effectively deducted, and was valued at £3,012,479 at the end of December 2019. Dividend yield on price is 3.15% for December (3.17% November). It should be remembered that this is a long term investment and prices can go up and down.

Investment Strategy – View on Interest Rates

88. Investment returns look set to stay flat for the next few months. However thereafter they could decrease if the economy does not show signs of growth or there is a worldwide economic downturn. Likewise rates could increase (by as much as 4% say some pundits if the £pound loses considerable value or the economy overheats.

Investment Return Expectations.

89. Bank Rate is forecast to increase steadily but slowly over the next few years to reach 1.25% by Quarter 1 2023. Bank Rate forecasts for financial year ends (March) are:

- 2019/20 0.75%
- 2020/21 1.00%
- 2021/22 1.00%
- 2022/23 1.25%

90. 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

91. The Council remains keen to pursue capital schemes that also generate income. Substantial investments in property, housing and energy projects will necessitate new borrowing. The levels of new borrowing that the Council can afford to take on board 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.

92. 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. external claims, 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.

93. The income generation proposals relating to the Housing Company have required revenue loans to be provided. 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.

End of Year Investment Report

94. 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

95. The Council uses Link Asset Services 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.

96. **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. In terms of Treasury management in general, training has been undertaken by members on an annual basis to date.

The training needs of treasury management officers are periodically reviewed.

97. **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.

98. 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.

99. 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

100. Please see Appendix 9.

Role of the Section 151 Officer

101. 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 2020/21

The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2008/9 , and will assess the MRP for 2020/21 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 2020/21 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 2020 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.

Repayments included in finance leases are applied as MRP. It should also be noted that the Council will not make any separate 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 Council PWLB loan (Principal and Interest) and the Council makes the payments to the PWLB. 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

Link Asset Services Interest rate forecast – Dec 2019 – March 2023

Bank Rate	NOW	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	0.75%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.25%
Capital Economics	0.75%	0.75%	0.75%	0.75%	0.75%	-	-	-	1.00%	-	-	-	-	-

5yr PWLB Rate	NOW	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	2.34%	2.40%	2.40%	2.50%	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.20%	3.20%
Capital Economics	2.34%	2.40%	2.50%	2.50%	2.60%	-	-	-	2.80%	-	-	-	-	-

10yr PWLB Rate	NOW	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	2.55%	2.70%	2.70%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.50%
Capital Economics	2.55%	2.60%	2.70%	2.80%	2.80%	-	-	-	3.10%	-	-	-	-	-

25yr PWLB Rate	NOW	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	3.07%	3.30%	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%
Capital Economics	3.07%	3.00%	3.10%	3.20%	3.20%	-	-	-	3.40%	-	-	-	-	-

50yr PWLB Rate	NOW	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	2.90%	3.20%	3.30%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%
Capital Economics	2.90%	3.00%	3.10%	3.20%	3.20%	-	-	-	3.50%	-	-	-	-	-

Note: PWLB rates and forecast shown above have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

APPENDIX 3 Economic Review (by Link Asset Services)

UK. Brexit. 2019 has been a year of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on 31 October 2019, with or without a deal. However, MPs blocked leaving on that date and the EU agreed an extension to 31 January 2020. In late October, MPs approved an outline of a Brexit deal to enable the UK to leave the EU on 31 January. Now that the Conservative Government has gained a large overall majority in the **general election** on 12 December, this outline deal will be passed by Parliament by that date. However, there will still be much uncertainty as the detail of a trade deal will need to be negotiated by the current end of the transition period in December 2020, which the Prime Minister has pledged he will not extend. This could prove to be an unrealistically short timetable for such major negotiations that leaves open two possibilities; one, the need for an extension of negotiations, probably two years, or, a no deal Brexit in December 2020.

GDP growth has taken a hit from Brexit uncertainty during 2019; quarter three 2019 surprised on the upside by coming in at +0.4% q/q, +1.1% y/y. However, the peak of Brexit uncertainty during the final quarter appears to have suppressed quarterly growth to probably around zero. The economy is likely to tread water in 2020, with tepid growth around about 1% until there is more certainty after the trade deal deadline is passed.

While the Bank of England went through the routine of producing another **quarterly Inflation Report,** (now renamed the Monetary Policy Report), on 7 November, it is very questionable how much all the writing and numbers were worth when faced with the uncertainties of where the UK will be after the general election. The Bank made a change in their Brexit assumptions to now include a deal being eventually passed. Possibly the biggest message that was worth taking note of from the Monetary Policy Report, was an increase in concerns among MPC members around weak global economic growth and the potential for Brexit uncertainties to become entrenched and so delay UK economic recovery. Consequently, the MPC voted 7-2 to maintain Bank Rate at 0.75% but two members were sufficiently concerned to vote for an immediate Bank Rate cut to 0.5%. The MPC warned that if global growth does not pick up or Brexit uncertainties intensify, then a rate cut was now more likely. Conversely, if risks do recede, then a more rapid recovery of growth will require gradual and limited rate rises. The speed of recovery will depend on the extent to which uncertainty dissipates over the final terms for trade between the UK and EU and by how much global growth rates pick up. The Bank revised its inflation forecasts down – to 1.25% in 2019, 1.5% in 2020, and 2.0% in 2021; hence, the MPC views inflation as causing little concern in the near future.

