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Audit Committee Agenda

Thursday, 21 January 2021 at 6.00 pm

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AUDIT COMMITTEE

12 NOVEMBER 2020

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

88. APOLOGIES FOR ABSENCE

Apologies received from Councillor Charman and Forward. Councillor Chowney substituted for Councillor Forward.

89. DECLARATIONS OF INTEREST

Councillor	Minute	Interest
Rankin	92.	Personal- Works in the housing industry

90. MINUTES OF THE LAST MEETING

RESOLVED- (Unanimously) that the minutes of the meeting held on the 22 January 2020 be approved.

91. ANNUAL TREASURY MANAGEMENT OUTTURN REPORT 2019/2020

The Assistant Director Financial Services and Revenues (Chief Finance Officer) presented a report to enable the Audit Committee to scrutinise the Treasury Management activities and performance of the last financial year.

The report reviews 2019/20 and generally before the main impact of the COVID-19 crisis. The current crisis has highlighted that good treasury management remains critical. The Council, as a result, has been able to maintain effective management of its money, services and reserves. The Council's money has been available when required. This has been achieved through the adopted policies and strategies the Council currently has. It is recommended that the policies and practices are not changed for the year - as they are currently proving to be effective.

In the year there was £12million of capital expenditure of which £9 million was financed through borrowing. The council had a small under borrowing position at year end. Paragraph 19, table 4 shows a breakdown of the loans the council has taken. In terms of investment returns, the performance was better than estimated. The interest rates are still at historically low levels but there was a 1% hike in borrowing rates in October 2019 for the PWLB (Public Works Loan Board). The council has not borrowed anything in advance of its need and has not borrowed since the interest rate hike.

The COVID-19 crisis did impact on the investments with CCLA e.g. property Fund. Paragraphs 48, 49 and 50 talk of this impact. These investments are recovering their

Capital values and the Council continues to obtain a good revenue return from the dividends – there is no intention to sell these investments.

Within the report there are also details of the investments we have been making including details of the loans to the Hastings Housing Company.

The councillors thanked him for the delivering a detailed report.

Councillors asked about Hastings Housing Company. HBC are lending money for them to buy housing. The company are not repaying the capital loans but have been repaying the revenue loan advanced. When the company started, they were, as expected, in a deficit. They are now in a financial position repay the loan. The interest rate payable by the company is a market rate and this requirement is beneficial to the council as this is higher than currently obtainable in the market.

Councillors asked about the PWLB rates. These rates are set by the Debt Management Office based on policy from central government. The PWLB has a limit on the borrowing they can give out. They raised the interest rates to reduce the levels of borrowing – particularly for purchasing investment properties. The government is currently reviewing how the PWLB is working. There is hope that the rates will drop. The Council's property portfolio continues to perform well – although a number of tenants are facing difficulties.

Councillors asked about where the council has lent money to other authorities. We lend to other authorities, on a short-term basis when cash flow permit; this is cost-effective for both parties. The Council has been careful who they have lent to.

RESOLVED- (Unanimously)

1. **To consider the report – no recommendations are being made to amend the current Treasury Management Strategy as a result of this review.**

Reasons for Recommendations

To ensure that members are fully aware of the activities undertaken in the last financial year, that Codes of Practice have been complied with and that the Council's strategy has been effective in 2019-20.

Under the Code adopted the Full Council are required to consider the report and any recommendations made.

92. CHIEF AUDITOR'S SUMMARY AUDIT AND RISK REPORT

The Chief Auditor presented a report to inform the Audit Committee of the key findings from the housing audit.

The Housing department experiences changes rapidly particularly with debt due to the pressures of homelessness provision. The Chief Auditor will produce a follow up report to these recommendations for the Audit committee at March's meeting. Senior management response to this report had been positive.

The report makes recommendations and advises on the priority that they should be looked at. There are no urgent priorities but there are 2 important and 6 action points.

The report talks about the challenges the software system has caused in terms of the auditing processes. The current software being used by the housing department is a standalone system. This means that it doesn't take to any of the other IT software in the Council. This has caused issues in the data collection and tracking which is necessary for activities such as collecting of monies and tracking of tenant financial updates.

Councillors were advised that this had led to the report showing no figure for the rent guarantor system.

ACTION: Chief Auditor will check with the external auditor and get the figure for the rent guarantor system. This will be circulated to audit committee members be email.

The IT software incompatibility has caused for many manual processes to be set up instead to ensure the correct actions and controls are in place. There had previously been issues trying to reconcile the money present in bank accounts with the data from the housing department this has since been resolved. The housing officers are keen to make positive changes and welcomed future training for this.

Councillors enquired whether the project management tools had been used when purchasing this software. This would have picked up on the incompatibility of the software. Councillors were advised that the project management tools would have highlighted this, but they were not in place during the time of this purchasing. It is unlikely that this would happen now as lessons have been learnt. This report helps reminds people that the right controls and correct planning needs to be in place.

RESOLVED- (Unanimously)
1. **That the Audit Committee accepts the report.**

Reasons for Recommendations

To monitor levels of control within the organisation.

93. AUDIT COMMITTEE REPORT TO COUNCIL 2020

The Chief Auditor presented a report to inform the Audit Committee on its annual review of the effectiveness of Internal Audit.

The original Audit schedule contained several audits which would have produced reports. Due to COVID-19 this has not been possible due to the audit officers needed on projects such as helping with the various COVID-19 grant schemes.

Councillors understood why things have been delayed. The COVID-19 scheme has meant that distributing the money to the community has been time critical and needed accurate recording and monitoring of these processes.

The Chief Auditor advised the committee that the Head of IT is helping with a report that deals with cyber attack risk. Other Local Authorities had been subjected to cyber attacks that had caused severe consequences. The council uses many software systems which has caused the need for this audit.

The committee were made aware that the Chief Auditor has approached other local authorities that have had an event that has caused severe consequences in a bid to gain lessons learned from this. The Chief Auditor hasn't received much information largely due to the local authorities being legally advised not to comment.

RESOLVED- (Unanimously)

1. **That the Audit Committee Report to Council 2020 is approved for presentation to Council**

Reasons for Recommendations
Regulation 6 of the Accounts and Audit Regulations (England) 2015 requires relevant bodies to conduct an annual review of the effectiveness of its system of internal audit and for a committee of the body to consider the findings.

94. REVISED INTERNAL AUDIT PLAN 2020-21

The Chief Auditor presented a report to Audit Committee to consider the revised internal audit plan for 2020/21.

The report contains a table of the amended Audit work programme for the year. The original work programme had been approved for the year in the Audit Committee held on 12 March 2020. Since then COVID-19 crisis had occurred and there has not been enough capacity to discharge the plan. The revised plan has taken out the emerging risks and value for money work. Business recovery was one of the audits that was deleted but the council has now gone onto pass this test. Checks are still being carried out and internal reviews will still be conducted where time permits.

The Councillors enquired about Audits involvement and responsibilities towards the COVID-19 grant schemes. The grant schemes were a system that was quickly put together. Audit responsibilities towards this is having a grant assurance program for this. There is an audit plan that documents what controls are in place and the processes the council are using. There is a danger that if the wrong payment was given out that the government might penalise the by not toping up the additional monthly payments we receive unless we can show we have taken the necessary precautions. Before payments are authorised both the Audit and Finances departments will do checks. Local knowledge pays a key part in knowing what local businesses are in the area and helps prevent successful fraudulent payments. The council also receives referrals from banks and other local authorities. At present the council is only aware of one incident of fraud which Legal and Revenues departments are working on.

There is an Audit plan to look at the Syrian refugee scheme. This scheme had previously had large deficits due to not getting back money owed from the government. There could be other areas in the scheme that need auditing as the scheme involves many different departments. There is limited capacity within the council's audit team at the moment so this may need to be audited externally. Currently the audit team are looking at the scheme profiling the risks and profiling.

RESOLVED- (Unanimously)

1. **That the Audit Committee approves the revised Internal Audit Plan 2020-21**

Reasons for the recommendations
To ensure that proper financial management arrangements and controls are in place and operating effectively in the Council.

The impact of Covid19 since lockdown on 23 March 2020 has diverted Internal Audit resources away from planned work particularly towards government grant assurance. It has therefore become necessary to reduce the planned work and focus just on the core audit coverage for the remainder of the 2020-21 year.

Accomplishment of the revised plan will bring the council totally up to date on coverage of its cyclical audit work.

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

The Chair took the opportunity to thank all the council's team for their hard work during the COVID-19 crisis.

The Chief Finance Officer raised the high impact of being inundated with government returns. Normally there would be final accounts from the external auditors for audit committee unfortunately they haven't been able to produce these. It is hoped that the accounts will be ready for Januarys committee. This delay is affecting other pieces of work. The foreshore accounts have not been completed and the Charity committee AGM has had to been postponed. Without the final accounts from the external audit it will also be hard to set a definitive amount for the reserves.

The councillors asked whether the level of reserves was healthy or would a S144 notice would be issued. The Chief Finance officer assured councillors that even with a further lockdown the council would be in a healthy position. The Government has stepped up and issued more money to help councils with the loss of income caused by the COVID-19 crisis. Income compensation schemes look set to repay lost car park income by as much as 75%. This financial year for the council looks good but future years need consideration with circumstances such as the rise in homelessness costs and not knowing if there will be additional grants to support these costs. This makes future planning a lot more difficult.

(The Chair declared the meeting closed at. 7.20 pm)

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Agenda Item 4

Report to: Audit Committee

Date of Meeting: 21 January 2021

Report Title: External Audit Findings Report

Report By: Peter Grace

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

Purpose of Report

To communicate the changes to the External Audit Plan and the key findings reviewed to date.

Recommendation(s)

1. **That the Audit Committee accepts the report.**

Reasons for Recommendations

Changes to the External Audit Plan were necessary due to the pandemic.

Background

External Audit management are in the process of reviewing the findings from the audit fieldwork carried out. The pandemic has impacted on their audit plan. Allowing a few extra days for the review will enable them to provide more detailed information and inform the committee of the results where the work has been completed.

A senior manager from Grant Thornton is expected to attend the meeting.

Wards Affected

None

Policy Implications

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

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

Additional Information

External Audit Findings Report to follow in advance of the committee meeting-.

Officer to Contact

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Agenda Item No:

Report to: **Audit Committee**

Date of Meeting: **21 January 2021**

Report Title: **Treasury Management Mid-Year Report 2020-21**

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 2020.

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 2020). It is a requirement of the Code of Practice that the Mid-year review is considered by Cabinet, Audit Committee and full Council.

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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."

   Covid-19 has highlighted the need to have proper and effective Treasury Management Practices and Policies in place. The Council has been able to sustain its services throughout this period, has not experienced undue difficulties in managing major cash flows, and retains sufficient reserves (given government assistance).

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 2020/21 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 2020/21;
   - A review of the Council's borrowing strategy for 2020/21;
   - A review of any debt rescheduling undertaken during 2020/21;
   - A review of compliance with Treasury and Prudential Limits for 2020/21.

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 over the last few years and this has entailed 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. The Council strengthened its reserves when taking on these additional risks and the level of reserves have to date proven more than adequate to cope with the immediate effects of Covid-19.

9. The Cabinet will have considered a similar report at their meeting on 4 January 2021.

Economic Update

10. As expected, the Bank of England's Monetary Policy Committee (MPC) has kept Bank Rate unchanged since reducing them to 0.1% in March 2020. Its forecasts have been optimistic in terms of three areas (as at Mid-year):

    i. The fall in GDP in the first half of 2020 was revised from 28% to 23% (subsequently revised to -21.8%). This is still one of the largest falls in output of any developed nation. However, it is only to be expected as the UK economy is heavily skewed towards consumer-facing services – an area which was particularly vulnerable to being damaged by lockdown.

    ii. The peak in the unemployment rate was revised down from 9% in Q2 to 7½% by Q4 2020.

    iii. It forecast that there would be excess demand in the economy by Q3 2022 causing CPI inflation to rise above the 2% target in Q3 2022, (based on market interest rate expectations for a further loosening in policy). Nevertheless, even if the Bank were to leave policy unchanged, inflation was still projected to be above 2% in 2023.

