

14th JANUARY 2019

CAPITAL & INVESTMENT STRATEGY

REPORT OF THE HEAD OF FINANCE

1. PURPOSE OF REPORT

1.1 To approve:-

- 1) a Capital Strategy
- 2) an Investment Strategy (including the Treasury Management Strategy)
- 3) the Treasury Management Policy
- 4) the Council's Minimum Revenue Provision (MRP) policy
- 5) Prudential Indicators for 2019/20, 2020/21 & 2021/22

2. NEED FOR A DECISION

- 2.1 It is required by part 1 of the Local Government Act 2003, related statutory guidance, Prudential code for Capital Finance in Local Authorities and CIPFA code of practice for Treasury Management in the public sector that the Council approves a number of policies and strategies in advance of the next financial year.
- 2.2 The Authority is also required under the Local Authorities (Capital Finance and Accounting) (England) (Amendment) regulations 2008 to prepare an annual statement of their policy on making MRP for submission to full Council.

3. RECOMMENDATION

- 3.1 That the following strategies and policies be approved for recommendation to Council:-
 1. The Capital Strategy (Appendix 1)
 2. The Investment Strategy (Appendix 2)
 3. The Treasury Management Policy (Appendix 3)
 4. The Council's Minimum Revenue Provision Policy (Appendix 4)
 5. The Prudential Indicators (Appendix 5)
- 3.2 That an Operational Boundary for external debt of £173m, £179m and £172m and an Authorised Limit for external debt of £181m, £187m and £180m for the financial years 2019/20, 2020/21 and 2021/22 respectively be approved for recommendation to Council.

4. **BACKGROUND AND/OR DETAILS**

- 4.1 The Council has previously been required to set both a Treasury Management Policy and Minimum Revenue Provision (MRP) Policy along with a suite of prudential indicators prior to the start of the new financial year.
- 4.2 Following recent updates of both the Prudential Code for Capital Finance in Local Authorities and the CIPFA Code of Practice for Treasury Management in the Public Sector, councils now need to produce both a capital strategy and investment strategy reflecting the requirements of these documents as well as the related Statutory Guidance on Local Government Investments.
- 4.3 There is no prescribed way in which the disclosures need to be made in order to satisfy the various publications but it is felt that reporting them all together would aid understanding of how they complement each other as a whole.

5. **OPTIONS CONSIDERED**

5.1 The Capital Strategy (Appendix 1)

5.1.1 In order to demonstrate that we take capital and investment decisions in line with service objectives and properly take account of stewardship, value for money, prudence, sustainability and affordability we need to put in place a capital strategy that sets out the long term context in which capital expenditure and investment decisions are made giving due consideration to both risk and reward and the impact on the achievement of priority outcomes.

5.1.2 The purpose of the capital strategy is therefore to:-

- ensure capital expenditure is aligned with the Council's priorities
- maximise the use of resources
- provide a clear framework for decisions relating to capital expenditure
- establish a corporate approach to generating capital resources

5.1.3 The appended strategy builds on the initial one that was agreed as part of the Medium Term Financial Strategy (MTFS) and also contains the Council's approach to the flexible use of capital receipts outside of the Capital Programme. This provides the Section 151 Officer with authority to use capital receipts to meet one-off transformation costs provided they are in accordance with the strategy and in the best interest of the Council in terms of the use of its overall resources.

5.2 The Investment Strategy (Appendix 2)

5.2.1 It has been normal practice for the Council to agree a Treasury Management Strategy and Policy before the start of the new financial year in keeping with the CIPFA Code of Practice.

5.2.2 Following concerns expressed by the National Audit Office and Public Accounts Committee, the Government has recently issued additional statutory guidance on local authority investments. This requires local authorities to publish a wider-ranging annual investment strategy. This strategy must incorporate both traditional treasury management activities as well as non-financial investments (which are essentially property investments bought for profit).

Financial/Treasury Management Strategy

5.2.3 The Treasury Management Policy and suite of Prudential Indicators are the Council's overarching guidelines for Treasury activities providing a framework within which the Council's Treasury function must operate. The Treasury Management Strategy on the other hand is the planned approach of operation consistent with those policies.

5.2.4 Any borrowings or investments carried out will therefore be within the limits as set out in those policies. It is felt that the basic strategy outlined in Appendix 2 will minimise risk, reduce short and long term interest costs to the Council but maximise investment income whilst providing sufficient flexibility to respond to movements in the economy and interest rates when they occur.

Non-financial (Property) Investment Strategy

5.2.5 Apart from historically holding a small number of investment properties, the Council has not yet embarked on the purchase or investment in other properties unlike many other local authorities. At Budget Council in February 2018 a saving was agreed based on an additional £300k annual profit from property investment. Within the MTFS agreed at Council 19th September 2018, Members therefore approved an investment sum of £15m. Although the Government is considering whether it needs to make further interventions to restrict local authority commercial borrowing the proposals in the strategy are within existing flexibilities and are not of the scale undertaken in some local authorities.

5.2.6 The strategy in Appendix 2 re-affirms and builds on the initial strategy approved within the MTFS. The strategy details the advice that the Council will need to procure, due diligence that is required, our investment criteria for each property and governance arrangements.

5.3 Treasury Management Policy (Appendix 3)

5.3.1 The Treasury Management Policy flows from the Investment Strategy and is, apart from normal annual updating, primarily the same as contained within last year's report to Cabinet on the 15th January 2018. The main change recommended in this year's policy is the reduction in the limits that apply to the Council's top three categories of counterparty reflecting the risk of potentially concentrating investments in any one of these as a result of smaller (and reducing) cash balances at the Council. The impact on the categories involved means that limits have reduced from £20m to £15m, £15m to £10m and from £10m to £8m.