The **MPC meeting of 19 December** repeated the previous month's vote of 7-2 to keep Bank Rate on hold. Their key view was that there was currently 'no evidence about the extent to which policy uncertainties among companies and households had declined' i.e. they were going to sit on their hands and see how the economy goes in the next few months. The two members who voted for a cut were concerned that the labour market was faltering. On the other hand, there was a clear warning in the minutes that the MPC were concerned that "domestic unit labour costs have continued to grow at rates above those consistent with meeting the inflation target in the medium term".

If economic growth were to weaken considerably, the MPC has relatively little room to make a big impact with Bank Rate still only at 0.75%. It would therefore, probably suggest that it would be up to the Chancellor to provide help to support growth by way of a **fiscal boost** by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy. The Government has already made moves in this direction and it made significant promises in its election manifesto to increase government spending by up to £20bn p.a., (this would add about 1% to GDP growth rates), by investing primarily in infrastructure. This is likely to be announced in the next Budget, probably in February 2020. The Chancellor has also amended the fiscal rules in November to allow for an increase in government expenditure.

As for **inflation** itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell again in both October and November to a three-year low of 1.5%. It is likely to remain close to or under 2% over the next two years and so, it does not pose any immediate concern to the MPC at the current time. However, if there was a hard or no deal Brexit, inflation could rise towards 4%, primarily because of imported inflation on the back of a weakening pound.

With regard to the **labour market,** growth in numbers employed has been quite resilient through 2019 until the three months to September where it fell by 58,000. However, there was an encouraging pick up again in the three months to October to growth of 24,000, which showed that the labour market was not about to head into a major downturn. The unemployment rate held steady at a 44-year low of 3.8% on the Independent Labour Organisation measure in October. Wage inflation has been steadily falling from a high point of 3.9% in July to 3.5% in October (3-month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.0%. As 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. The other message from the fall in wage growth is that employers are beginning to find it easier to hire suitable staff, indicating that supply pressure in the labour market is easing.

USA. President Trump's massive easing of fiscal policy in 2018 fuelled a temporary boost in consumption in that year which generated an upturn in the rate of growth to a robust 2.9% y/y. **Growth** in 2019 has been falling after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2 and then 2.1% in quarter 3. The economy looks likely to have maintained a growth rate similar to quarter 3 into quarter 4; fears of a recession have largely dissipated. The strong growth in employment numbers during 2018 has weakened during 2019, indicating that the economy had been cooling, while inflationary pressures were also weakening. However, CPI inflation rose from 1.8% to 2.1% in November, a one year high, but this was singularly caused by a rise in gasoline prices.

The Fed finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not intended to be seen as the start of a series of cuts to ward off a downturn in growth. It also ended its programme of quantitative tightening in August, (reducing its holdings of treasuries etc.). It then cut rates by 0.25% again in September and by another 0.25% in its October meeting to 1.50 – 1.75%. At its September meeting it also said it was going to **start buying Treasuries again**, although this was not to be seen as a resumption of

quantitative easing but rather an exercise to relieve liquidity pressures in the repo market. Despite those protestations, this still means that the Fed is again expanding its balance sheet holdings of government debt. In the first month, it will buy $60bn, whereas it had been reducing its balance sheet by $50bn per month during 2019. As it will be buying only short-term (under 12 months) Treasury bills, it is technically correct that this is not quantitative easing (which is purchase of long term debt). The Fed left rates unchanged in December. However, the accompanying statement was more optimistic about the future course of the economy so this would indicate that further cuts are unlikely.

Investor confidence has been badly rattled by the progressive ramping up of increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This **trade war** is seen as depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China.
However, in November / December, progress has been made on agreeing a phase one deal between the US and China to roll back some of the tariffs; this gives some hope of resolving this dispute.

EUROZONE. Growth has been slowing from +1.8 % during 2018 to around half of that in 2019. Growth was +0.4% q/q (+1.2% y/y) in quarter 1, +0.2% q/q (+1.2% y/y) in quarter 2 and then +0.2% q/q, +1.1% in quarter 3; there appears to be little upside potential in the near future. German GDP growth has been struggling to stay in positive territory in 2019 and fell by -0.1% in quarter 2; industrial production was down 4% y/y in June with car production down 10% y/y. Germany would be particularly vulnerable to a no deal Brexit depressing exports further and if President Trump imposes tariffs on EU produced cars.