11. It also squashed any idea of using negative interest rates, at least in the next six months or so. It suggested that while negative rates can work in some circumstances, it would be "less effective as a tool to stimulate the economy" at this time when banks are worried about future loan losses. It also has "other instruments available", including Quantitative Easing.

12. The MPC expected the £300bn of quantitative easing purchases announced between its March and June meetings to continue until the "turn of the year". This implies that the pace of purchases will slow further to about £4bn a week, down from £14bn a week at the height of the crisis and £7bn more recently.

13. In conclusion, this would indicate that the Bank could now just sit on its hands as the economy was recovering better than expected. However, the MPC acknowledged that the "medium-term projections were a less informative guide than usual" and the minutes had multiple references to downside risks, which were judged to persist both in the short and medium term.

14. Brexit uncertainties, in terms of impact, remain. The wind down of the initial generous furlough scheme through to the end of October was another development that caused the Bank to review the need for more support for the economy later in the year. Admittedly, the Chancellor announced in late September a second six month package from 1st November of government support for jobs whereby it pays up to 22% of the costs of retaining an employee working a minimum of one third of their normal hours. There was further help for the self-employed, freelancers and the hospitality industry. However, this is a much less generous scheme than the furlough package and will inevitably mean there will be further job losses from the 11% of the workforce that were still on furlough in mid September.

15. Overall, the pace of recovery is not expected to be in the form of a rapid V shape, but a more elongated and prolonged one after a sharp recovery in June through to August which left the economy 11.7% smaller than in February. The last three months of 2020/21 are now unlikely to show significant growth .

16. There are expected to be some painful longer term adjustments e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever. There is also likely to be a reversal of globalisation as this crisis has shown up how vulnerable long-distance supply chains are. On the other hand, digital services are an area that has already seen significant growth.

17. One key addition to the Bank's forward guidance was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate.

Interest rate forecasts

18. The Council's treasury advisor, Link Group, provided the following forecasts on 11th August 2020 (PWLB rates are certainty rates, gilt yields plus 180bps): More recent updates are included in the draft Treasury Management Strategy 2021/22 (also on the agenda).

Link Group Interest Rate View 11.8.20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month average earnings	0.05	0.05	0.05	0.05	0.05	-	-	-	-	-
6 month average earnings	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
12 month average earnings	0.15	0.15	0.15	0.15	0.15	-	-	-	-	-
5yr PWLB Rate	1.90	2.00	2.00	2.00	2.00	2.00	2.10	2.10	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50

19. The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it has left Bank Rate unchanged. The Governor of the Bank of England has made it clear that he currently thinks that a move to negative interest rates would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected within the forecast horizon ending on 31st March 2023 as economic recovery is expected to be only gradual and, therefore, prolonged.

The Council's Treasury Position – 30 September 2020

Borrowing

20. The Council's debt and investment position at the 30 September 2020 was as follows

Table 1 – Borrowing

Debt	1 April 2020 Principal	Start Date	Maturity Date	30 Sept 2020 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)	£185,915	21/03/2016	20/03/2026	£171,117	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)	£7,002,787	01/06/2017	01/06/2057	£6,946,261	2.53%
PWLB (Annuity)	£8,111,852	22/11/2017	22/11/2057	£8,050,277	2.72%
PWLB	£2,000,000	12/12/2018	12/06/2028	£2,000,000	1.98%
PWLB (Annuity)	£3,941,522	13/12/2018	13/12/2058	£3,911,723	2.55%
PWLB (Annuity)	£2,463,534	31/01/2019	31/01/2059	£2,444,950	2.56%
PWLB (Annuity)	£4,365,748	31/01/2019	31/01/2069	£4,343,197	2.56%
PWLB (Annuity)	£9,262,267	20/03/2019	20/03/2059	£9,192,086	2.54%
PWLB (Annuity)	£4,770,452	02/09/2019	02/09/2069	£4,740,634	1.83%
Total Debt	**£65,301,339**			**£64,997,506**	2.82%

21. At the 30 September 2020 the Council had debt amounting to £64.99m (PWLB debt). The Council has not taken on any more debt in the year (as at 4 January 2021) – pending the outcome of the Treasury's review into Public Works Loan Board (PWLB) lending – the results of which were announced on 25 November; New lending terms from the PWLB applying from the 26 November 2020.

22. 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.
23. 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.

24. 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.

25. 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).

26. The Council's 2020/21 MRP Policy was approved as part of the Treasury Management Strategy Report for 2020/21 by Council in February 2020.

27. 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	**2019/20 Actual £000's**	**2020/21 Estimate £000's**
Opening balance	58,094	66,373
Add unfinanced capital expenditure	9,455	9,248
Less MRP	(1,176)	(1,499)
Closing balance	**66,373**	**74,122**

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

29. 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 2020/21 plus the expected changes to the CFR over 2021/22 and 2022/23 from financing the capital programme. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2020/21.

Table 3 Internal Borrowing	**2019/20 Actual £000's**	**2020/21 Estimate As at 30/11/20 £000's**

Capital Financing Requirement	66,373	74,122
External Borrowing	65,301	64,998
Net Internal Borrowing	**1,072**	**9,124**

30. 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 2020-21

31. The table below provides a snapshot of the investments and deposits held on 30 September 2020. 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.

32. In addition to the investments there was £20,719,445 in the Lloyds current account which was being held for Business Grant payments (and repayments back to the government) and other funding potentially required at short notice during COVID-19.

33. The Council also had longer term investments with CCLA in a property fund and Diversified Income Fund

Table 4 – Investments and deposits (Other than Lloyds)

Counterparty	Rate/ Return	Start Date	End Date	Principal	Term
Barclays Corporate	0.40%			**5,000,000**	Call
NAT West	0.05%			**6,155**	Call

34. As at 30 September 2020 three longer term loans are outstanding to other organisations.

Table 5 – Loans to Other Organisations

Counterparty	Rate/ Return (%)	Start Date	End Date	Principal O/S (£)	Term
Amicus (Optivo)	3.78	04/09/2014	02/09/2044	1,788,235	Fixed
The Source	2.43	17/12/2015	17/12/2025	15,718	Fixed
Foreshore Trust	1.66	21/03/2016	20/03/2026	171,117	Annuity

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 2020/21 provided an average return of 0.66% (1.48% including CCLA) (2019/20 0.91%).

37. The total interest receivable for the first 6 months is £43,628 (£134,422 including CCLA) (2019/20 £120,348) These figures exclude the interest receivable in respect of the three loans to other organisations.

Loans to Hastings Housing Company Ltd

38. Hastings Housing Company repaid the revenue loan and interest due to the Council in September 2020. It still has a capital loan of £5,489,398 outstanding. The capital loan interest rate is based on the rate prevailing at the time of the advance and is fixed for the period of the loan. The borrowing 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 provide updates on:

- 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 2020/21.

Table 6 Capital Expenditure (Net) by Service	2020/21 Original Estimate (net) £'000	2020/21 Revised Estimate (net) £'000
Corporate Resources	13,379	6,053
Operational Services	3,557	3,199
Total Capital Expenditure (Net)	**16,936**	**9,252**

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 2020/21 from borrowing include:-

(1) Buckshole Reservoir Works

(2) Temporary accommodation incl. Next Steps Accommodation Pathway property purchases

(3) Country Park – Visitor Centre

(4) Priory Street Car Park – concrete works/lighting

(5) Electric vehicles and infrastructure

(6) 12/13 York Buildings

(7) Lacuna Place

Impact on the prudential indicators

43. The Capital Financing Requirement has increased over the last 18 months. It is expected to reach some £74.1m by April 2021. The position at 30 November 2020 is shown in Table 3 above, and highlights that there would be an underlying financing requirement of some £9.1m by the year end if no further borrowing is undertaken in 2020/21.

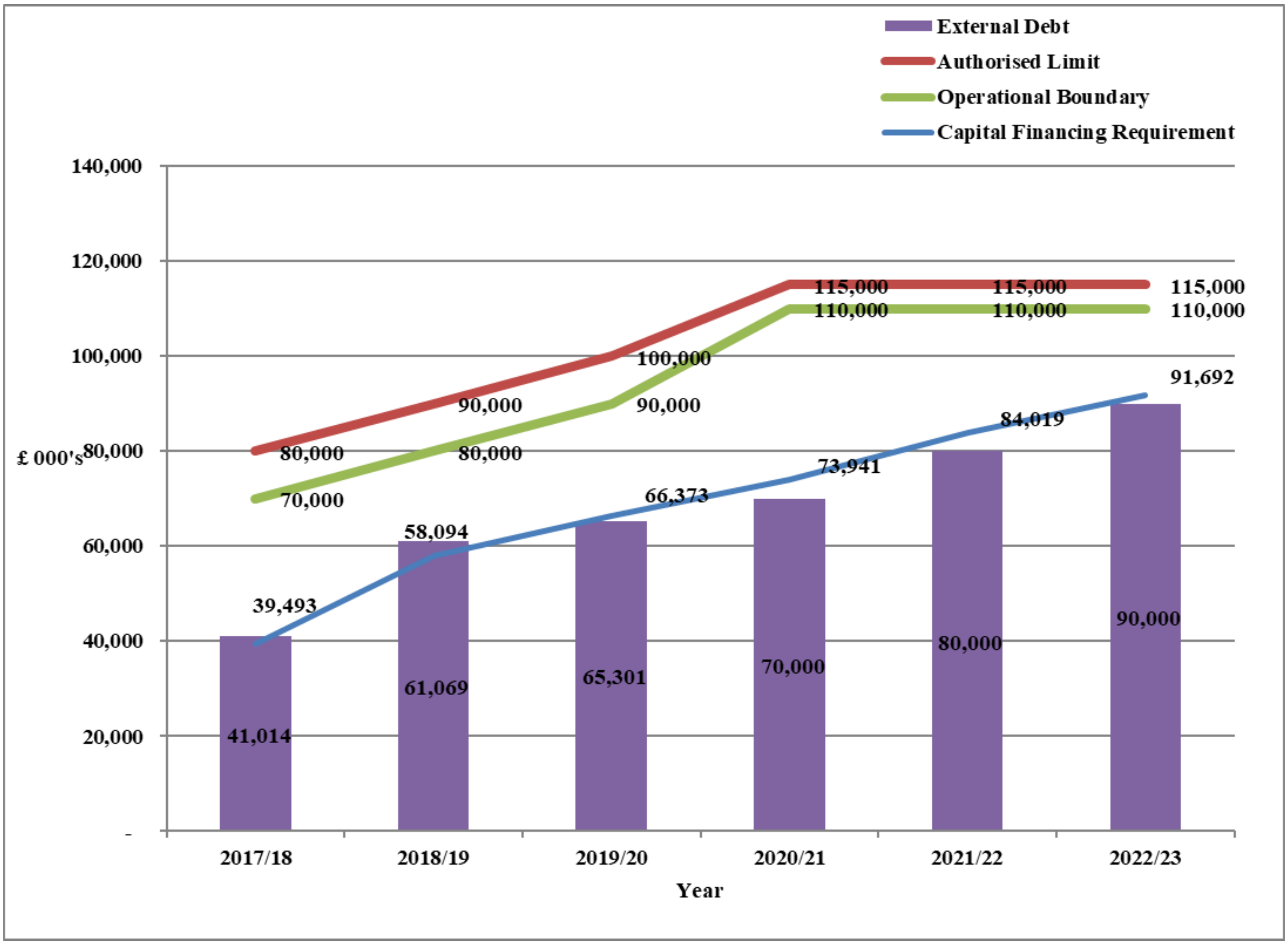
Compliance with the limits in place for borrowing activity.

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 2020/21 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; this is set by full Council and can only be revised by full Council. 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 graph below shows that the Council is operating within its approved borrowing limits.

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



Borrowing Strategy

47. The Council now has some £64.99m of PWLB debt and could potentially borrow up to a level of £74.1m (estimated CFR at 31 March 2021). 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 after March 2023. 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. 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.