5.4 The Council's Minimum Revenue Provision Policy (Appendix 4)

5.4.1 Capital expenditure incurred by the Council can be paid for from grants or capital receipts, but sometimes the expenditure is financed by "credit arrangements" such as borrowing or leasing. Local authorities are required to pay off these credit arrangements (or debt) by charging an amount to their revenue budget each year. This is called the Minimum Revenue Provision (MRP).

5.4.2 The MRP policy that is being recommended for approval is set out in Appendix 4 and is a continuation of the practices agreed previously. In summary, the Council will set aside 2% of its Capital Financing Requirement (CFR) each year as its MRP on outstanding capital expenditure previously supported by Government. For capital expenditure financed by prudential borrowing or under a PFI arrangement, MRP will be based on the life of the assets created. It is also recommended that the Council only begins to charge MRP into its accounts the year after a capital asset first becomes operational. The policy delegates authority to the Head of Finance to make any changes to MRP if overpayments from previous years are identified.

5.5 Prudential Indicators for 2019/20 to 2021/22 (Appendix 5)

5.5.1 Under the Prudential Code for Capital Finance in Local Authorities, before the start of each financial year, the Council is required to set its prudential indicators for the forthcoming and following two years.

5.5.2 The prudential indicators shown in Appendix 5 are consistent with the plans and approach taken in the Capital Strategy, Investment Strategy and MRP Policy recommended within this report. The majority of the indicators are estimates and actuals relating to capital expenditure/financing as well as borrowing costs compared to the Authority's overall budget and these are for members to note.

5.5.3 In addition to these there are two limits relating to the debt ceiling which also need formally approving to give members assurance and control over the borrowings of an authority. The Council's Operational Boundary (expected level) for external debt is recommended to be £173m, £179m & £172m for the financial years 2019/20, 2020/21 and 2021/22 respectively. Authorised Limits (maximum debt levels) of £181m, £187m and £180m for the financial years 2019/20, 2020/21 and 2021/22 respectively are also being recommended.

6. **FINANCIAL IMPLICATIONS**

6.1 The implications are contained within the report and are reflected in the 2019/20 revenue budget.

7. **LEGAL IMPLICATIONS**

7.1 Due to the nature of this report there are no legal implications

8. **CONSULTATION**

8.1 Although no direct consultation has been carried out, the report is in keeping with previous years and builds on the strategy set out in the Medium Term Financial Strategy that was approved by Council 19th September 2018. Information has also been collected from financial brokers and institutions.

9. **ENVIRONMENT, HEALTH AND ECONOMIC IMPLICATIONS**

9.1 None arising out of this report.

10. EQUALITY AND DIVERSITY

10.1 None arising out of this report.

11. SUMMARY AND RECOMMENDATIONS

11.1 To approve the Capital Strategy detailed in Appendix 1 of this report.

11.2 The report sets revised prudential indicators and recommends a continuation of existing Council policy. The prudential code supports the system of capital investment and Local Government in a publicly accountable manner. The Authority is required to abide by the prudential code and the resulting limits it sets itself. Calderdale is not, however, bound to the indicators set in this report if they are subsequently found not to be in the interests of the Authority. In these circumstances a report will be brought to Members to either amend the limits already set or to recommend the instigation of management action to ensure that the current limits are not breached.

11.3 The report recommends that the Minimum Revenue Provision policy contained within Appendix 4 of the report be approved.

11.4 The report recommends that an Operational boundary for external debt of £173m, £179m and £172m and an Authorised limit for external debt of £181m, £187m and £180m for the financial years 2019/20, 2020/21 and 2021/22 be approved.

11.5 The report and amended policy includes an investment strategy to deal with the purchase of commercial properties which was agreed in the Medium Term Financial Strategy which went to Cabinet on the 3rd September 2018 and subsequently approved by Council on the 19th September 2018.

11.6 The report recommends that it be recommended to Council that the Capital Strategy 2019/20, the Prudential indicators 2019/20, 2020/21 & 2021/22 and the Treasury Management and Investment strategy and Policy 2019/20 are approved.

FOR FURTHER INFORMATION ON THIS REPORT CONTACT:

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DOCUMENTS USED IN THE PREPARATION OF THIS REPORT:

1. CIPFA's Code of Practice on Treasury Management 2017
2. CIPFA's Code of practice for Prudential Indicators 2017
3. 2018/19 Annual Strategy Report
4. 2018/19 Prudential indicators report
5. The Medium Term Financial Strategy 2019/20

DOCUMENTS ARE AVAILABLE FOR INSPECTION AT:

Finance Services, Westgate House, Halifax, HX1 1PS

CAPITAL STRATEGY

1 Introduction

- 1.1 The Prudential code for Capital Finance in Local Authorities was updated by the Chartered Institute of Public Finance and Accountancy (CIPFA) in December 2017. The framework established by the Prudential Code supports local strategic planning, local asset management planning and proper option appraisal.
- 1.2 The objectives of the Prudential Code are to ensure that the capital expenditure plans of local authorities are affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good professional practice and in full understanding of the risks involved.
- 1.3 The Prudential code requires authorities to look at capital expenditure and investment plans in the light of overall organisational strategy and resources and ensure that decisions are made with sufficient regard to the long run financing implications and potential risks to the authority.
- 1.4 The Prudential code sets out that, in order to demonstrate that the authority takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability, authorities should have in place a capital strategy. The capital strategy should set out the long term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.
- 1.5 This capital strategy sets out the framework for the self-management of capital finance and involves the following areas.
 - Capital Expenditure and investment plans
 - Prudential indicators
 - External debt
 - Treasury Management

The purpose of the capital strategy is:-

- To ensure capital expenditure is aligned with the Council's priorities
- To maximise the use of resources
- To provide a clear framework for decisions relating to capital expenditure
- To establish a corporate approach to generating capital resources

2 Calderdale's Approach to Maximising Capital Funding

- 2.1 Around three quarters of the Council's capital programme is currently funded by Government grant or other external funding without calling upon the Council's resources, for example, the West Yorkshire Transport scheme is fully funded by grant. This will be drawn down as the scheme progresses through various approval stages.