The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which then meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by quantitative easing purchases of debt. However, the downturn in EZ growth in the second half of 2018 and into 2019, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the ECB to take new measures to stimulate growth. At its March meeting it said that it expected to leave interest rates at their present levels “at least through the end of 2019”, but that was of little help to boosting growth in the near term. Consequently, it announced a **third round of TLTROs**; this provides banks with cheap borrowing every three months from September 2019 until March 2021 that means that, although they will have only a two-year maturity, the Bank was making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of a bank’s eligible loans. However, since then, the downturn in EZ and world growth has gathered momentum; at its meeting on 12 September it cut its deposit rate further into negative territory, from -0.4% to -0.5%, and announced a **resumption of quantitative easing purchases of debt for an unlimited period.** At its October meeting it said these purchases would start in November at €20bn per month - a relatively small amount compared to the previous buying programme. It also increased the maturity of the third round of TLTROs from two to three years. However, it is doubtful whether this loosening of monetary policy will have much impact on growth and, unsurprisingly, the

ECB stated that governments would need to help stimulate growth by 'growth friendly' fiscal policy.

There were no policy changes in the December meeting, which was chaired for the first time by the new President of the ECB, Christine Lagarde. However, the outlook continued to be down beat about the economy; this makes it likely there will be further monetary policy stimulus to come in 2020. She did also announce a thorough review of how the ECB conducts monetary policy, including the price stability target. This review is likely to take all of 2020.

On the political front, Austria, Spain and Italy have been in the throes of **forming coalition governments** with some unlikely combinations of parties i.e. this raises questions around their likely endurance. The latest results of German state elections has put further pressure on the frail German CDU/SDP coalition government and on the current leadership of the CDU. The results of the Spanish general election in November have not helped the prospects of forming a stable coalition.

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 shadow banking systems. In addition, there still needs to be a greater switch from investment in industrial capacity, property construction and infrastructure to consumer goods production.

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.

WORLD GROWTH. Until recent years, world growth has been boosted by increasing **globalisation** i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products. It is achieving this by massive financial support, (i.e. subsidies), to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, likely that we are heading into a period where there will be a **reversal of world globalisation and a decoupling of western countries** from dependence on China to supply products. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation. **Central banks are, therefore, likely to come under more pressure to support growth by**

looser monetary policy measures and this will militate against central banks increasing interest rates.

The trade war between the US and China is a major concern to **financial markets** due to the synchronised general weakening of growth in the major economies of the world, compounded by fears that there could even be a recession looming up in the US, though this is probably overblown. These concerns resulted in **government bond yields** in the developed world falling significantly during 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US). There are also concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks and the use of negative central bank rates in some countries. The latest PMI survey statistics of economic health for the US, UK, EU and China have all been predicting a downturn in growth; this confirms investor sentiment that the outlook for growth during the year ahead is weak.

INTEREST RATE FORECASTS

The interest rate forecasts provided by Link Asset Services in paragraph 3.3 are **predicated on an assumption of an agreement being reached on Brexit between the UK and the EU.** On this basis, while GDP growth is likely to be subdued in 2019 and 2020 due to all the uncertainties around Brexit depressing consumer and business confidence, an agreement on the detailed terms of a trade deal is likely to lead to a boost to the rate of growth in subsequent years. This could, in turn, increase inflationary pressures in the economy and so cause the Bank of England to resume a series of gentle increases in Bank Rate. Just how fast, and how far, those increases will occur and rise to, will be data dependent. The forecasts in this report assume a modest recovery in the rate and timing of stronger growth and in the corresponding response by the Bank in raising rates.

- In the event of an **orderly non-agreement exit in December 2020**, 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 were 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. Quantitative easing could also be restarted by the Bank of England. 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 even, but dependent on a successful outcome of negotiations on a trade deal.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.
- In the event that a Brexit deal was agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

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 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** 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.** In 2018, Italy was a major concern due to having a populist coalition government which made a lot of anti-austerity and anti-EU noise. However, in September 2019 there was a major change in the coalition governing Italy which has brought to power a much more EU friendly government; this has eased the pressure on Italian bonds. Only time will tell whether this new coalition based on an unlikely alliance of two very different parties will endure.
- Weak capitalisation of some **European banks**, particularly Italian banks.
- **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. The CDU has done badly in recent state elections but the SPD has done particularly badly and this has raised a major question mark over continuing to support the CDU. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until 2021.
- **Other minority EU governments.** Austria, Finland, Sweden, Spain, Portugal, Netherlands and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU. There has also been rising anti-immigration sentiment in Germany and France.
- In October 2019, the IMF issued a report on the World Economic Outlook which flagged up a synchronised slowdown in world growth. However, it also flagged up that there was **potential for a rerun of the 2008 financial crisis**, but his time centred on the huge debt binge accumulated by corporations during the decade of low interest rates. This now means that there are corporates who would be unable to cover basic interest costs on **some $19trn of corporate debt in major western economies,** if world growth was to dip further than just a minor cooling. This debt is mainly held by the shadow banking sector i.e. pension funds, insurers, hedge funds, asset managers etc., who, when there is $15trn of corporate and government debt now yielding negative interest rates, have been searching for higher returns in riskier assets. Much of this debt is only marginally above investment grade so any rating downgrade could force some holders into a fire sale, which would then depress prices further and so set off a spiral down. The IMF's answer is to suggest imposing higher capital charges on lending to corporates and for central banks to regulate the investment operations of the shadow banking sector. In October 2019,

the deputy Governor of the Bank of England also flagged up the dangers of banks and the shadow banking sector lending to corporates, especially highly leveraged corporates, which had risen back up to near pre-2008 levels.