50. 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. It had suspected this might be a possibility given the government's concern at the level of borrowing by a few councils for commercial property investments. The Council did undertake borrow in September 2019 and has not borrowed since on the basis that once the treasury review was concluded and further restrictions were put in place rates would be decreased. This has proven to be the case with rates being reduced by 1% on the 26 November 2020. This announcement was earlier than anticipated.

Debt Rescheduling

51. 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 even greater than when last considered. It is understood that the Treasury may review their policy in this area.

Investment Strategy

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

53. 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.

54. 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.

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

Property Fund

56. 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 from June 2019 is detailed below:

CCLA – LA's Property Prices and Dividend yields

End of	Sep-20	Aug-20	Jul-20	Jun-20	May-20	Apr-20	Mar-20	Dec-19	Sep-19	Jun-19
Offer Price p	302.56	301.67	302.10	303.14	305.90	310.33	315.70	322.70	324.35	327.66
Net Asset Value p	283.43	282.60	283.00	283.97	286.55	290.71	295.74	302.30	303.84	306.94
Bid Price p	279.04	278.22	278.61	279.57	282.11	286.20	291.15	297.61	299.13	302.19
Dividend* on XD Date p	3.10	-	-	2.80	-	-	3.25	3.21	3.45	3.15
Dividend* - Last 12 Months p	12.07	12.72	12.72	12.72	13.06	13.06	13.06	13.12	13.22	12.94
Dividend Yield on NAV %	4.26	4.50	4.49	4.48	4.56	4.49	4.41	4.34	4.35	4.22
Fund Size £m	1,155.80	1,152.40	1,154.10	1,158.00	1,168.60	1,185.50	1,206.00	1,200.10	1,173.10	1,178.20

57. The dividend yield is around 4.4% on the net asset value, which results in quarterly cash dividends of around £19,250. Full year dividends are estimated at around £78,000.

Property Fund Capital Value

Units (651,063)	Sep-20	Aug-20	Jul-20	Jun-20	May-20	Apr-20	Mar-20	Dec-19	Sep-19	Jun-19
Mid Market Price(£)	1,845,308	1,839,904	1,842,508	1,848,824	1,865,621	1,892,705	1,925,454	1,968,163	1,978,190	1,998,373
Bid Price (£)	1,816,726	1,811,387	1,813,927	1,820,177	1,836,714	1,863,342	1,895,570	1,937,629	1,947,525	1,967,447

58. The Capital value has decreased by 1.51% between April 2017 and September 2020. 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. At the end of November 2020 the mid-market value is £1.848,628.

Diversified Income Fund

59. 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.

60. The capital value has decreased by 5.05% from the initial investment and was valued at £2,848,617 at the end of November 2020. The quarterly dividend yield was 3.46% for September (£23,744). It should be remembered that this is a long term investment and prices can go up and down – as the impact of the pandemic has highlighted.

Compliance with Treasury Limits

61. As a result of Covid-9, the potential unknown impacts on foreign countries, their economies and banks along with the high levels of funding for business rate grants being provided by the government, the limits for balances held with Lloyds bank were raised substantially – approved by the Chief Finance officer in compliance with the Council's Treasury Management Practices. The council was thus able to manage, for example the £27,782,000 received in respect of business support grants for the first lockdown period. The money was held in either a call account or the general bank account. Exceeding the normal approved limits is a decision that is not taken lightly, and whilst the investment return achieved will have been lower than otherwise may have been the case, the need for security was considered to be more important – as

was the ability to use the funds as and when necessary i.e. to pay out the grants.

62. The Prudential Indicators have been complied with - reproduced in Appendix 1 for reference.

Financial Implications

63. The Council's 2020/21 budget included an estimated return on investments of 0.75%. The Bank Base Rate was 0.75% from 2 August 2018 and remained at that level until it fell to 0.25% on 11 March 2020 and then to 0.1% on 19 March 2020. Since then interest rates on investments have changed significantly. The Council's actual average rate of return to 30 September was 0.66% (1.48% including the CCLA investments).

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 2020 and will be reviewed and updated annually.

65. The 2021/22 Treasury Management Strategy suite of reports will be considered by the Audit Committee on the 21 January 2021 and thereafter considered by Cabinet on 8 February 2021 and Budget Council on 17 February 2021 in conjunction with the budget papers and Corporate plan.

Risk Management

66. The Council continues to face serious risks in terms of volatility in its income streams, expenditure and future funding. Business rates and property income are susceptible during economic recessions and business rate appeals for example can have sudden and significant impacts. The Council has seen a massive increase in its homelessness expenditure this year, along with significant reductions in collection rates for Council tax and business rates, let alone sales fees and charges e.g. car park income. 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 fact that the Council's reserves were cash backed meant that there was no need to borrow at high interest rates when funds were required.

70. 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. However, there are no reasons to sell the current investments at this time.

Timetable of Next Steps

1. 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 & Capital Strategy	Setting of 2021/21 Budget	February 2021	Chief Finance Officer
Treasury Management Outturn Report to Cabinet	Close of 2020/21 accounts	July 2021	Chief Finance Officer

Wards Affected - None

Area(s) Affected

None

Implications

Relevant project tools Applied? N/A

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 13.7.

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

Peter Grace
Chief Finance Officer
pgrace@hastings.gov.uk

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	**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

The Council's external borrowing at 30 September 2020 amounted to £64,997,506 which is well within approved borrowing limits.

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	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 2019/20

	lower	**Upper**
Under 12 Months	0%	100%
12 months to 2 years	0%	100%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%
10 years 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 2019/20

	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.

Affordability Prudential indicator - Ratio of Financing Costs to Net Revenue Stream					
Prudential Indicator Financing Cost to Net revenue Stream					
Prudential Indicator: Financing Cost to Net Revenue Stream	**2018/19 Actual**	**2019/20 Rev.Est**	**2019/20 Outturn**	**2020/21 Estimate**	**2021/22 Estimate**
Financing Costs	£'000	£'000	£'000	£'000	£'000
1. Interest Charged to General Fund	1,218	1,914	1,810	2,315	2,869
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	-596	-693	-787
5. Amounts payable or receivable in respect of financial derivatives	-	-	-	-	-
6. MRP, VRP	795	1,176	1,176	1,624	1,884
7. Depreciation/Impairment that are charged to the amount to be met from government grants and local taxpayers	-	-	-	-	-
Total	1,710	2,546	2,390	3,246	3,966
Net Revenue Stream					
Amount to be met from government grants and local taxpayers	13,373	13,329	13,329	13,063	13,392
Ratio					
Financing Cost to Net Revenue Stream	**13%**	**19%**	**18%**	**25%**	**30%**
Note: Outturn figures are unaudited					

This prudential indicator shows that the ratio of financing costs to the net revenue stream is generally increasing. This is not unexpected given that the Council agreed a programme for over £50m of Capital expenditure over the period 2017/18 to 2021/22 - thus increasing borrowing costs.

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Report To:	**Audit Committee**
Date of Meeting:	**21 January 2021**
Report Title:	**Treasury Management, Annual Investment Strategy and Capital Strategy 2021/22**
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 full Council as appropriate. This is to ensure that there is an effective framework for the management of the Council's investments, cash flows and borrowing activities prior to the start of the new financial year.

The Council is expected to have some £64.69 million of debt (as at 31 March 2021), and investments which can fluctuate between £15m and £30m in the year. The level of debt is set to increase to some £92m by 2022/23.

Recommendation(s)

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 are updated as necessary during 2021/22 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.**

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.

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 Cabinet are due to the same report and strategies at its meeting on the 8 February 2021 and thereafter to recommend the policies and strategies to 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 Year report	Cabinet and Council	Mid-year
Treasury Management Strategy/Capital Strategy / Annual Investment Strategy / MRP policy – updates or revisions at other times	Cabinet and Council	As required
Annual Treasury Outturn Report	Cabinet and Council	Annually by 30 September after the end of the year
Treasury Management Practices	S151 Officer	Reviewed as required (minimum - annually)
Scrutiny of Treasury Management Strategy	Audit Committee	Annually before the start of the year
Scrutiny of treasury management performance and strategy	Audit Committee	Quarterly Monitoring reports, Mid-Year report,

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.

Capital Strategy

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

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

19. 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.

20. 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.

21. 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.

22. 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.

23. 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.

24. 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

25. 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 eight years as and when these have been further developed by its advisers.

26. 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.

27. 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.

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

29. The additional risks that the Council has taken 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, pandemics 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.

30. 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 Treasury Services) ratings advice.

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

Economic/Financial Implications

32. The Council generally has investments in the year of between £15 million and £30 million at any one time and is estimated to have longer term borrowings approaching £65m by the end of March 2021 (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

33. 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.

34. 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.

35. 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.

36. 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
Arrange Training for members/ officers	Year End & Mid-Year Review Report	July 2021	Chief Finance Officer

Wards Affected

None

Policy Implications

Reading Ease Score: 24.3
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)
Draft Budget Report - Cabinet 8 February 2021 (Consultation)

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Treasury Management Strategy (TMS) for 2021/22

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 2021/22 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.

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 the last 12 months in respect of the Capital programme. The level of borrowing has risen but is lower than forecast as a result of covid-19 and has remained within the operational and authorised boundaries.

The Capital expenditure plans of the Council are expected to involve more new borrowing again in 2021/22 and the years ahead. The borrowing limits proposed in the strategy are those previously agreed when determining the budget for 2020/21.

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 – to cover potential short term cash deficits. Such monies cannot be borrowed from the Public Works Loan Board, and will be financed from the market or where there are revenue loans made e.g. to the housing company then 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 uncertain over the next few years as the bank base rate is very low and economic environment uncertain. 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 further potential calls on reserves..

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 2021/22 TO 2023/24

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 2020/21 £'000s	2021/22 £'000s	2022/23 £'000s	2023/24 £'000s
Gross Capital Expenditure	13,863	21,263	12,145	1,959
Net Capital Expenditure	9,252	12,331	10,306	120
Financing from own resources	4	125	216	120
Borrowing Requirement	9,248	12,206	10,090	0

In terms of **net cost**, the **2020/21** programme has been revised to £9,252,000 from £16,936,000. The **2021/22** programme amounts to £12,331,000 net of grants and contributions (£21,263,000 Gross).

Capital Expenditure – Financing

12. 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.

13. The larger schemes in the capital programme which are expected to require financing in **2021/22** from borrowing are:-

- Castleham Industrial Units – roofing (£140k)
- Cornwallis Street Development (£6.946m in 21/22 or 22/23)
- Churchfields Business centre (£2.639m in 21/22)
- Buckshole Reservoir (£160k in 21/22)
- Energy projects (£484k in 21/22)
- Harold Place at £1.2m

- Lacuna Place (£188k)
- York Buildings (£179k)

Impact on the prudential indicators

14. 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	**2019/20**	**2020/21**	**2021/22**	**2022/23**	**2023/24**
	£'000	£'000	£'000	£'000	£'000
Debt	95,000	110,000	110,000	110,000	110,000
Other long term liabilities	5,000	5,000	5,000	5,000	5,000
TOTAL	100,000	115,000	115,000	115,000	115,000

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

Operational Boundary	**2019/20**	**2020/21**	**2021/22**	**2022/23**	**2023/24**
	£'000	£'000	£'000	£'000	£'000
Debt	85,000	105,000	105,000	105,000	105,000
Other long term liabilities	5,000	5,000	5,000	5,000	5,000
TOTAL	90,000	110,000	110,000	110,000	110,000

16. 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’.

17. 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).

18. 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.

19. **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

20. 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.

The following table provides an overview (please also see Appendix 2).

Interest Rate Forecasts								
Bank Rate	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
Link	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
Cap Econ	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
5Y PWLB RATE								
Link	0.80%	0.80%	0.80%	0.80%	0.90%	0.90%	0.90%	0.90%
Cap Econ	0.95%	0.95%	0.95%	0.95%	0.95%	0.95%	0.95%	0.95%
10Y PWLB RATE								
Link	1.10%	1.10%	1.10%	1.10%	1.20%	1.20%	1.30%	1.30%
Cap Econ	1.30%	1.30%	1.30%	1.30%	1.30%	1.30%	1.30%	1.30%
25Y PWLB RATE								
Link	1.50%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%
Cap Econ	1.80%	1.80%	1.80%	1.80%	1.80%	1.80%	1.80%	1.80%
50Y PWLB RATE								
Link	1.30%	1.40%	1.40%	1.40%	1.40%	1.50%	1.50%	1.50%
Cap Econ	1.70%	1.70%	1.70%	1.70%	1.70%	1.70%	1.70%	1.70%

21. 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 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.