- 2.2 The Council is selective in the bids it makes for external funding by ensuring consistency with its corporate priorities and financial strategies, i.e. there is still a risk of cost overruns as grant funding is usually cash limited. The Council has a forward programme of capital receipts covering surplus property, planned release of accommodation and development opportunities. The asset management team manages the disposals process drawing on expertise from the Council's Planning, Legal, Land & Property services and Finance Services.
- 2.3 The Council's property policy is to rationalise the property portfolio (for example as part of the asset management review) and provide fewer buildings, which are maintained to a better standard, which are fit for purpose and provide better access to services. The capital receipts generated from this rationalisation process along with other surplus assets are re-invested according to the Council's priorities.
- 2.4 Most grant funding is un-ringfenced. Council policy is still to passport most of this funding to specific work programmes and therefore virtually all of this is directed towards major priority areas. All other schemes rely principally on external support (e.g. securing grant funding), prudential borrowing or the pool of capital receipts (funding raised by the sale of Council assets).

3 The use of Capital Resources

- 3.1 The Council's approach to prioritising the use of capital expenditure and resources can be summarised as follows:-
- (a) For major annual programmes of work funded by specific Government allocations or where Members have chosen to passport resources in Schools, Highways and Housing to maintain the allocation of grant funding broadly in line with the earmarked Government allocations. Programmes for this work are determined once allocations are finalised and the funding is prioritised according to the overarching strategies and needs in those areas within the resources allocated.
 - (b) To progress projects which are fully funded and which therefore will have no effect on the Council's overall capital financing position. This includes schemes which are funded by grants or which will be financed by prudential borrowing. Capital projects which are fully funded or self-financing, can be referred to Cabinet for inclusion in the capital programme at any time (subject to them still meeting the objectives of the Council). The appraisal process for schemes which are partly funded or for which there is no funding in place are considered as part of the prioritisation process outlined below.
 - (c) To prioritise all other schemes within the remaining level of capital resources available to the Council over the planned period.
- 3.2 As part of the November 2015 Spending Review, the Government announced that it would introduce flexibility for the period of the Spending Review for local authorities to use capital receipts from the sale of non-housing assets to fund the revenue costs of service reform and transformation. Statutory guidance on the use of this flexibility was issued in March 2016 which applies to the

financial years 2016/17 through to 2019/20. In the Provisional Local Government Settlement 2018/19 (announced 19 December 2017) the Government confirmed that the flexibility to use capital receipts to help meet the revenue costs of transformation will be extended for a further 3 years to April 2022. The Guidance requires local authorities to prepare, publish and maintain a Flexible Use of capital receipts Strategy. This part of the Capital Strategy constitutes the Calderdale Council Strategy.

- 3.3 The Guidance provides a definition of expenditure which qualifies to be funded from the capital receipts flexibility. Qualifying expenditure is expenditure on any project that is designed to generate on-going revenue savings in the delivery of public services and/or transform service delivery to reduce costs and/or transform service delivery in a way that reduces costs or demand for services in future years for any of the public sector delivery partners.
- 3.4 There are a wide range of projects that could generate qualifying expenditure. The key determining criterion to use when deciding whether expenditure can be funded by the capital receipts flexibility is that it is forecast to generate ongoing savings to an authority's net service expenditure. Within the above definition, it is for individual local authorities to decide whether or not a project qualifies for the flexibility. The Guidance sets out examples of qualifying expenditure which includes "funding the cost of service reconfiguration, restructuring or rationalisation (staff or non-staff), where this leads to ongoing efficiency savings or service transformation" and it is for this purpose that the Council is proposing to use capital receipts.
- 3.5 The Council intends to use capital receipts to fund or part fund a number of types of project (subject to sufficient capital receipts being generated and the flexibility being required). Specific approval of projects and allocation of funds arising from the use of flexible capital receipts will however ultimately be at the discretion of the Section 151 Officer, but will include voluntary retirement/severance or other costs associated with service transformation in accordance with the strategy.
- 3.6 The Future Workforce Programme recognises that people are key to the Council achieving improvement in its services and it is essential that the Council has the right people, with the right skills, in the right place and at the right time to maintain and improve existing and future service outcomes and generate efficiencies. Capital receipts may be used to fund the upfront costs of residual elements of this scheme designed to generate on-going savings of £5.5m including the release of employees on Voluntary Severance/Early Retirement following the assessment and approval of a business case.
- 3.7 Various reviews of service are underway to reshape the delivery of activities within, for example, Early Intervention/Prevention, Business Support, Transport, Adult Social Care and Children's Services to provide a more targeted approach to the provision of services that is focussed on improved customer outcomes and delivered within a sustainable financial envelope. It is therefore proposed that the costs associated with staff leaving the Council through service reconfiguration from 2018/19 until the end of the period covered by the statutory guidance should be funded through the Flexible Use

of Capital Receipts. It is also proposed that any in-year capital receipts received which exceed the amount required to cover the release cost of these staff be used to fund revenue funded activities which are being incurred to support the Council's service development and delivery of savings and efficiencies. The legitimacy of this use will be determined by the s151 Officer in order to ensure that it meets the requirements set out by the Secretary of State.

- 3.8 The Council will have due regard to the requirements of the Prudential Code and the impact on its prudential indicators from implementing any proposed projects. As transformation proposals develop and the cost associated with them is incurred this will be included in the Council's Capital Programme to be funded by capital receipts generated in the financial year. The capital expenditure prudential indicators will be amended and approved as appropriate.
- 3.9 The Council will also have due regard to the Local Authority Accounting Code of Practice when determining and including the entries required from undertaking and funding this scheme within the Council's Statement of Accounts.
- 3.10 The strategy will be monitored throughout the financial year and may be updated and replaced as proposals are developed and expenditure is incurred. The flexible use of capital receipts strategy will only be used however if the costs are in accordance with the above categories and in the best interest of the Council in terms of the use of its overall resources.