- **Geopolitical risks,** for example in 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 agreement was reached all round that removed all threats of economic and political disruption between the EU and the UK.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary 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	2018/19	2019/20	2020/21	2021/22	2022/23
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt					
borrowing	85,000	95,000	110,000	110,000	110,000
other long term liabilities	5,000	5,000	5,000	5,000	5,000
TOTAL	90,000	100,000	115,000	115,000	115,000
Operational Boundary for external debt					
borrowing	75,000	85,000	105,000	105,000	105,000
other long term liabilities	5,000	5,000	5,000	5,000	5,000
TOTAL	80,000	90,000	110,000	110,000	110,000

Interest Rate Exposures	2019/20 Upper	2020/21 Upper	2021/22 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 · Investments only	 100% 100%	 100% 100%	 100% 100%
Limits on variable interest rates · Debt only · Investments only	 30% 100%	 30% 100%	 30% 100%

Maturity Structure of fixed interest rate borrowing 2020/21

	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 2020/21

	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	2018/19 Actual	2019/20 Rev.Est	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Financing Costs	£'000	£'000	£'000	£'000	£'000
1. Interest Charged to General Fund	1,218	1,914	2,315	2,869	3,152
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	0	0	0	0	0
4. Interest and Investment Income	-303	-544	-818	-787	-771
5. Amounts payable or receivable in respect of financial derivatives	-	-	-	-	-
6. MRP, VRP	795	1,176	1,624	1,884	2,425
6. Depreciation/Impairment that are charged to the amount to be met from government grants and local taxpayers	-	-	-	-	-
Total	1,710	2,546	3,121	3,966	4,806
Net Revenue Stream					
Amount to be met from government grants and local taxpayers	13,373	13,018	13,358	13,460	13,688
Ratio					
Financing Cost to Net Revenue Stream	**13%**	**20%**	**23%**	**29%**	**35%**

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 check on the status of any fund it may consider using. Appropriate due diligence will also be undertaken before investment of this type is undertaken. These are longer term investments and will extend beyong 365 days (expected to be invested for 5 years or more)*	
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 10.1.2020)

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).

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.

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Draft Capital Strategy (2020/21)

Introduction

1. The CIPFA revised 2017 Prudential and Treasury Management Codes requires all local authorities to prepare 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 2020/21

10. The Council's Capital programme amounts to some £26.1m (£16.9m net of grants and contributions) in 2020/21. The major areas of expenditure include**:-**

(i) Buckshole Reservoir (£837,000 of which £160,000 is expected to be spent in 2020/21)
The January 2020 Cabinet approved works to improve the spillway design and to change the drawdown operation.

(ii) Energy Initiatives – Ground Mounted Solar
The potential ground mounted solar project consists of a number of feasibility reports (£84,000) and power connection costs (£200,000). If feasibility studies are positive then an investment of some may result in 2021/22 providing cost savings and an income stream to the Council (£1.9m identified in the capital programme). There remains a sum of £1.638m in 2021/22 earmarked currently for solar panels and a further £2.116m remains unallocated. Any plans for spending these monies will need business cases and Cabinet/Council approval.

(iii) Commercial Property (£10m of which £8.65m is expected to be spent in 2020/21)
In line with the strategic priority of economic and physical regeneration this funding will look to invest in commercial property within the borough. The intention is to provide new jobs or secure 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 (£5.76m of which £2.575m is expected to be spent in 2020/21)
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 (£450,000 of which £50,000 is expected to be spent in 2020/21)
The Council owns 10% of the Priory Meadow shopping centre. The money represents its share of the estimated capital investment costs for 2020/21. 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 (£846,000 of which £164,000 is expected to be spent in 2020/21)
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 (£771,000 of which £463,000 is expected to be spent in 2020/21)
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 (£50,000)
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) Lower Bexhill Road – Housing Development (£7.04m of which £6.035m is expected to be spent in 2020/21)
The Council has received funding of some £6.9m to progress this site (grant claimed in arrears). The Council will need to determine whether and how to proceed with the scheme at a future date. This may be with a joint venture partner and may involve the Council financing some or all of the development – subject to Cabinet /Council determination.

(x) Pelham Crescent – Building Works and Road (£144,000)
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 (£140,000)
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 see lighting replaced, rewiring and automated gate controls.

(xii) Sea Defences (£35,000 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.

(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 (£1.8m (Est) – all grant funding)
Property related grants for adapting homes. In 2019/20 the Council will receive funding approaching £1.812m. The figure for 2020/21 is as yet unknown.

(xv) Empty Homes (£50,000)
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.