22. Whilst substantial growth is expected in the economy in at least the latter parts of 2021/22 this is from the low comparative base of 2020/21 and it will take some years potentially for the economy to recover to pre-covid levels. Unemployment levels of 4.9% (for the 3 months to October 2020) are expected to increase substantially, estimates vary from between 7.5% and 9%) should the furlough scheme end in April 2021.

23. An economic review from the Council's treasury advisors is included in Appendix 3. Such forecasts are being kept under regular review.

BORROWING STRATEGY

24. 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

25. The Council's forecast debt position for 31 March 2021, if no further borrowing is taken for the rest of the financial year, as at 4 January 2021, amounted to £64.69m (See Table below).

Debt	1 April 2020 Principal	Start Date	Maturity Date	31 March 2021 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)	£185,915	21/03/2016	20/03/2026	£156,196	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)	£7,002,787	01/06/2017	01/06/2057	£6,889,020	2.53%
PWLB (Annuity)	£8,111,852	22/11/2017	22/11/2057	£7,987,864	2.72%
PWLB	£2,000,000	12/12/2018	12/06/2028	£2,000,000	1.98%
PWLB (Annuity)	£3,941,522	13/12/2018	13/12/2058	£3,881,544	2.55%
PWLB (Annuity)	£2,463,534	31/01/2019	31/01/2059	£2,426,128	2.56%
PWLB (Annuity)	£4,365,748	31/01/2019	31/01/2069	£4,320,356	2.56%
PWLB (Annuity)	£9,262,267	20/03/2019	20/03/2059	£9,121,014	2.54%
PWLB (Annuity)	£4,770,452	02/09/2019	02/09/2069	£4,710,543	1.83%
Total Debt	**£65,301,339**			**£64,689,926**	**2.83%**

26. The Council has loaned money to other organisations. As at 31 December 2020 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	£156,196	Annuity
The Source	2.43%	17/12/2015	16/12/2024	£13,254	Annuity
			Total	**£1,957,685**	

27. 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.

28. The above table excludes the loan to the Hastings Housing Company. As at 31 December 2020 the Capital loan was £5,489,398. The company has fully repaid the revenue loan.

Borrowing Limit – Capital Financing Requirement (CFR)

29. 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.

30. The Council has at the time of writing some £64.69m of PWLB debt. To borrow for the remainder of the 2020/21 capital programme i.e. up to the projected level of the CFR (£74.1m) it would need to borrow a further £ 9.4m by the end of March 2021. The Capital Financing Requirement has increased significantly over the last few years. It is expected to reach some £92.8m by 2022/23 (based on the capital programme).

31. 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 2020/21 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.

32. 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.

33. 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).

34. The Council had achieved a near fully funded position at the start of this year which put the Council in a good position when the pandemic hit. 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 had been 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.

35. 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 and thus there is a stronger case now to not borrow externally until we really have to i.e. temporarily use existing resources. This was the strategy that was proposed for 2020/21 (as far as practical) and has saved on borrowing costs and assisted the Council's revenue account. There is however only a limited ability to do this given the depletion of Council reserves, and funds already invested for longer periods.

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).

	2019/20 Actual	2020/21 (Est)	2021/22 (Est)	2022/23 (Est)	2023/24 (Est)
	£'000s	£'000s	£'000s	£'000s	£'000s
CFR- Opening	58,094	66,373	74,122	84,643	92,800
less MRP	(1,176)	(1,499)	(1,685)	(1,933)	(2,520)
Plus New Borrowing	9,455	9,248	12,206	10,090	0
CFR- Closing	66,373	74,122	84,643	92,800	90,280

(Table excludes leasing element – which is very small)

36. 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

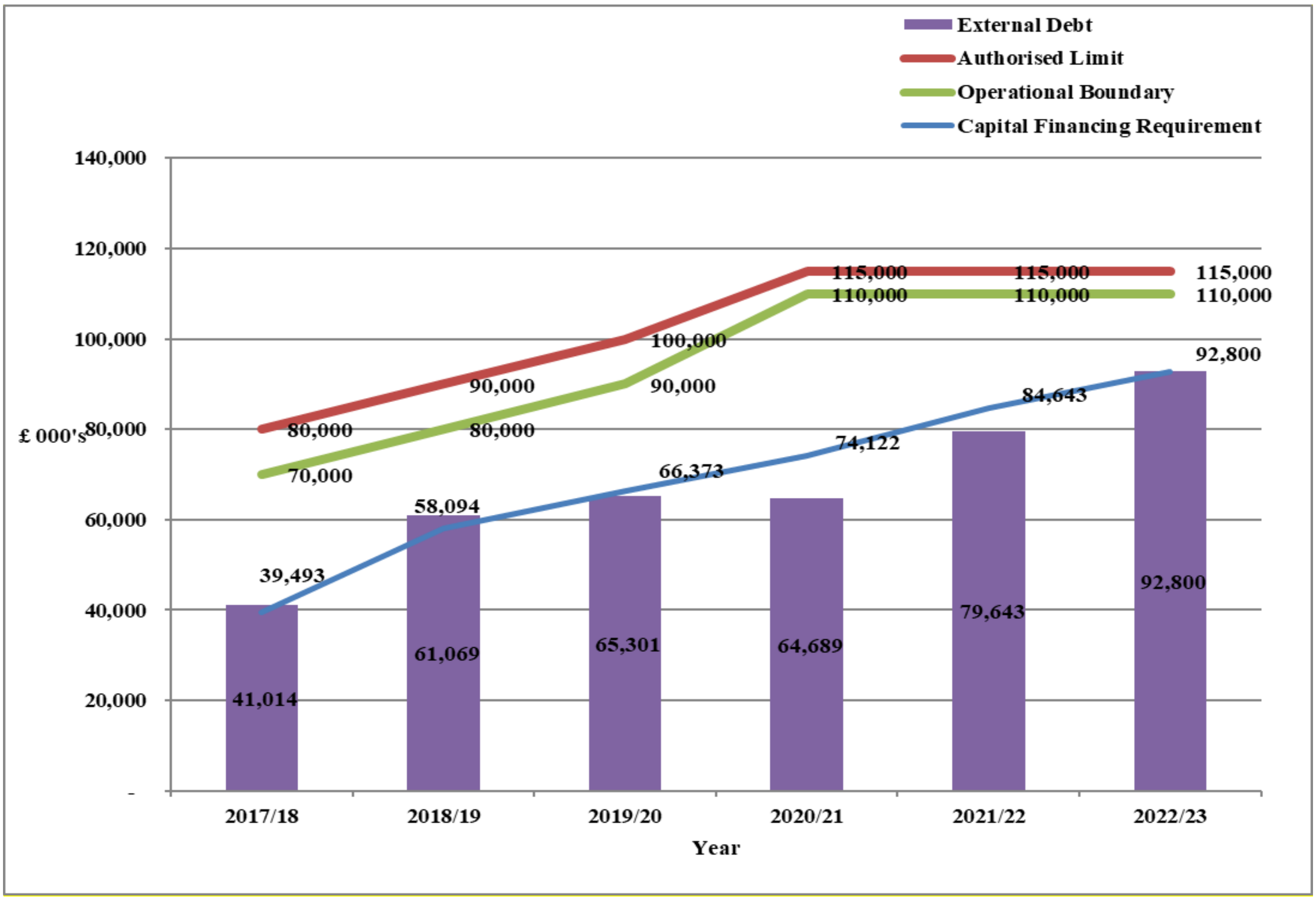
Internal Borrowing	**2019/20 Actual £000's**	**2020/21 Estimate £000's**	**2021/22 Estimate £000's**	**2022/23 Estimate £000's**
Capital Financing Requirement	66,373	74,122	84,643	92,800
External Borrowing	65,301	64,689	79,643	92,800
Net Internal Borrowing	**1,072**	**9,433**	**5,000**	**0**

37. The Council is now (4 January 2021) maintaining an under-borrowed position.

38. 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.

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



40. **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% p.a. (based on a maturity loan with a 2.5% interest rate) i.e. £50,000 p.a.

41. 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.

42. **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 2021/22 and thereafter – for as long as it remains available.

43. **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.

44. **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 at historically low levels. The timing of new borrowing is therefore important to minimise the overall costs to the Council.

45. Given that rates 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. If rates decrease, then opportunities to borrow may be taken. Given that the Council is increasingly using its reserves these need to be readily available and not subjected to unnecessary risk or exposure.

Summary

46. 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 - 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, and the need to have cash reserves during the pandemic (and not be forced to borrow at a time of high rates).

47. 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.

48. For the remainder of 2020/21 and 2021/22 the cheapest borrowing will be internal borrowing by running down cash balances and foregoing interest earned at historically low rates. However, the Council may not have sufficient balances to temporarily finance all the Capital expenditure in 20/21 and may need to borrow before March 2021. In view of the overall forecast for long term borrowing rates to increase in the medium term, 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 will continue to be taken when good opportunities arise in the interest of minimising the costs of debt over the long term.

49. 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.

50. 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

51. 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.

52. 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

53. 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.

54. 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.

55. 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)

56. 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.

57. 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).

58. The MRP for 2021/22 is estimated at £1,685,000 (the statutory charge to revenue that remains within the accounts).

ANNUAL INVESTMENT STRATEGY

Investment Policy

59. The Council's investment policy has regard to the MHCLG'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.

60. 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.

61. 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.

62. 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.

63. 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.

64. 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.

65. 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

66. 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

67. 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.

68. 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

69. 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.

70. 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.

71. 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.

72. 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.

73. 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.

74. 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

75. 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.

76. As at 31 December 2020 the Council had balances amounting to £36,105,188. The monies held are significantly higher than would normally be expected and include monies that the Council is holding in respect of a number of grant schemes – some £6m of which is due to be repaid to government shortly.

77. Priority is given to security and liquidity of investments in order to reduce counterparty risk to the maximum possible extent. To this end at the start of the Covid-19 crisis special arrangements were made with the Council's bankers to be able to accommodate larger than normal balances and daily transaction amounts associated with the government's business grant schemes. The Council is again in the position to ensure that its cash balances are spread across numerous counterparties.

78. The Council has had various investment 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 Link Treasury 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.

79. The Eurozone and Brexit 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 was anticipated but the higher returns that were on offer are no longer there.

80. The pandemic has impacted on countries around the world and in turn on credit ratings. The Council follows the Credit ratings of Link Treasury services and the ratings now enable the Council to invest £5m with any one institution with a minimum short term rating of F (rather than F+), and a long term rating of A+ and above (Unchanged), supported by a red (6 month) rating. The changes are reflected in the updated Treasury Management Practices (updated as at 7 January 2021).

Investment Strategy – Property Fund

81. 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-20	Aug-20	Apr-20	Dec-19	Dec-18	Dec-17	Apr-17
Offer Price p	306.91	301.67	310.33	322.7	329.35	319.44	307.19
Net Asset Value p	287.5	282.6	290.71	302.3	308.53	299.24	287.77
Bid Price p	283.05	278.22	286.2	297.61	303.75	294.60	283.31
Dividend* on XD Date p	3.1	0	0	3.21	3.32	3.38	
Dividend* - Last 12 Months p	12.26	12.72	13.06	13.12	12.98	13.71	13.19
Dividend Yield on NAV %	4.27	4.5	4.49	4.34	4.21	4.58	4.58
Fund Size £m	1172.6	1152.4	1185.5	1200.1	1,099.0	930.8	710.2

82. The dividend yield is around 4.27% p.a. on the net asset value. Dividends for the first 3 quarters of 2020/21 amount to £58,622 (£63,783 at the same point last year). Full year dividends for 2020/21 are estimated at around £78,000 and a similar return is anticipated for 2021/22.