4 Prioritisation of Surplus Resources

- 4.1 The Capital Strategy demonstrates and sets the framework for how the Council's Capital Programme supports its corporate priorities. In order to prioritise the allocation of the available resources Members will consider the extent to which schemes contribute to the Vision 2024 or the Council's agreed outcomes:

- Growing the economy
- Reducing inequalities
- Building a sustainable future

- 4.2 Cabinet will also need to consider in this prioritisation underlying criteria around value for money, necessity (e.g. fire safety works) and customer impact. It is assumed that any schemes that come forward requesting prudential borrowing approval, on a self-financing basis, will be considered separately on the strength of the business case and risks presented.

5 Links to Other Strategies

- 5.1 The four year Capital Programme includes £48.6m of forecast expenditure to be funded by prudential borrowing, with the majority of this spend being on the Street Lighting LED project, Northgate redevelopment, transport fleet replacement, the asset review programme and the concluding elements of the

three major town centre schemes. The annual cost of servicing this borrowing is £2.0m. This has either been specifically budgeted for (£0.4 m) in the revenue budget or is due to be met from savings expected to be delivered by the schemes (£1.6m).

- 5.2 Council has additionally agreed to include within the MTFS the revenue implications of prudential borrowing of up to £10m. Effectively this provided “headroom” within the Capital Programme to fund priority capital schemes which would not necessarily be self-financing, i.e. would not generate sufficient income or cost savings to pay for the associated prudential borrowing. There is currently £2.2m available within the capital programme but of this £2.0m is being reserved to offset additional prudential borrowing on the town centre schemes.
- 5.3 The capital programme outside of the externally funded schemes is financed mainly from capital receipts from the disposal of surplus assets held by the Council and any prudential borrowing agreed by Members to be included in the MTFS. The revenue implications of the capital programme in terms of the cost of borrowing have been built into the MTFS. The sponsoring directorates accommodate within their revenue budgets the on-going revenue implications in terms of additional costs/income associated with the investment. The MTFS makes assumptions about the level of interest rates that the Council will pay on its borrowings and the period over which it will pay these (the Minimum Revenue Position or MRP). These assumptions around revenue related capital programme costs are in line with the Prudential Code and Treasury Management strategy both of which form part of this report.
- 5.4 The capital strategy is subject to continuous review and has been prepared in collaboration with other directorates to ensure that it is consistent with the MTFS, which has itself been reviewed and updated. The revenue implications of the capital strategy have also been built into the MTFS.

6 Monitoring and Review of Capital Investment

- 6.1 Capital investment activities are reported four times a year to Cabinet giving details of its overall shape, the progress being made and the funding flexibility available over the forecast period to promote new schemes. The report focuses on the cost, associated funding of schemes, delivery dates and provides an update on other major issues especially on the more significant schemes within the programme.

7. The Capital Budget Forecast

7.1 *Background*

- 7.1.1 As highlighted above, the Council’s capital strategy is to maximise the use of resources, to provide a clear framework for decisions relating to capital expenditure and to establish a corporate approach to generating capital resources.

7.1.2 Capital expenditure relates to spending on assets which are to be used by the Council over the long term. This includes the buying of equipment and the purchase, construction or improvement of land and buildings. The current programme includes provision for the Council's major projects including the replacement of Halifax Pool, Street Lighting LED replacement and the West Yorkshire Transport Fund schemes. These key projects alone will result in an investment in the area well over £75m with the economic and environmental benefits of this investment continuing far into the future.

7.2 *Forecast Expenditure*

7.2.1 It is currently expected that over the 4 year period to the end of 2021/22 the Council will be spending around £200m on the schemes below. The figures do not include expenditure incurred in previous years or any additional expenditure yet to be approved.

- Major annual programmes of work funded by specific Government allocations, or where Members have chosen to “passport” resources:-
 - Schools (£38m)
 - Housing (£16m)
 - Roads (£21m)
 - Other rolling programmes of improvements, e.g. Council buildings, play areas and car parks (£10m)
 - Regeneration initiatives (£14m)
 - Other (£3m)
- One-off schemes previously committed:
 - West Yorkshire Transport Scheme (£68m)
 - Flood Prevention (£1m)
 - Flood Repairs (£2m)
 - Town Centre Office Strategy (£2m)
 - Halifax Pool (£2m)
 - Street Lighting LED Replacement (£22m)
 - Transport Fleet (£1m)

7.3 *Capital Resources*

7.3.1 The main elements of capital financing are: -

- i) Government-funded Grants
- ii) Prudential (Unsupported) Borrowing
- iii) Revenue and Reserves
- iv) Pooled Resources – Capital receipts

7.3.2 The largest proportion of Council capital spend is financed by Central Government grants. Although most of this is now un-ringfenced, Council policy is still to passport this to specific work programmes. Virtually all this funding is therefore directed towards school, road/transport and housing schemes as can be seen above. All other schemes rely principally on other external support, prudential borrowing or the pooling of capital receipts (funding raised by the sale of Council assets).