(xvi) Cornwallis Street Development (£6.5m of which £500,000 is expected to be spent in 2020/21)
The redevelopment of Cornwallis street car park for a hotel. This is expected to help regenerate the town centre, provide much needed overnight accommodation, as well as securing new jobs.

(xvii) Castleham Car Park resurfacing (£100,000)

(xviii) Electric Vehicles (£172,000)
A number of vehicles have been identified as requiring replacement. The Council will seek to replace with electric vehicles. The costs above include some £8,000 for associated infrastructure – charging points. The replacement programme will be reviewed and updated on a regular basis (currently includes 2020/21 and 2021/22 requirements).

Capital Expenditure 2021/22

11. The main areas of expenditure in 2021/22 are Priory Meadow – contribution to Capital costs (£400,000), Cornwallis Street Hotel development (£6.5m), energy (£1.9m potentially for ground mounted solar, £1.638m potentially for solar panels, £2.116m unallocated), potential loans to Hastings Housing Company (£3.9m), Disabled Facility Grants (£1.8m), Buckshole Reservoir (£627,000), Groyne refurbishment (£35,000), Empty Homes (£50,000), Electric Vehicles (£86,000)

Capital Expenditure 2022/23

12. The main areas of expenditure are currently, Public Realm (£50,000), Groyne Refurbishment (£35,000), Disabled Facility Grants (£1.8m).

Summarised Capital Expenditure and Funding (2019-20 (Revised) to 2022-23)

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

	Revised 2019/20 £'000s	**2020/21 £'000s**	**2021/22 £'000s**	**2022/23 £'000s**
Gross Capital Expenditure	18,461	26,100	19,122	1,882
Net Capital Expenditure	15,580	16,936	17,310	70
Financing from own resources	185	185	208	70
Borrowing Requirement	15,395	16,567	17,102	0

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 £65m which will have been borrowed by 31 March 2020.

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	2019/20 (Rev Est)	2020/21 (Est)	2021/22 (Est)	2022/23 (Est)	2023/24 (Est)
	£	£	£	£	£
CFR-Opening	59,370,380	73,641,380	88,471,380	103,737,380	101,267,380
Less MRP	(1,176,038)	(1,623,844)	(1,883,773)	(2,424,943)	(2,434,520)
Plus, New Borrowing	15,395,000	16,567,000	17,102,000	0	0
CFR Closing	73,589,342	88,584,536	103,689,607	101,312,437	98,832,860

18. The table above highlights that by 2021/22 the level of debt will have increased to some £104m (subject to viability and the approval of schemes within the Capital programme)

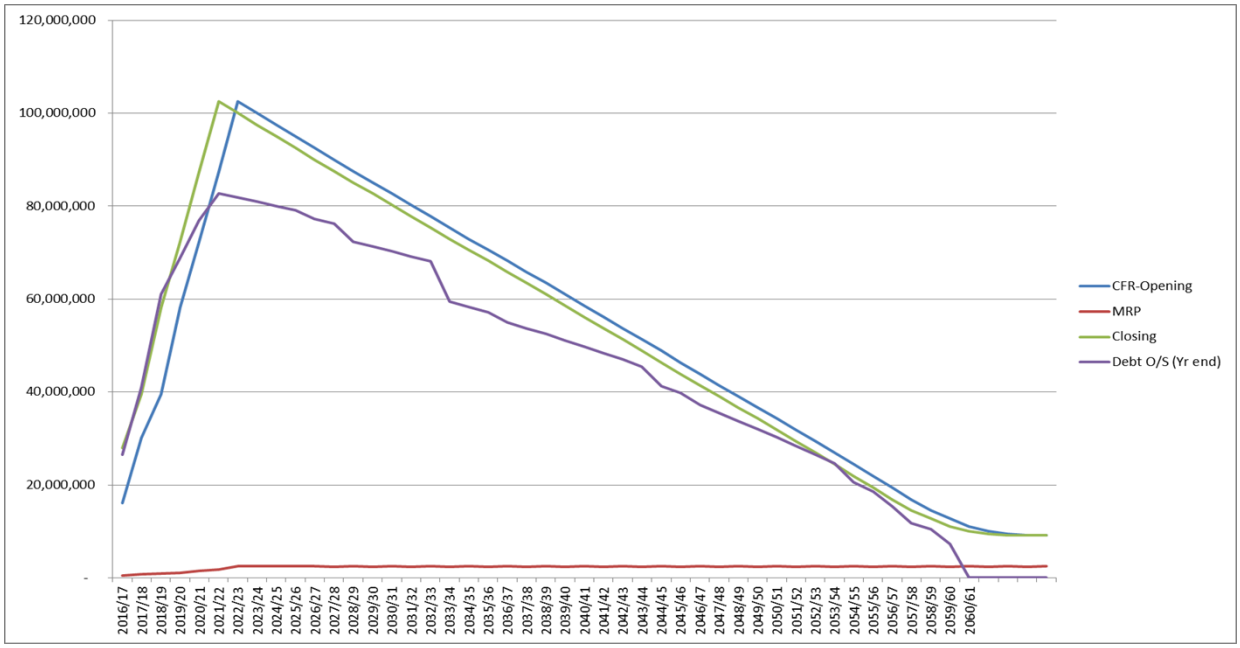
Revenue Consequences of the Capital Programme on the General Fund

19. Not all projects provide savings or generate income but, in 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. A number of the larger schemes listed in the Capital programme will generate income for the General Fund (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 £158.774m at 31 March 2019 (£141.89m as at 31 March 2018).