Table: CCLA - Property Fund Capital Value

Units (651,063)	Dec-20	Aug-20	Apr-20	Dec-19	Dec-18	Dec-17	Apr-17
Mid Market Price(£)	1,871,806.13	1,839,904	1,892,705	1,968,163	2,008,724.67	1,948,240.92	1,873,564.00
Bid Price (£)	1,842,833.82	1,811,387	1,863,342	1,937,629	1,977,603.86	1,918,031.60	1,844,526.59

83. The Capital value is similar to that of April 2017 when the original investment was made and continues to recover from the low point experienced in August 2020 following the impact of Covid-19. 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

84. 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 had recovered from the initial investment where charges are effectively deducted and was valued at £3,012,479 at the end of December 2019. In March 2020 the market value had fallen to £2.62m but continues to recover and is currently valued at £2.863m (95.45% of its original value). Dividend yield on price is 3.36% for December 2020 (3.15% December 2019). Dividends payable for the first 3 quarters of 2020/21 amount to £73,632. It should be remembered that this is a long term investment and prices can go up and down.

Investment Strategy – View on Interest Rates

85. Investment returns look set to stay flat for many months. However thereafter they could begin to increase if the economy shows signs of growth. The Council at this time needs access to its cash reserves and as such cannot afford to invest further longer term – until it achieves a balanced budget or has capital receipts.

Investment Return Expectations.

86. Bank Rate is forecast to stay low for the foreseeable future, with no increase potentially before 2024. However, the financial position can often change quickly, and the Council needs to be prepared for increases in rates as well as potentially negative interest rates.

87. 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.

Regeneration and Economic Development – Income Generation

88. The Council has remained keen to pursue capital schemes that also generate income. Substantial investments 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.

89. 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.

90. The income generation proposals relating to the Housing Company have required revenue loans to be provided – now repaid in full. Such funding was not available from the Public Works Loan Board and was therefore from existing Council reserves and balances. The rates of interest that are charged to the company 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

91. 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

92. 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.

93. **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.

94. **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.

95. 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.

96. 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

97. Please see Appendix 9.

Role of the Section 151 Officer

98. 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 2021/22

The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2008/9 and will assess the MRP for 2021/22 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 2021/22 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 2021 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.

Where the Council generates additional income from capital Investments it 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 2020 – March 2024

Link Group Interest Rate View	9.11.20							(The Capital Economics forecasts were done 11.11.20)						
	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	1.80	1.80	1.80	1.80	1.80	1.90	1.90	1.90	1.90	1.90	2.00	2.00	2.00	2.00
10 yr PWLB	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30	2.30	2.30	2.30	2.30
25 yr PWLB	2.50	2.50	2.60	2.60	2.60	2.60	2.70	2.70	2.70	2.70	2.80	2.80	2.80	2.80
50 yr PWLB	2.30	2.30	2.40	2.40	2.40	2.40	2.50	2.50	2.50	2.50	2.60	2.60	2.60	2.60
Bank Rate														
Link	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Capital Economics	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
5yr PWLB Rate														
Link	1.80	1.80	1.80	1.80	1.80	1.90	1.90	1.90	1.90	1.90	2.00	2.00	2.00	2.00
Capital Economics	1.90	1.90	1.90	1.90	1.90	1.90	1.90	1.90	1.90	-	-	-	-	-
10yr PWLB Rate														
Link	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30	2.30	2.30	2.30	2.30
Capital Economics	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	-	-	-	-	-
25yr PWLB Rate														
Link	2.50	2.50	2.60	2.60	2.60	2.60	2.70	2.70	2.70	2.70	2.80	2.80	2.80	2.80
Capital Economics	2.80	2.80	2.80	2.80	2.80	2.80	2.80	2.80	2.80	-	-	-	-	-
50yr PWLB Rate														
Link	2.30	2.30	2.40	2.40	2.40	2.40	2.50	2.50	2.50	2.50	2.60	2.60	2.60	2.60
Capital Economics	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70	-	-	-	-	-

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 Treasury Services)

ECONOMIC BACKGROUND

- **UK.** The Bank of England's Monetary Policy Committee has kept **Bank Rate** unchanged. However, it revised its economic forecasts to take account of a second national lockdown from 5th November to 2nd December which is obviously going to put back economic recovery and do further damage to the economy. It therefore decided to do a further tranche of **quantitative easing (QE) of £150bn**, to start in January when the current programme of £300bn of QE announced in March to June, runs out. It did this so that "announcing further asset purchases now should support the economy and help to ensure the unavoidable near-term slowdown in activity was not amplified by a tightening in monetary conditions that could slow the return of inflation to the target".
- Its forecasts appeared, at the time, to be rather optimistic in terms of three areas:
  - The economy would recover to reach its pre-pandemic level in Q1 2022
  - The Bank also expects there to be excess demand in the economy by Q4 2022.
  - CPI inflation is therefore projected to be a bit above its 2% target by the start of 2023 and the "inflation risks were judged to be balanced".
- Significantly, there was no mention of **negative interest rates** in the minutes or Monetary Policy Report, suggesting that the MPC remains some way from being persuaded of the case for such a policy, at least for the next 6 -12 months. However, rather than saying that it "stands ready to adjust monetary policy", the MPC this time said that it will take "whatever additional action was necessary to achieve its remit". The latter seems stronger and wider and may indicate the Bank's willingness to embrace new tools.
- One key addition to **the Bank's forward guidance** in August was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. Our Bank Rate forecast currently shows no increase through to quarter 1 2024 but there could well be no increase during the next five years due to the slow rate of recovery of the economy and the need for the Government to see the burden of the elevated debt to GDP ratio falling significantly. **Inflation** is unlikely to pose a threat requiring increases in Bank Rate during this period as there is likely to be spare capacity in the economy for a considerable time. It is expected to briefly peak at around 2% towards the end of 2021, but this is a temporary short lived factor and so not a concern.
- However, the minutes did contain several references to **downside risks**. The MPC reiterated that the "recovery would take time, and the risks around the GDP projection were judged to be skewed to the downside". It also said "the risk of a more persistent period of elevated unemployment remained material". Downside risks could well include severe restrictions remaining in place in some form during the rest of December and most of January too. That could involve some or all of the lockdown being extended beyond 2nd December, a temporary relaxation of restrictions over Christmas, a resumption of the lockdown in January and lots of regions being subject

to Tier 3 restrictions when the lockdown ends. Hopefully, restrictions should progressively ease during the spring. It is only to be expected that some businesses that have barely survived the first lockdown, will fail to survive the second lockdown, especially those businesses that depend on a surge of business in the run up to Christmas each year. This will mean that there will be some level of further permanent loss of economic activity, although the extension of the furlough scheme to the end of 31st March will limit the degree of damage done.

- As for **upside risks**, we have been waiting expectantly for news that various **COVID19 vaccines** would be cleared as being safe and effective for administering to the general public. The Pfizer announcement on 9th November was very encouraging as its 90% effectiveness was much higher than the 50-60% rate of effectiveness of flu vaccines which might otherwise have been expected. However, their phase three trials are still only two-thirds complete. More data needs to be collected to make sure there are no serious side effects. We don't know exactly how long immunity will last or whether it is effective across all age groups. The Pfizer vaccine specifically also has demanding cold storage requirements of minus 70C that might make it more difficult to roll out. However, the logistics of production and deployment can surely be worked out over the next few months.

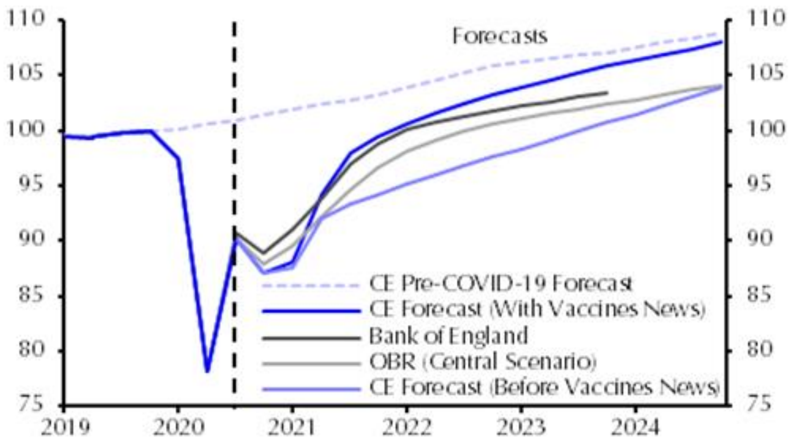
- However, there has been even further encouraging news since then with another two vaccines announcing high success rates. Together, these three announcements have enormously boosted confidence that **life could largely return to normal during the second half of 2021**, with activity in the still-depressed sectors like restaurants, travel and hotels returning to their pre-pandemic levels, which would help to bring the unemployment rate down. With the household saving rate currently being exceptionally high, there is plenty of pent-up demand and purchasing power stored up for these services. A comprehensive roll-out of vaccines might take into late 2021 to fully complete; but if these vaccines prove to be highly effective, then there is a possibility that restrictions could begin to be eased, possibly in Q2 2021, once vulnerable people and front-line workers had been vaccinated. At that point, there would be less reason to fear that hospitals could become overwhelmed any more. Effective vaccines would radically improve the economic outlook once they have been widely administered; it may allow GDP to rise to its pre-virus level a year earlier than otherwise and mean that the unemployment rate peaks at 7% next year instead of 9%. But while this would reduce the need for more QE and/or negative interest rates, increases in Bank Rate would still remain some years away. There is also a potential question as to whether the relatively optimistic outlook of the Monetary Policy Report was swayed by making positive assumptions around effective vaccines being available soon. It should also be borne in mind that as effective vaccines will take time to administer, economic news could well get worse before it starts getting better.

- **Public borrowing** is now forecast by the Office for Budget Responsibility (the OBR) to reach £394bn in the current financial year, the highest ever peace time deficit and equivalent to 19% of GDP. In normal times, such an increase in total gilt issuance would lead to a rise in gilt yields, and so PWLB rates. However, the QE done by the Bank of England has depressed gilt yields to historic low levels, (as has similarly occurred with QE and debt issued in the US, the EU and Japan). This means that new UK debt being issued, and this is being done across the whole yield curve in all maturities, is locking in those historic low levels through until maturity. In addition, the UK has one of the longest average maturities for its entire debt portfolio, of any country in the world. Overall, this means that the total interest bill paid by the

Government is manageable despite the huge increase in the total amount of debt. The OBR was also forecasting that the government will still be running a budget deficit of £102bn (3.9% of GDP) by 2025/26. However, initial impressions are that they have taken a pessimistic view of the impact that vaccines could make in the speed of economic recovery.

- Overall, **the pace of recovery** was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp but after a disappointing increase in GDP of only 2.1% in August, this left the economy still 9.2% smaller than in February; this suggested that the economic recovery was running out of steam after recovering 64% of its total fall during the crisis. The last three months of 2020 were originally expected to show zero growth due to the impact of widespread local lockdowns, consumers probably remaining cautious in spending, and uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year also being a headwind. However, the second national lockdown starting on 5th November for one month is expected to depress GDP by 8% in November while the rebound in December is likely to be muted and vulnerable to the previously mentioned downside risks. It was expected that the second national lockdown would push back recovery of GDP to pre pandemic levels by six months and into sometime during 2023. However, the graph below shows what Capital Economics forecast will happen now that there is high confidence that successful vaccines will be widely administered in the UK in the first half of 2021; this would cause a much quicker recovery than in their previous forecasts.

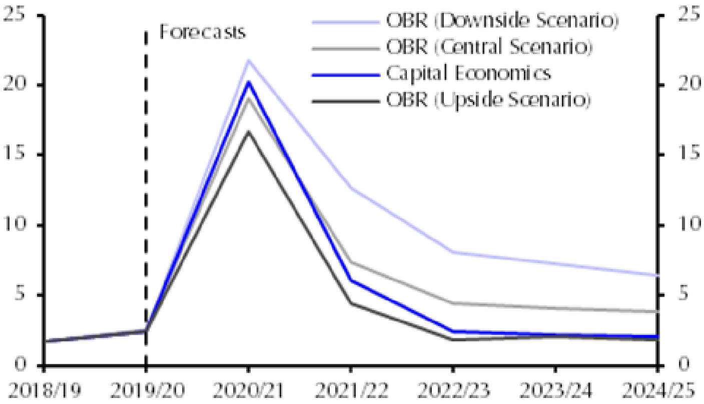
Chart: Level of real GDP (Q4 2019 = 100)



(if unable to print in colour…... the key describing each line in the above graph is in sequential order from top to bottom in parallel with the lines in the graph.