- 7.3.3 The Government no longer provides supported borrowing (i.e. where loan costs are paid to the Council through Revenue Support Grant) for new schemes. However, the Council has the power to supplement funding through prudential borrowing where it is proved to be sustainable (ideally backed by a valid business case) or funded from compensatory savings. When prudential borrowing is carried out the cost of this is charged to the revenue account as principal and interest. As mentioned previously, the Capital Programme includes over £48.6m of expenditure funded by prudential borrowing.
- 7.3.4 On-going development with partners to provide a joined up service is well established in Calderdale. The Council also works in partnership to maximise value for money and return on capital, examples of this are working with Heritage Lottery Fund (HLF), NHS organisations, West Yorkshire Combined Authority and Together Housing.
- 7.3.5 It is anticipated that after the highlighted deficit has been addressed there will be future capital resources available of £2.2million. There is £10million of additional prudential borrowing (funded by £500k annual revenue budget) of which £5.5million has been fully committed to supporting the capital programme and £2m earmarked for supporting the current year revenue budget. This leaves £2.5million which is currently retained as a corporate capital contingency against the significant capital schemes which are nearing completion or are in progress.
- 7.3.6 As a result total resources currently available are £2.2million, although, as said previously, this is being reserved to offset additional prudential borrowing on the Town Centre Schemes. It should also be remembered that other schemes either awaiting final approval from Council or being considered elsewhere on the agenda would reduce the available resources should they be agreed.

Overall Capital Financial Forecast

	2018/19 £m	2019/20 £m	2020/21 £m	2021/22 £m	Total £m
Directorate Spend:-					
Adult Services and Wellbeing	1.9	3.2	4.2	3.7	13.0
Children & Young People's Services	17.4	3.9	5.7	1.9	28.9
Public Services	2.3	0.4	0.2	0.3	3.2
Regeneration and Strategy	29.8	49.0	46.3	30.3	155.4
Total Expenditure	51.4	56.5	56.4	36.2	200.5
Financed by:-					
Grants and Contributions	37.4	25.6	43.9	35.7	142.6
Revenue Funding & Reserves	1.4	0.7			2.1
Ring fenced/Prudential Borrowing	10.0	26.3	12.0	0.4	48.7
Use of Pooled Resources	4.8				4.8
Total Capital Finance Available	53.6	52.6	55.8	36.1	198.2
Current Surplus (+) /Deficit (-)					-2.3
Potential Additional Resources:-					
Assumed Capital Receipts	0.3	2.4	1.8		4.5
Borrowing from Extra MTFS Resources	0	0	0		
Potential Available Capital Resources					2.2

TREASURY MANAGEMENT AND NON-FINANCIAL INVESTMENT STRATEGY 2019/20

1. Introduction and Background

- 1.1 On the 1 April 2002, the revised CIPFA code of practice for Treasury Management in the public sector came into being. The treasury management policy statement was revised and approved by Cabinet/Council at that time to take account of this.
- 1.2 In 2009 the Treasury Management Code was revised as Local Authority investments had been placed under the national spotlight following the collapse of the Icelandic banks.
- 1.3 CIPFA has revised the code of practice in 2017/18 which now recommends that Council's produce an investment strategy to include the purchase of commercial properties. The strategy should set out the main elements and criteria to adopt to provide a good overall balance between risk, rental and capital growth when acquiring investment properties.

2. Changes to the current Treasury Management strategy

- 2.1 The policy is assessed each year to ensure it complies with current legislation and that it maximises the financial benefits of the Council's borrowing and investing activities at the lowest possible risk.
- 2.2 The changes proposed to this year's policy is to review the counterparty limits to reflect the Council's reducing cash balances and to include the main elements and criteria to adopt when acquiring commercial investment properties.

3. Treasury Management Strategy for 2019/20

Interest Rates and the Economy

- 3.1 In order to maintain price stability the Government has set the Bank of England's Monetary Policy Committee (MPC) a 2% target for Consumer Price Index (CPI) inflation.
- 3.2 Currently, CPI inflation is running at 2.3%, and, largely as a result of the depreciation of sterling, inflation is expected to be higher throughout the next three years. The MPC's main tool to deal with heightened inflation would normally be to raise the base rate.
- 3.3 The Bank of England base rate started the 2018/19 financial year at 0.5% where it stayed until the 09 August 2018 when it was raised to 0.75% it has remained at this level up to the writing of this report.

- 3.4 Although it is not possible to accurately predict where the interest rate base rate is heading it is likely that the Bank of England will be cautious in its approach trying to strike a balance between unacceptably high inflation and low interest rates to support economic activity.
- 3.5 Any long term borrowing is at present carried out through the Public Works Loan Board (PWLB). The benchmark period that we compare against is 24.5 to 25 years (being mid-way between the shortest and longest borrowing periods available to the Council). At the start of the financial year 2018/19, the 24.5-25 year rate was 2.75% it steadily rose to just under 3.13% as at the 10 October 2018. It has fallen back to 2.85% as at the end of December 2018.

Basic Strategy

- 3.6 The overall strategy is to adhere to the Treasury Management Policy and to the Prudential Indicators. Any borrowings or investments carried out will be within the limits as set out in those policies.
- 3.7 At present any long term borrowing is only carried out for prudential (Council-financed) schemes as the Government has ended supported borrowing. If any borrowing is required it is usually borrowed from the PWLB. Other forms of borrowing could be explored but obviously any use of non-PWLB loans would be approached cautiously given the risks involved.
- 3.8 We have been in the situation of long term PWLB rates being a higher than short term (up to one year) money market rates for a number of years now so it has been cheaper to borrow (or reduce our investments) for short periods than to borrow long term. This strategy has helped us deliver significant savings against the Treasury Management budget.
- 3.9 However, rapidly reducing cash balances combined with PWLB rates that have now fallen to very attractive levels, mean that there is an opportunity to borrow long term again in 2019/20. The major capital schemes that we have carried out over the last few years have lowered cash balances to a level that we feel we now need to keep in reserve plus there is another raft of new capital schemes which are to be funded by prudential borrowing including Street Lighting and Northgate redevelopment. The Head of Finance has therefore taken the decision to continue to borrow in 2019/20 in the region of £25 million (depending on slippage of capital expenditure in 2018/19 and any new schemes that are approved after the date of this report).
- 3.10 It is proposed though to keep a watching brief on borrowing requirements and interest rate movements to borrow for the Council at an opportune time as possible. In the absence of clear evidence to support assumptions of movements in interest rates, the strategy will be to spread any long term borrowings over the year (i.e. pound cost averaging to minimise the risk of exposure to sudden fluctuations in interest rates).