Table: Borrowing and Repayment Projections (to 2060/61)



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.

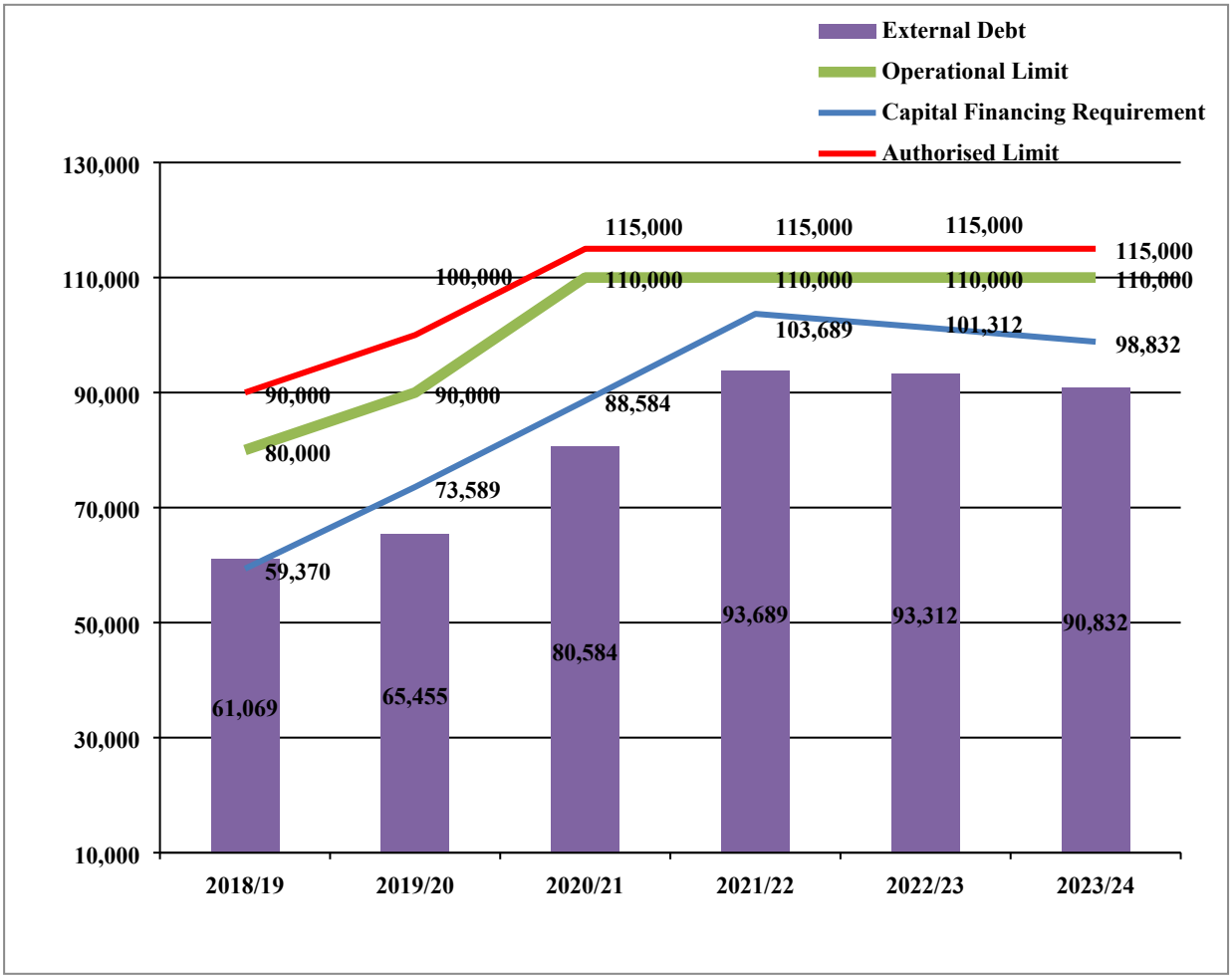
25. To arrive at an overall borrowing level (Authorised and Operational borrowing limits), the Council needs to take a considered view of its other potential liabilities, future borrowing requirements, guarantees and loans given, bad debts, claims against the Council , future funding, and security and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

26. Based on the existing Capital programme, by 2022/23 annual interest on debt will amount to some £3.1m p.a. with capital repayments approaching £2.4m, offset by investment income. This represents some 35% 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 has invested a further £3m tranche of monies in a diversified investment fund in 2020/21.

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.