This recovery of growth which eliminates the effects of the pandemic by about the middle of the decade would have major repercussions for public finances as it would be consistent with the government deficit falling to 2% of GDP without any tax increases. This would be in line with the OBR's most optimistic forecast in the graph below, rather than their current central scenario which predicts a 4% deficit due to assuming much slower growth. However, Capital Economics forecasts assume that there is a reasonable Brexit deal and also that politicians do not raise taxes or embark on major austerity measures and so, (perversely!), depress economic growth and recovery.

Chart: Public Sector Net Borrowing (As a % of GDP)



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- Capital Economics have not revised their forecasts for Bank Rate or gilt yields after this major revision of their forecasts for the speed of recovery of economic growth, as they are also forecasting that inflation is unlikely to be a significant threat and so gilt yields are unlikely to rise significantly from current levels.

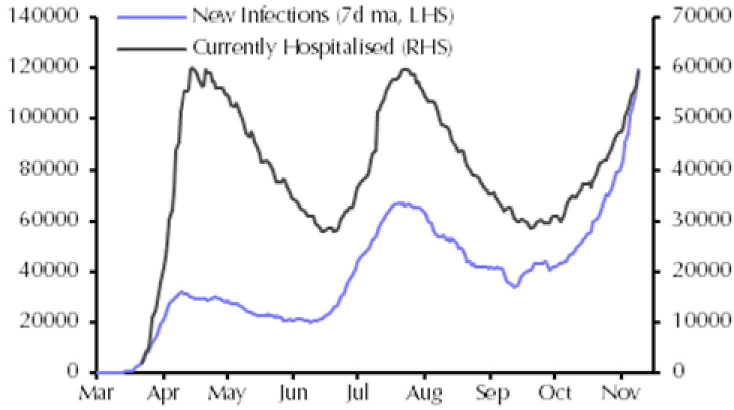
- There will still be some **painful longer term adjustments** as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever, even if vaccines are fully successful in overcoming the current virus. There is also likely to be a reversal of globalisation as this crisis has exposed how vulnerable long-distance supply chains are. On the other hand, digital services are one area that has already seen huge growth.

- The **Financial Policy Committee** (FPC) report on 6th August revised down their expected credit losses for the banking sector to "somewhat less than £80bn". It stated that in its assessment "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

US. The result of **the November elections** means that while the Democrats have gained the presidency and a majority in the House of Representatives, it looks as if the Republicans will retain their slim majority in the Senate. This means that the Democrats will not be able to do a massive fiscal stimulus, as they had been hoping to do after the elections, as they will have to get agreement from the Republicans. That would have resulted in another surge of debt issuance and could have put particular upward pressure on debt yields – which could then have also put upward pressure on gilt yields. On the other hand, equity prices leapt up on 9th November on the first news of a successful vaccine and have risen further during November as more vaccines announced successful results. This could cause a big shift in investor sentiment i.e. a swing to sell out of government debt to buy into equities which would normally be expected to cause debt prices to fall and yields to rise. However, the rise in yields has been quite muted so far and it is too early to say whether the Fed would feel it necessary to take action to suppress any further rise in debt yields. It is likely that the next two years, and possibly four years in the US, could be a political stalemate where neither party can do anything radical.

The economy had been recovering quite strongly from its contraction in 2020 of 10.2% due to the **pandemic** with GDP only 3.5% below its pre-pandemic level and the unemployment rate dropping below 7%. However, the rise in new cases during quarter 4, to the highest level since mid-August, suggests that the US could be in the early stages of a third wave. While the first wave in March and April was concentrated in the Northeast, and the second wave in the South and West, the latest wave has been driven by a growing outbreak in the Midwest. The latest upturn poses a threat that the recovery in the economy could stall. This is **the single biggest downside risk** to the shorter term outlook – a more widespread and severe wave of infections over the winter months, which is compounded by the impact of the regular flu season and, as a consequence, threatens to overwhelm health care facilities. Under those circumstances, states might feel it necessary to return to more draconian lockdowns.

COVID-19 New infections & hospitalisations



However, with the likelihood that highly effective vaccines are going to become progressively widely administered during 2021, this should mean that life will start to return to normal during quarter 2 of 2021. Consequently, there should be a sharp pick-up in growth during that quarter and a rapid return to the pre-pandemic level of growth by the end of the year.

After Chair Jerome Powell unveiled the **Fed's adoption of a flexible average inflation target** in his Jackson Hole speech in late August, the mid-September meeting of the Fed agreed by a majority to a toned down version of the new inflation target in his speech - that *"it would likely be appropriate to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation had risen to 2% and was on track to moderately exceed 2% for some time."* This change was aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary “trap” like Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade, (and this year), so financial markets took note that higher levels of inflation are likely to be in the pipeline; long-term bond yields duly rose after the meeting. The Fed also called on Congress to end its political disagreement over providing more support for the unemployed as there is a limit to what monetary policy can do compared to more directed central government fiscal policy. The FOMC’s updated economic and rate projections in mid-September showed that officials expect to leave the fed funds rate at near-zero until at least end-2023 and probably for another year or two beyond that. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal. The Fed's meeting on 5 November was unremarkable - but at a politically sensitive time around the elections.

EU. The economy was recovering well towards the end of Q2 and into Q3 after a sharp drop in GDP caused by the virus, (e.g. France 18.9%, Italy 17.6%). However, growth is likely to stagnate during Q4, and Q1 of 2021, as a second wave of the virus has affected many countries, and is likely to hit hardest those countries more dependent on tourism. The €750bn fiscal support package eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support, and quickly enough, to make an appreciable difference in the worst affected countries. With inflation expected to be unlikely to get much above 1% over the next two years, the ECB has been struggling to get inflation up to its 2% target. It is currently unlikely that it will cut its central rate even further into negative territory from -0.5%, although the ECB has stated that it retains this as a possible tool to use. It is therefore expected that it will have to provide more monetary policy support through more quantitative easing purchases of bonds in the absence of sufficient fiscal support from governments. The current PEPP scheme of €1,350bn of QE which started in March 2020 is providing protection to the sovereign bond yields of weaker countries like Italy. There is therefore unlikely to be a euro crisis while the ECB is able to maintain this level of support. However, the PEPP scheme is regarded as being a temporary measure during this crisis so it may need to be increased once the first PEPP runs out during early 2021. It could also decide to focus on using the Asset Purchase Programme to make more monthly purchases, rather than the PEPP scheme, and it does have other monetary policy options.

However, as in the UK and the US, the advent of highly effective vaccines will be a game changer, although growth will struggle during the closing and opening quarters of this year and next year respectively before it finally breaks through into strong growth in quarters 2 and 3. The ECB will now have to review whether more monetary support will be required to help recovery in the shorter term or to help individual countries more badly impacted by the pandemic.

China. After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and then into Q3 and Q4; this has enabled China to recover all of the contraction in Q1. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth. At the same time, China's economy has benefited from the shift towards online spending by consumers in developed markets. These factors help to explain its comparative outperformance compared to western economies.

However, this was achieved by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns in the longer term. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.

Japan. Japan's success in containing the virus without imposing draconian restrictions on activity should enable a faster return to pre-virus levels of output than in many major economies. While the second wave of the virus has been abating, the economy has been continuing to recover at a reasonable pace from its earlier total contraction of 8.5% in GDP. However, there now appears to be the early stages of the start of a third wave. It has also been struggling to get out of a deflation trap for many years and to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. There has also been little progress on fundamental reform of the economy. The change of Prime Minister is not expected to result in any significant change in economic policy.

World growth. While Latin America and India have, until recently, been hotspots for virus infections, infection rates have begun to stabilise. World growth will be in recession this year. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

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.

Summary

Central banks are, therefore, likely to support growth by maintaining loose monetary policy through keeping rates very low for longer. Governments could also help a quicker recovery by providing more fiscal support for their economies at a time when total debt is affordable due to the very low rates of interest. They will also need to avoid significant increases in taxation or austerity measures that depress demand in their economies.

If there is a huge surge in investor confidence as a result of successful vaccines which leads to a major switch out of government bonds into equities, which, in turn, causes government debt yields to rise, then there will be pressure on central banks to actively manage debt yields by further QE purchases of government debt; this would help to suppress the rise in debt yields and so keep the total interest bill on greatly expanded government debt portfolios within manageable parameters. It is also the main alternative to a programme of austerity.

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	2019/20	2020/21	2021/22	2022/23	2023/24
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt					
borrowing	95,000	110,000	110,000	110,000	110,000
other long term liabilities	5,000	5,000	5,000	5,000	5,000
TOTAL	100,000	115,000	115,000	115,000	115,000
Operational Boundary for external debt					
borrowing	85,000	105,000	105,000	105,000	105,000
other long term liabilities	5,000	5,000	5,000	5,000	5,000
TOTAL	90,000	110,000	110,000	110,000	110,000

Interest Rate Exposures		2020/21	2021/22	2022/23
		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 2021/22				
			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 2021/22				
			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	2019/20 Actual	2020/21 Original.Est	2020/21 Rev.Est	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Financing Costs	£'000	£'000	£'000	£'000	£'000	£'000
1. Interest Charged to General Fund	1,810	2,315	1,914	2,115	2,326	2,414
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	0
4. Interest and Investment Income	-580	-667	-551	-608	-671	-660
5. Amounts payable or receivable in respect of financial derivatives	-	-	-	-	-	-
6. MRP, VRP	1,176	1,499	1,685	1,873	2,520	2,531
7. Depreciation/Impairment that are charged to the amount to be met from government grants and local taxpayers	-	-	-	-	-	-
Total	2,406	3,147	3,048	3,380	4,175	4,285
Net Revenue Stream						
Amount to be met from government grants and local taxpayers	13,329	13,063	14,845	13,845	13,058	13,273
Ratio						
Financing Cost to Net Revenue Stream	**18%**	**24%**	**21%**	**24%**	**32%**	**32%**

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 had an income generation strategy that has resulted in increased Capital expenditure over the period 2017/18 to 2021/22. The above ratio does not take into account the income is being generated from the initiatives and commercial property acquisitions.

Other Prudential Indicators

Internal Borrowing and Gearing ratios for the authority are included in the Capital Strategy.

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 beyond 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 24.12.2020)

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

2. AA+
    - Finland
    - Canada

3. AA
    - Abu Dhabi (UAE)
    - France

4. AA-
    - Belgium
    - Qatar
    - U.K.

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 (2021/22)

Introduction

1. The CIPFA revised Prudential and Treasury Management Codes require 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 continuing to evolve 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 2021/22

10. The Council's Capital programme amounts to some £21.2m (£12.3m net of grants and contributions) in 2021/22. The major areas of expenditure include**:-**

(i) Buckshole Reservoir (£837,000 of which £160,000 is expected to be spent in 2021/22)
The January 2020 Cabinet approved works to improve the spillway design and to change the drawdown operation.

(ii) Energy Initiatives – Ground Mounted Solar & Solar Panels (£3.884m of which some £400,000 is expected to be spent in 2021/22)
The ground mounted solar project consists firstly of a number of feasibility reports. If feasibility studies are positive, then an investment of some £1.9m may result in 2022/23 providing cost savings and an income stream to the Council (£284,000 being spent in 2021/22).

There remains a sum of £1.638m earmarked currently for solar panels (£200,000 in 2021/22) and a further £2.116m remains unallocated for energy related projects. Any plans for spending these monies will need business cases along with separate Cabinet and Council approval.

(iii) Commercial Property – Lacuna Place (£347,000 of which £188,000 is expected to be spent in 2021/22)
In line with the strategic priority of economic and physical regeneration this funding will look to develop the ground floor of this Council owned property. The ground floor has remained vacant, with no main services and has been boarded up for many years. The works are intended to bring the property up to a lettable standard in order to enhance the area and provide new jobs as well as secure new income and business rates for the Council, which in turn will help to sustain services within the borough.