- 3.11 It is also good practice for authorities to have smooth debt maturity profiles in order to reduce their exposure to a substantial borrowing requirement in a particular period in the future when interest rates might be high. The Council's current loans will mature relatively evenly in the future so the primary consideration on when to borrow money to will be based on which periods offer the best overall combination of low interest rates and long term certainty.
- 3.12 For information, the Authority's predicted debt profile can be found in Appendix 6 (N.B. this shows only those years in which the debt will mature). There are gaps between the years in the very long term as it is only recently that the PWLB have offered rates from 30 to 50 years so there will be opportunities to fill these gaps when borrowing in future years.

4. Commercial Property and Investment Strategy

- 4.1 Following concerns expressed by the National Audit Office and Public Accounts Committee, the Government has recently issued statutory guidance on local authority investments, which require local authorities to publish an annual investment strategy. The new guidance covers the following types of investment. The Government is also planning to discuss with treasury whether further interventions are needed to curb excessive local authority commercial borrowing.
- 4.2 Specified Investments – these are short term financial investments with Government, local authorities, parish council's or rated institutions. These are already covered by the Treasury Management strategy and policy.
- 4.3 Non Specified investments – these are financial investments in unrated institutions, such as small building societies and are also covered in the treasury management policy and strategy.
- 4.4 Loans – as part of the investment strategy the Council will be required to publish the total amount of loans it is prepared to make in any one year and how it will deal with any credit losses. These loans could be to community organisations but also local authority wholly owned companies. This will need to incorporate the planned loans to the Council's development company. The strategy should also include the basis for determining the rate of interest which should be charged on these loans which need to reflect the level of risk and liquidity of them. Given the proposals which have already been agreed by Council for the development company it is recommended that a limit on the total amount of loans be set at £10 million for 2019/20 and that the minimum rate of interest should be at least 1% above the rate at which the Council can borrow from the PWLB for the appropriate period. The limit to be applied to loans and the minimum interest rate to be charged will be reviewed and agreed each year as part of the Prudential indicators section in this report.
- 4.5 The strategy also needs to incorporate a set of criteria against which any loan applications should be assessed including for example to support local regeneration, economic benefit, in response to local market failure including the resilience of anchor organisations or for financial yield/profit. At this stage it is recommended that these criteria be used to determine any applications.

- 4.6 Non-financial investments – these are investments in assets which organisations hold primarily or partially to generate a profit including property investment. The prudential indicators section of this report will need to set limits and measures for the following:-
- An assessment of whether the fair value of the investment is sufficient to provide security against loss
 - Where this is not the case, what mitigating action can be taken by the Council
 - The Council's approach to assessing risk
 - The maximum period over which the investment will be committed
 - The assessment of the local authority's dependence on profit generating investments using various indicators
 - The criteria used for determining why the local authority is investing.

Commercial Property Investment Strategic Overview

- 4.7 For the Council, Commercial property investment is the purchase of already developed and income producing property. It is not the development of new property, refurbishment of existing property or an employment creator.
- 4.8 The Council has already agreed an income target of £300,000 per annum from year 2019/20 from commercial investment including the acquisition of property and other assets as part of the budget process. It is anticipated based on expected yields that investment of up to £15m may be required and therefore this investment has been added to the Council's Capital Programme.
- 4.9 The commercial property market is very well established with many specialist organisations involved. These include local investors, high net worth individuals, property companies and pension funds. As a result, the demand for commercial property investments is high with those involved being highly knowledgeable and experienced and, importantly, able to react quickly to opportunities that arise. Equally however a significant number of local authorities have also entered the property investment market in response to the continuation of public sector austerity.
- 4.10 The Council will require specialist external advice to determine certain aspects of the investment strategy. In particular advice on the current investment market, covenant strength, rent levels and yields. Legal advice may also be required to establish which type of company is best to purchase and hold the premises. The commercial property investment market works mainly on the basis of agent introductions where the agents will either be retained or un-retained to sell a particular property investment. Where they are retained they will obtain a fee from the seller. If they are un-retained then they will require an introductory fee which will be in the region of 1%.
- 4.11 It is therefore best to retain a company to act on the Council's behalf to ensure a flow of opportunities and so they can provide advice on any potential purchase as part of the due diligence process required for any investment. If a company is not retained then the Council would need to instruct a company

each time an opportunity arises which would cause a long delay to the procurement procedures.

Evaluation of Commercial Property Acquisitions

4.12 There are three main elements that need to be agreed so the Council can proceed to acquire investments:

- The Council's criteria for acquiring commercial property investments
- An evaluation matrix to be used as part of assessing the suitability of an investment based on the Council's criteria mentioned in point 1 above
- The decision making process for acquisition of investments

4.13 The main criteria that the Council will adopt to provide a good overall balance between risk, rental and capital growth are laid out in the following table:-

Criteria	Requirement
Geographical location	Anywhere in the UK. No geographical restriction provides a better chance of identifying opportunities and therefore acquiring property investments.
Type of property	Potentially all sectors. Retail, industrial, office, leisure and specialist (e.g. care homes) but market-led, i.e. which sectors offer the greatest potential
Risk profile	Low risk as far as possible to protect the Council's finances
Yield (return)	Low yield/lower risk. 2% - 6% net initial yield (not including costs of finance)
Tenant covenant strength	Financially strong tenant(s), again, to reduce risk
Type of tenant(s)	All types of tenant will be considered with no general bar on any tenant due to the activities they carry out (although this will be considered on an individual basis)
Governance	Decisions delegated to officers to act within parameters set out in the strategy. This will allow the Council to be competitive and reactive to opportunities within the market
How will the investment be held	Investment to be held by the Council not in a separate company.
Rental growth	Investments with a potential for an increase in rental value of the property during the period of ownership will be considered. This is normally driven by demand and/or availability of supply
Capital growth	This is not a pre-requisite but is driven by similar considerations as rental growth
Finance	Borrowing will be via the Public Works Loan Board (unless a better value alternative becomes apparent)