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 Outstanding £	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	£185,915	Annuity
The Source	2.43%	17/12/2015	16/12/2024	£15,718	Annuity
			Total	**£1,989,868**	

33. 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.

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

35. 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

36. 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.

37. The Council's General and earmarked reserves are set to fall further over the forthcoming 12 months. The balance at 1 April 2019 was some £18.4m. At the 31 March 2020 the projected balance is some £15.0m with the balance at the end of 2020/21 amounting to some £12.7m. If Clinical Commissioning Group and Disabled Facility Grant monies are excluded the balance at the end of 2020/21 reduces to an estimated £10.2m.

38. 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

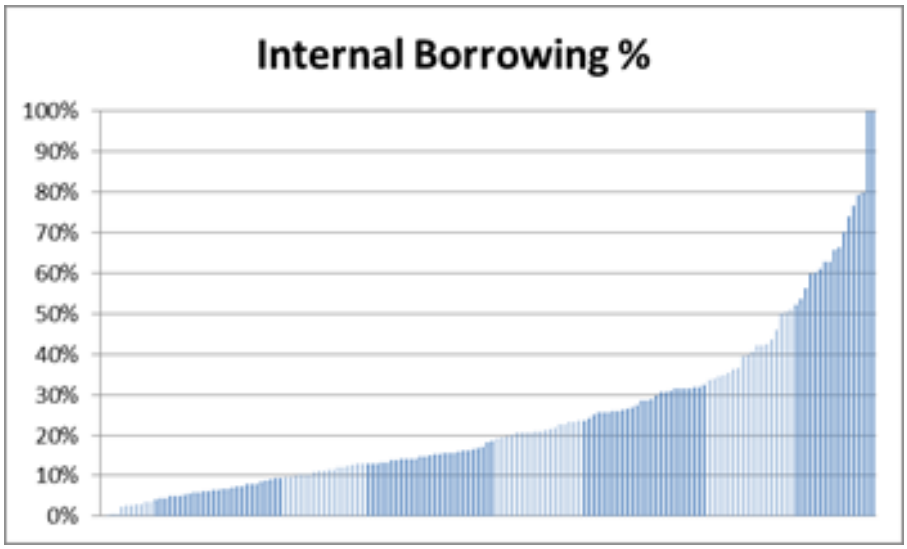
Internal Borrowing

39. 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.

40. 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)



41. 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.

42. 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.

43. For 2019/20 the level of internal borrowing by year end is some £8.1m out of a total borrowing requirement of some £73.6m (11%)

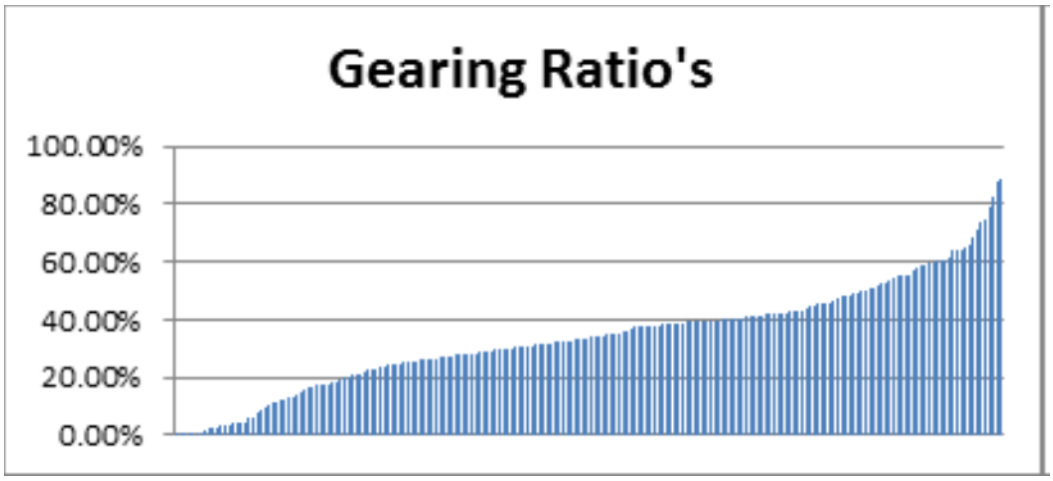
Gearing

44. 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.

45. 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**.

46. 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)



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

48. 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%.

49. For Hastings, the gearing ratio of debt (CFR) to long term assets is set to increase from 37% in 2018/19 to 46% in 2020/21 (assuming no changes to asset valuations and Capital programme). When compared against the net assets of the authority the ratio increases to some 120% in 2020/21.

50. 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 of the Council's position.

51. **Table showing Future Projections of Gearing Ratios – based on Capital programme**

Gearing Calculations	Actual	Estimates					Operational Boundary
	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Capital Expenditure (net)		15,580	16,936	17,310	-	-	
New borrowing		15,395	16,567	17,102	-	-	
Net Assets	73,497	73,682	74,051	74,259	74,259	74,259	74,259
Long Term Assets	158,774	174,354	191,290	208,600	208,600	208,600	219,768
Capital Financing Requirement	59,370	73,589	88,584	103,689	101,312	98,832	110,000
RATIOS:							
Debt: Net Assets	**81%**	**100%**	**120%**	**140%**	**136%**	**133%**	**148%**
Debt: Long Term Assets	**37%**	**42%**	**46%**	**50%**	**49%**	**47%**	**50%**

52. 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 (£110m), then debt to long term assets ratio could rise to 51%.