(iv) Electric Vehicles (£468,000 of which £86,000 is expected to be spent in 2021/22)
A number of vehicles have been identified as requiring replacement. The Council will seek to replace with electric vehicles. The replacement programme will be reviewed and updated on a regular basis (currently does not extend beyond 2021/22 requirements).

(v) Priory Meadow Contribution to capital works (£538,000 of which £250,000 may be spent in 2020/21)
The Council owns 10% of the Priory Meadow shopping centre. The money represents its share of any capital investment costs for 2021/22. 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 (£1,011,000 of which £179,000 is expected to be spent in 2021/22)
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) Churchfield Business Centre (£3.3m of which some £3.169 m is expected to be spent in 2021/22)

The development of a business incubator hub (27 units) at Sidney Little Road. Original estimates of £3.3m are currently included in the Capital programme. Very significant levels of external funding are required to make the construction of these units viable within Hastings – given the low rental values that areas of high deprivation generally command. Currently some £800,000 of external funding is secured.

(viii) Playgrounds Upgrade (£86,000 in 2021/22)
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 £5.697m is expected to be spent in 2021/22)
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 shortly. 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 (£881,000 of which £222,000 is expected to be spent in 2021/22)
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. The works to the road/roof may not be completed until 2022.

(xi) Priory St Multi Storey Car Park (£140,000 of which £25,000 is expected to be spent in 2021/22)
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 (£70,000 groyne refurbishment funded by HBC and £470,000 of works funded by Defra/Environment Agency)
Preserving sea defences and the town is a key priority. This work is mostly 100% grant funded. The Council funds the groyne refurbishment/ sea defence works and sets aside £35,000 p.a. for this – sometimes packaged together over several years.

(xiii) Public Realm (£31,000)
In line with the strategic priorities of an attractive town, the Council is allocating £31,000 to seek to maintain the fabric of the town e.g. signposting, benches, seats, planters, highway and lighting improvements.

(xiv) Disabled Facility Grants (£1.812m (Est) – all grant funding)
Property related grants for adapting homes. In 2020/21 the Council will receive funding approaching £2.056m. The figure for 2021/22 is not yet known – but is not expected to be less.

(xv) Harold Place (£1.2m of which £1.171m is expected to be spent in 2021/22)
The development of this key Council owned site for a restaurant/café.

(xvi) Cornwallis Street Development (£7m of which £6.946m is expected to be spent in 2021/22)
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. The expenditure may well fall into 2022/23 as well – subject to planning and contract requirements.

(xvii) Castleham Industrial Units (£140,000 in 2021/22)
This is a major refurbishment project to over-roof units 6,7,8 & 9/10

(xviii) Electric Vehicles (£468,000 of which £86,000 is expected to be spent in 2021/22)
A number of vehicles have been identified as requiring replacement. The Council will seek to replace with electric vehicles. The replacement programme will be reviewed and updated on a regular basis (currently does not extend beyond 2021/22 requirements).

Capital Expenditure 2022/23

11. The main areas of expenditure in 2022/23 are Priory Meadow – contribution to capital costs (£288,000), Energy (£1.9m potentially for ground mounted solar, £1.438m potentially for solar panels, £2.116m unallocated), potential loans to Hastings Housing Company (£3.881m), Disabled Facility Grants (£1.8m), Buckshole Reservoir (£467,000), Groyne refurbishment (£35,000), Empty Homes (£50,000), Lower Bexhill Road (£70,000).

Capital Expenditure 2023/24

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

Summarised Capital Expenditure and Funding (2020-21 (Revised) to 2023-24)

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

	Revised 2020/21 £'000s	2021/22 £'000s	2022/23 £'000s	2023/24 £'000s
Gross Capital Expenditure	13,863	21,263	12,145	1,959
Net Capital Expenditure	9,252	12,331	10,306	120
Financing from own resources	4	125	216	120
Borrowing Requirement	9,248	12,206	10,090	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 2021.

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)

	2019/20 Actual	2020/21 (Est)	2021/22 (Est)	2022/23 (Est)	2023/24 (Est)
	£'000s	£'000s	£'000s	£'000s	£'000s
CFR- Opening	58,094	66,373	74,122	84,643	92,800
less MRP	(1,176)	(1,499)	(1,685)	(1,933)	(2,520)
Plus New Borrowing	9,455	9,248	12,206	10,090	0
CFR- Closing	66,373	74,122	84,643	92,800	90,280

18. The table above highlights that by 2022/23 the level of debt will have increased to some £92.8m (subject to viability and the approval of schemes within the Capital programme).

Revenue Consequences of the Capital Programme on the General Fund

19. Borrowing has long term revenue consequences. The debt, currently £64.69m 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 £172.457m at 31 March 2020 (£158.774m as at 31 March 2019).

Financial Risk Management

20. 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

21. 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.

22. Where borrowing money to finance economic development or regeneration schemes the Council is increasingly dependent upon the income streams to finance the debt repayments. No matter how good the business cases, 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.

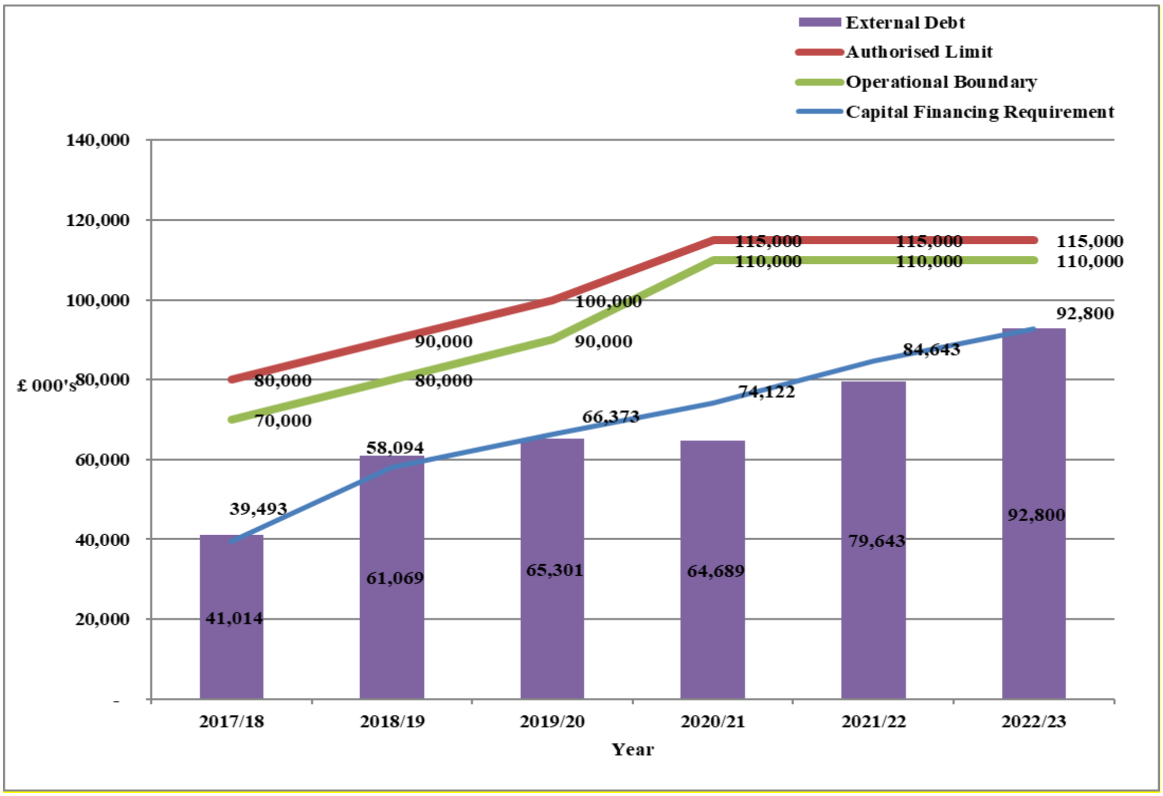
23. To arrive at an overall borrowing level (Authorised and Operational borrowing limits), the Council needs to take a considered view of its other potential liabilities, future borrowing requirements, guarantees and loans given, bad debts, claims against the Council, future funding, and security and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

24. Based on the existing Capital programme, by 2023/24 interest on debt will amount to some £2.41m p.a. with capital repayments (MRP) of £2.52m; offset by income & interest. This represents some 32% of the net revenue stream (amount met from government grants and local taxpayers). Interest on debt is estimated at £2.115m for 2021/22.

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

26. 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



27. 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 a further £3m tranche of monies in a diversified investment fund in 2020/21.

28. In terms of asset backed investments and projects e.g. involving commercial property and housing, the business cases 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.

29. 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

30. 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	£156,196	Annuity
The Source	2.43%	17/12/2015	16/12/2024	£13,254	Annuity
			Total	**£1,957,685**	

31. The above table excludes a series of loan to the Hastings Housing Company in respect of property purchases. As at 31 December 2020 the Capital loans amount to £5,489,398. The company has access to a revenue loan facility from the Council; the company fully repaid the revenue loan.

32. 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.

33. 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

34. 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.

35. The Council's General and Earmarked reserves are set to fall further over the forthcoming 12 months. The balance at 1 April 2020 was some £18.055m (unaudited). At the 31 March 2021 the projected balance is some £15.923m with the balance at the end of 2021/22 amounting to some £13.2m. If Disabled Facility Grant monies are excluded the balance at the end of 2021/22 reduces to an estimated £11.15m.

36. 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.

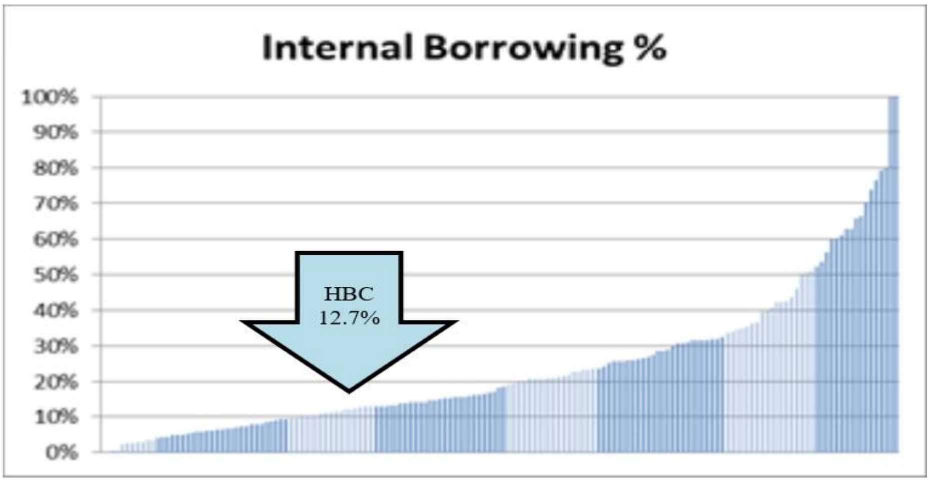
Risk Appetite & Prudential Indicators

Internal Borrowing

37. 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 from reserves) to temporarily fund the assets.

38. 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)



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

40. For Hastings BC the Council has previously 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. Currently, with interest rates looking set to continue at very low levels for the near future, a higher level of internal borrowing has temporarily been adopted.