- 4.14 An evaluation matrix is to be used as part of assessing the suitability of an investment based on the Council's criteria as set out above. The Council needs to have an evaluation method to broadly assess suitability against its criteria once potential investments are identified. It is envisaged that this will be by way of an evaluation matrix, which will be the main tool to assess the investment. There will also be the need to take into account other objective and subjective information during the evaluation process.
- 4.15 Final details of the evaluation matrix and the authority to acquire commercial investment property are to be delegated to the Director of Regeneration and Strategy, the Head of Legal and Democratic Services and the Head of Finance in consultation with the Cabinet Member Resources, Performance & Business Change and the Cabinet Member Regeneration & Economic Strategy.
- 4.16 The commercial property investment market is very competitive requiring quick decisions on properties that come to the market. It is therefore essential that the Council puts in place a mechanism which ensures that it can make decisions swiftly and react quickly to opportunities that come to the market.
5. Other Considerations when Acquiring a Commercial Property
- 5.1 Proportionality - In terms of proportionality, as referred to in paragraph 5.2.5 of the covering report, the size of the planned investment is not of the scale undertaken in some local authorities.
- 5.2 The Government has suggested a range of indicators as a starting point for local authorities to work from. The Council will therefore develop a range of indicators as and when its investment property plans are more developed for members to consider.
- 5.3 Although the Authority is planning to invest approximately £15m, the revenue costs of this are not considered significant compared to the size of the revenue budget and reserves available to it should a short term contingency plan be needed whilst compensatory savings are found.
- 5.4 Full Council has already agreed a net saving of £300k based on this modest level of property investment, weighing up the level of risk versus the return the investment could generate. It was felt therefore that as the risk is relatively small compared to the benefits of using the surplus to safeguard vital services for the most vulnerable residents of the Borough.
- 5.5 The strategy also sets out very clearly how the due diligence process will work and if a property doesn't meet our expectations then the Council will be under no obligation to proceed. In addition, until market opportunities are sought and tested against our criteria, it is not yet known whether they will be sited outside of our region or within it thus providing further economic or social benefits which will accrue to our residents.

TREASURY MANAGEMENT POLICY

Treasury Management Policy Statement

1. The Authority defines Treasury Management activities as:-
The Management of the Local Authority's investments, cash flows, its banking, money market transactions; the effective control of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks.
2. The Authority 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 Authority.
3. The Authority 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 best value in Treasury Management, and to employing suitable performance measurement techniques, within the context of effective risk management.

Treasury Management Practices

1 Risk Management

The CIPFA code of practice identifies eight Treasury Management risks which are:-

A. Credit and counterparty risk

There is a risk of failure by a third party to meet its contractual obligations to the Authority. Excepting the Bank of England and the UK Government (which includes the Government's Debt management office for whom we do not set a limit) we minimise this risk by having limits for investments to the approved organisations below.

When referring to ratings it should be remembered that investments are made based on an organisation's rating at the time of the investment. However, Banks or Building Societies can be downgraded by the ratings agencies whilst we are holding the investment prior to it being repaid to the Council. This risk is mitigated by only dealing with the very highest rated Banks or Building Societies. Although the downgrading of a counterparty might only be to the next level down (which still might be a high rating) if it is not as high as the Council demands no further investments will be made to that counterparty until such time as its rating is revised back upwards to meet the Council's policy.

1 External specified investments are to be limited for a period of up to 1 year as follows:

a) MAXIMUM £15 MILLION

Specifically any of the four big clearing banks (HSBC, Royal Bank of Scotland, Barclays and Lloyds) with a short term rating of F1+ by Fitch and P-1 by Moody's combined with assets over £400 billion along with other Local Authorities.

b) MAXIMUM £10 MILLION

Specifically any of the four big clearing banks (HSBC, Royal Bank of Scotland, Barclays and Lloyds) with a short term rating of F1 by Fitch and P-1 by Moody's combined with assets over £400 billion.

c) MAXIMUM £8 MILLION

- (i) Any other institution authorised under the Banking Act 1987 with the minimum short term ratings of F1 from Fitch and P-1 from Moody's combined with assets over £100 billion.
- (ii) Building Societies (within the meaning of the Building Societies Act 1986) with gross assets over £100 billion combined with the minimum short term ratings of F1 from Fitch and P-1 from Moody's.

d) MAXIMUM £6 MILLION

- (i) Any other institution authorised under the Banking Act 1987 with any of the following combined ratings from both Fitch and Moody's F1/P-1, F1/P-2 and F2/P-1 also combined with assets over £20 billion.
- (ii) Building Societies (within the meaning of the Building Societies Act 1986) with any of the following combined ratings from both Fitch and Moody's F1/P-1, F1/P-2 and F2/P-1 also combined with assets over £20 billion.

e) MAXIMUM £4 MILLION

- (i) Any other institution authorised under the Banking Act 1987 with at least short term ratings of F2 from Fitch and P-2 from Moody's combined with assets over £5 billion.
- (ii) Building Societies (within the meaning of the Building Societies Act 1986) with gross assets over £5 billion combined with at least short term ratings of F2 from Fitch and P-2 from Moody's.

f) MAXIMUM £2 MILLION

- (i) Any other institution authorised under the Banking Act 1987 which are only rated by one of our ratings agencies should be at least short term

rated F2 by Fitch or P-2 by Moody's combined with assets over £1 billion.