53. 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.

54. 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 released in autumn 2019. The government have also advised that they are keeping lending to local authorities under review – resulting from the activities of a few.

55. Any new limitations on accessing PWLB monies could have significant implications for the Council.

Ratio of Financing Costs to Net Revenue Stream

56. 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.

57. In Hasting's case the ratio of financing costs in 2020/21 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.

58. 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.

59. 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.

60. 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

61. 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.

62. The cabinet also agreed £25,000 be identified from general reserves to fund taxation and legal advice for setting up a joint venture.

63. The Council has received a near £7m grant from Homes England to bring forward the site, undertaking flood protection/ remediation works. A further report is to follow on viability and how to proceed with the scheme e.g. joint venture. 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, as well as providing loan finance.

Industrial Units – Churchfields Estate (Sidney Little Road)

64. The Council has a substantial plot of undeveloped industrial land. There is potential to develop the site

    Plot 1 – 28 Starter Units (now included in Capital Programme)
    Plot 2 – 35 Square foot factory
    Plot 3 – 3 to 8 factory units (flexible sizes)

65. The initial estimates identified construction costs for the 3 sites at some £9.3m. External funding has been agreed for Plot 1 which makes this part of the project viable. Given the current rentals chargeable in Hastings, the remaining sites are

not viable without external funding. There is expected to be the opportunity to bid for further development funding or alternatively make use of the Towns Fund.

Development Sites – HBC Land

66. 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

67. 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. Given the Council's need for Capital receipts the budget report has proposed the sale of such sites (unless an alternative viable option is identified that generates similar revenue streams within the same timescales)

Bohemia

68. The Travel lodge site looks likely to progress to redevelopment, along with the construction of a significant number of new properties.

69. 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 £70m.

Commercial Property/ Housing/Energy Initiatives

70. The Capital programme includes new monies for Commercial property acquisitions, energy and housing projects. For such projects to proceed they will be subject to a viable business case being produced, or where the housing company is concerned a revised business plan.

Corporate Governance Arrangements – Project Approval Process

71. 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.

72. 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.

73. 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).

74. 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 2019 the Council's Long term Assets were valued at some £158m whilst debt (CFR) amounted to some £59m.

75. 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

76. 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 2019/20 the expected spend amounts to £906,000 and in 2020/21 is estimated at £912,000. As a result of expenditure exceeding income the balance on the reserve is expected to fall to some £797,000 by the end of March 2021.

Information Technology Reserve

77. 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.

78. 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.

79. The Council contributes £214,000 p.a. into the fund. The expenditure is estimated at £243,000 in 2019/20 and £214,000 in2020/21(Please see budget).

80. The balance on the fund is expected to be £124,000 by the end of March 2021.

Knowledge, Skills and Training

81. 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.

82. 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.

83. 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.

84. Where specialist knowledge is required the Council will obtain expert advice, particularly around property specialisms, taxation, and legal advice.

Summary

85. 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.

86. 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.

87. 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 the sale of some sites.

88. 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 reserves the level of unallocated General Reserve will only be marginally above the minimum recommended level by the end of 2020/21 (£6m) – and the Council must look to achieve a sustainable and balanced budget in 2021/22.

89. The investments that may be made in Energy, Housing and Commercial Property are expected to make significant contributions to the Council's budget and thus help to preserve services and jobs within the borough.

90. 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

91. 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.

92. The draft Corporate Plan and draft budget for 2020/21 are subject to public consultation from the 10 January 2020.

Equality Impact Assessment

93. Equality Impact assessments are considered as part of the business case when considering individual capital proposals.

Appendix 1

Financing Costs to Net Revenue Stream

Prudential Indicator: Financing Cost to Net Revenue Stream	2018/19 Actual	2019/20 Rev.Est	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Financing Costs	£'000	£'000	£'000	£'000	£'000
1. Interest Charged to General Fund	1,218	1,914	2,315	2,869	3,152
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	0	0	0	0	0
4. Interest and Investment Income	-303	-544	-818	-787	-771
5. Amounts payable or receivable in respect of financial derivatives	-	-	-	-	-
6. MRP, VRP	795	1,176	1,624	1,884	2,425
6. Depreciation/Impairment that are charged to the amount to be met from government grants and local taxpayers	-	-	-	-	-
Total	1,710	2,546	3,121	3,966	4,806
Net Revenue Stream					
Amount to be met from government grants and local taxpayers	13,373	13,018	13,358	13,460	13,688
Ratio					
Financing Cost to Net Revenue Stream	**13%**	**20%**	**23%**	**29%**	**35%**

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