41. For 2020/21 the level of internal borrowing by year end is expected to be £9.433m out of a total borrowing requirement of some £74.122m (12.7%)

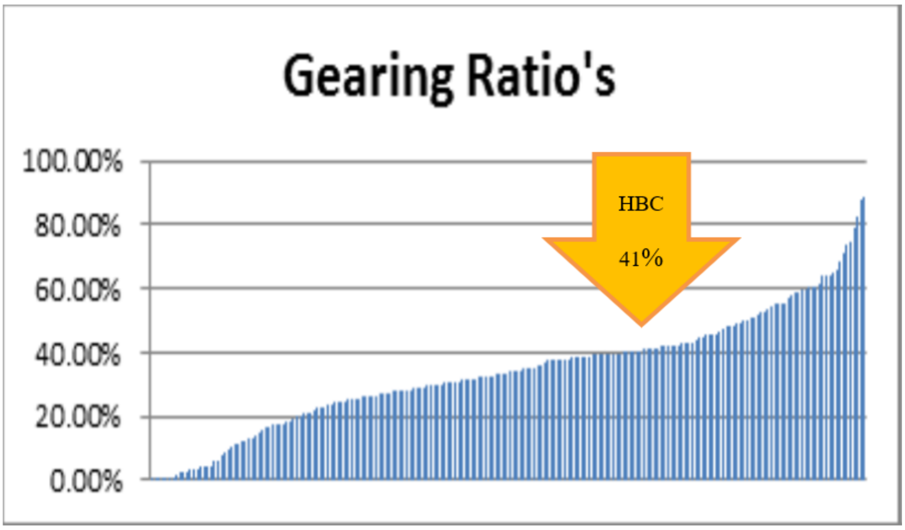
Gearing

42. 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.

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

44. Due to the nature of assets held, services provided and historical debt decisions, positions will vary across different types of authority, and many authorities the ratios will have increased since 2017/18.However, it still provides a useful comparator.

Table: Gearing ratios in Councils (Link Treasury Service's Client Base)



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

46. 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%.

47. For Hastings, the gearing ratio of debt (CFR) to long term assets is set to remain at 41% in 2021/22 (assuming no changes to asset valuations and Capital programme). When compared against the net assets of the authority the ratio increases to some 94% in 2021/22.

48. 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 (all is now at fixed rates).

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)			9,252	12,331	10,306	120	
New borrowing			9,248	12,206	10,306	120	
Net Assets	73,497	84,981	84,985	85,110	85,110	85,110	85,110
Long Term Assets	158,774	172,457	181,709	194,040	204,346	204,466	224,397
Capital Financing Requirement	58,094	66,373	74,122	79,643	92,800	90,280	110,000
RATIOS:							
Debt: Net Assets	**79%**	**78%**	**87%**	**94%**	**109%**	**106%**	**129%**
Debt: Long Term Assets	**37%**	**38%**	**41%**	**41%**	**45%**	**44%**	**49%**

49. 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 49%.

50. 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.

51. 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.

52. The government revised their lending criteria for the Public Works Loan Board (PWLB) on the 25 November 2020 which effectively prevents Councils from borrowing for commercial property investments where the primary purpose is to make a return (yield). The Council has no intention of purchasing commercial property primarily for yield and were it to consider doing so it would need to seek full Council approval to do so.

Ratio of Financing Costs to Net Revenue Stream

53. 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.

54. In Hasting's case the ratio of financing costs in 2021/22 represents, 24%, of the Net Revenue Stream (Appendix 1), which only leaves 76% of the revenue stream for all the other services to be provided. The higher the percentage, therefore, the less is left for running services.

55. 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 (Increases to 32% by 2022/23).

56. 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.

57. 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?

58. The Council's expenditure plans are evolving and there are numerous potential projects that the Council will be involved in over the next few years.

Bexhill Road – lower tier site

59. 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.

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

61. 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 shortly on viability and how to proceed with the scheme e.g. joint venture, sale of land. 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)

62. The Council has a substantial plot of undeveloped industrial land. There is potential to develop the site – subject to obtaining additional grant funding.

Plot 1 – 29 Starter Units (now included in Capital Programme)
Plot 2 – 6 factory units (some 265 sqm each)
Plot 3 – 3 to 8 factory units (flexible sizes)

63. The initial estimates identified construction costs for the 3 sites at some £10m. Some 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

64. 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

65. 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 council agreed last year to pursue the sale of such sites (unless an alternative viable option is identified that generates similar revenue streams within the same timescales).

Bohemia

66. The Travel lodge site looked likely to progress to redevelopment, along with the construction of a significant number of new properties. Covid-19 has impacted on the project and negotiations.

67. The development of the remaining area of Bohemia is currently on hold whilst the Towns Fund bid is developed along with a new development Plan for the borough.

Towns Fund

68. The Council is in the process of finalising its Town Investment plan to take advantage of the £3.6bn Towns Fund announced by the Prime Minister in July 2019. The intention of the fund is to help drive sustainable economic regeneration for long term economic and productivity growth.

69. The Council's bid will be submitted in 2021, and it is understood to include a very wide range of projects that will also draw in external investment. The Council will be involved in a range of these and there are expected to be calls for very significant projects to be included in the Capital programme – to be delivered over the next 6 years. Such projects could include, for example, a new leisure centre.

Commercial Property/ Housing/Energy Initiatives

70. The Capital programme includes new monies for 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.

Other Expenditure

71. There are other items of expenditure that the Council needs to be conscious of when considering future budgets.

These include:

- Priory Street multi-Storey Car Park - Major refurbishment (£1.4m 2025/26)
- Playground – Repair and Refurbishment (£50,000 p.a. 2022/23 onwards)
- Public Realm (no specific projects yet identified in current programme)
- DSO Street cleaning vehicle replacement (£1m -£3m in 2025/26 and every 7 - 10 years thereafter)
- Cliff works – Programmed and reactive repairs (£50,000 - £100,000 p.a. initially financed from the Renewal and Repairs Reserve. Future replacement of catch fencing could result in expenditure of £1m+ within the next 20 years).
- West Marina – Ministry of Defence Site and Ex-Stamco site; the potential to acquire the site and develop it will be explored further.

Corporate Governance Arrangements – Project Approval Process

72. 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.

73. 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.

74. 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).

75. 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 2020 the Council's Long term Assets were valued at some £172m whilst debt (CFR) amounted to some £65m.

76. 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

77. 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 2020/21 the expected spend amounts to £697,300 and in 2021/22 it is estimated at £850,500. As a result of expenditure exceeding income the balance on the reserve is expected to fall from £1.556m at 31 March 2020 to some £1.07m by the end of March 2022.

Information Technology Reserve

78. 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.

79. 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.

80. The Council contributes £214,000 p.a. into the fund. The expenditure is estimated at £147,000 in 2020/21 and £248,000 in 2021/22(Please see budget).

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 at some major economic development and regeneration schemes.

87. The Council will wish to progress developments rapidly following outline planning permission - particularly of its own land. Given the scale of some of the

developments and 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 for 2022/23.

89. The investments that may be made in Energy, Housing 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 2021/22 are subject to public consultation from January 2021.

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	2019/20 Actual	2020/21 Original.Est	2020/21 Rev.Est	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Financing Costs	£'000	£'000	£'000	£'000	£'000	£'000
1. Interest Charged to General Fund	1,810	2,315	1,914	2,115	2,326	2,414
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	0
4. Interest and Investment Income	-580	-667	-551	-608	-671	-660
5. Amounts payable or receivable in respect of financial derivatives	-	-	-	-	-	-
6. MRP, VRP	1,176	1,499	1,685	1,873	2,520	2,531
7. Depreciation/Impairment that are charged to the amount to be met from government grants and local taxpayers	-	-	-	-	-	-
Total	2,406	3,147	3,048	3,380	4,175	4,285
Net Revenue Stream						
Amount to be met from government grants and local taxpayers	13,329	13,063	14,845	13,845	13,058	13,273
Ratio						
Financing Cost to Net Revenue Stream	**18%**	**24%**	**21%**	**24%**	**32%**	**32%**

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Agenda Item 7

Report to: Audit Committee

Date of Meeting: 21 January 2021

Report Title: Chief Auditor's Summary Audit and Risk Report

Report By: Tom Davies
Chief Auditor

Purpose of Report

To inform the Audit Committee of the key findings from the National Fraud Initiative Council Tax to Electoral Roll matching exercise.

Recommendation(s)

1. That the Audit Committee accepts the report.

Reasons for Recommendations

To monitor levels of control within the organisation.

Summary Report to Audit Committee

National Fraud Initiative Council Tax Single Person Discount Data Matching Exercise

Background

1. Single Person Discount (SPD) is a 25% reduction in Council Tax liability for occupants who are the only adult residing at a property. There are currently 17,000 people in the borough claiming SPD and the total value of these discounts amounts to £6.7million per year.

2. It is therefore imperative that Single Person Discounts are awarded correctly and entitlement to SPD is regularly reviewed.

3. The purpose of the National Fraud Initiative (NFI) data matching exercise is to prevent and detect fraud, whilst also identifying potential issues caused by administrative error.

4. The main NFI data matching exercise is conducted every two years and compares computer records, held by Hastings Borough Council, with data from organisations such as Her Majesty's Revenue & Customs (HMRC); Department for Work and Pensions (DWP); National Health Service, and other local authorities.

5. In addition, separate matching exercises are conducted annually that compare the following data-sets:

   * Council Tax Single Person Discount records with occupants listed on the Council's electoral register;
   * Council Tax Single Person Discount records with those nearing the age of 18;
   * Council Tax Single Person Discount records with HMRC household composition records;

6. This audit has concentrated on examining matches within the "Council Tax Single Person Discount to Electoral Register" data-set in order to gain assurance that Council Tax records are accurate and Single Person Discounts (SPD) should continue to be awarded for those cases where a match has occurred.

Audit Conclusion

Overall Audit Assessment: B – Satisfactory.

Some controls are in place to ensure SPD is awarded correctly and that entitlement is regularly reviewed. Additional controls are due to be re-introduced at the start of the 2021/22 financial year.

Key Findings

* The audit examined 1,164 matches and found that SPD records were correct in approximately 59% (686) of the cases.

* For approximately 40% (469) of the cases, data from the electoral register did not match the Council Tax records of either a current or previous occupant(s) at the address in question. Additionally, there was no trace on the Northgate Revenues & Benefits system of the occupant(s) at any other address. In such cases, further enquiries would be required in order to confirm the correct occupant(s) at each specific address.

* Of the remaining matches examined, audit identified nine instances where SPD had been awarded incorrectly. The principal cause of these errors was often where a partner had joined a household and SPD had not been cancelled from that point.

* Other errors included occasions where information on the Council Tax Reduction (CTR) claim had not been transferred to the Council Tax account correctly. An example of this is a case where the CTR claim confirmed that a non-dependant adult occupied the household, but the Council Tax account showed a Single Person Discount.

* The total value of SPD awarded in error amounted to £7,572 and in all nine cases, the Council Tax payer was re-billed for the correct amount.

* The recent Council Tax Reduction (CTR) audit confirmed that Single Person Discount entitlement is an area regularly checked by Quality Assurance officers, when reviewing CTR assessment calculations.

* Audit have discussed the findings of the NFI exercise with the Revenues and Benefits Service Manager. It was agreed that further reminders and training would be given to staff in order to ensure SPD entitlement is reviewed whenever there is a change to occupants and CTR is in payment.

* Although SPD entitlement is regularly reviewed for those individuals in receipt of CTR, a separate exercise must be conducted to review the entitlement of recipients who do not fall within this category.

* Single Person Discount reviews have previously been undertaken on behalf of the Council and other Local Authorities in East Sussex by a company called Datatank Ltd.

* The Hastings Borough Council (HBC) Council Tax web page contains details of a current Datatank SPD exercise that was intended to remain in operation for the period 2020/21.

* The aim of this exercise was to:

  + confirm the discount for genuine claimants efficiently and;
  + accurately remove ineligible or incorrect claims and increase revenue for the Council.

* In order to achieve these outcomes, Datatank utilise a combination of Council data, third party data sources and specialist validation services.

* However, the audit has confirmed that, due to the current COVID-19 situation, it was not possible for the Revenues and Benefits Service Manager to finalise the details of the exercise and its implementation has therefore been postponed until the start of the 2021/22 financial year.

* Audit are satisfied that a targeted review of SPD entitlement will be conducted as soon as possible, as this will further strengthen controls for ensuring SPD is correctly awarded to those recipients who are not in receipt of CTR.

* It is also encouraging that further steps are being taken to provide additional training and reminders are given to staff that SPD entitlement should be reviewed whenever a change to occupants occurs where CTR is in payment.

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Wards Affected

None

Policy Implications

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

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

Additional Information

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Officer to Contact

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