- (ii) Building Societies (within the meaning of the Building Societies Act 1986) which are only rated by one of our ratings agencies should be at least short term rated F2 by Fitch or P-2 by Moody's combined with assets over £1 billion.

g) MAXIMUM £5 MILLION ON CALL

We currently have a call account facility with the Council's own bankers (Nat West) which means that we have instant access to our funds at any time. We propose to limit the amount in the call account to a maximum of £5 million at any one time.

2 External non-specified investments are to be limited for a period of up to 1 year as follows.

a) MAXIMUM £1.5 MILLION PER BUILDING SOCIETY WITH A MAXIMUM OF £6 MILLION IN TOTAL

Any Building society authorised under the Banking Act 1987 which are not rated by either of our ratings agencies combined with assets over £1 billion. These investments are termed as non-specified investments.

The Authority currently uses both Fitch and Moody's which are recognised as "relevant rating agencies" by the Securities and Futures Authority and are two of the three major international rating agencies and we refer to their websites every time we carry out an investment. The short term ratings of both companies which apply to our policy are set out below:-

	MINIMUM FITCH	MINIMUM MOODY'S		
Limits	Short term	Short term	Assets over	Grade Meaning
Maximum £15 million	F1+	P-1	£400 billion	Extremely strong grade
Maximum £10 million	F1	P-1	£400 billion	Very strong grade
Maximum £8 million	F1	P-1	£100 billion	Very strong grade
Maximum £6 million	F1/F2	P-1/P-2	£20 billion	Very strong grade
Maximum £4 million	F2	P-2	£5 billion	Strong grade
Maximum £2 million	Either F2	Or P-2	£1 billion	Strong grade

NOTE TO THE ABOVE If only one of the agencies actually rates a certain Bank or Building Society then that single rating will have to be at least F2 by Fitch or P-2 by Moody's.

3 Country Limits

a) MAXIMUM £10 MILLION

The criteria for lending to foreign-domiciled financial institutions would be firstly that the country in question would have to be rated AAA by Fitch and Aaa by Moody's. Secondly, the bank in that country would have to comply with the external specified policy above. Thirdly they would have to be incorporated within the UK or allowed to accept deposits through a branch in the UK. The maximum limit of £10 million per country would then apply. N.B. this limit doesn't apply to UK domiciled banks and building societies.

4 Group Limits

Any Bank or Building Society that we deal with which are owned by another one of our Counterparties will be subject to a group limit which is set at the highest limit attained by the parent Bank or Building Society. This means that if the parent company qualifies for a limit of £15 million and its subsidiary qualifies for a limit of £6 million then the limit for the two organisations together would be set at £15 million.

5 Other external investments for a period of up to 1 year as follows:

- (i) Gilt-edged Securities.
- (ii) Securities admitted to the official list of the stock exchange and in respect of which, all repayments of principal and interest are guaranteed by Her Majesty's Government.
- (iii) Money Market Funds
- (iv) Certificates of Deposit

6 External investments for a period longer than 364 days

Investment in the CCLA managed Local Authority Property Fund up to a maximum limit of £5 million.

With immediate effect investments in commercial property up to a maximum of £15 million.

7 External borrowings of periods up to 1 year

The Authority will only enter into short term external borrowings with the following:

- (i) The Bank of England or any other institution authorised under the Banking Act 1987.
- (ii) Building Societies (within the meaning of the Building Societies Act 1986).

- (iii) Persons or bodies listed in part II of schedule to the Local Authorities (Capital Finance approved investments) regulations 1990. These bodies are Local or Public Authorities and Public Corporations.

B. Liquidity risk

The Authority will have an effective cash flow forecasting and monitoring system which will identify the extent to which the authority is exposed to the effects of potential cash flow variations and shortfalls. Also the authority has access to the money markets and an overdraft facility with our bankers sufficient to meet most circumstances.

C. Interest rate risk

The Authority will obtain reliable and informed information and advice from brokers, the media and the internet on the likely future courses of interest rates, to enable us to assess the extent to which movements may impact on the authority and to permit the effective management and control of its exposures to the same. The Authority is required to set fixed and variable interest rate exposure limit indicators on its borrowings and investment principal sums outstanding which for 2019/20 are recommended as follows:

1 Fixed rate exposure

- (i) For Authorities that have no investments fixed debt would remain within 100% of net debt. However, Calderdale has short term investments due to a number of factors such as reserves and balances and a beneficial cash flow position at certain times of the year. Due to the formula to calculate this indicator, the Authority's fixed debt can exceed 100% of its net outstanding principal sums (i.e. fixed debt will be more than net overall debt).
- (ii) Therefore it is recommended that the Council sets an upper limit on its fixed rate exposure for 2019/20 of 115% of its net outstanding principal sums. This takes account of both Calderdale's particular expected position whilst providing the flexibility to take advantage of interest rate movements whilst limiting any potential exposure.
- (iii) If future Council decisions on expenditure are taken and the levels of investments fall significantly then a further report to members with a revised upper limit on fixed interest rate exposure may be necessary.

2 Variable interest rate exposure

- (i) It is further recommended that the Council sets an upper limit of its variable interest rate exposures for 2019/20 of 15% of its net outstanding principal sums. Again this will enable us to retain sufficient flexibility to cover our day to day obligations and take advantage of interest rate movements within an overall exposure limit.

D. Exchange rate risk

All transactions are conducted in GB pounds so therefore there is no exchange rate risk to the Authority.

E. Refinancing risk

The Authority will keep reliable records and forecasts of the terms and the maturities of its borrowings, capital projects and partnership funding, to allow the authority to plan the timing of, and successfully negotiate appropriate terms for its refinancing. Also to aid this, the Council will set upper and lower limits for the maturity structure of its borrowings so that when taking long term borrowing decisions the Council will consider the repayment date of new and existing loans. Repayable loans as a percentage of total debt will be kept within the limits indicated for the following periods.

Period	Lower limit	Upper limit
Under 12 months	0%	10%
12 months and within 24 months	0%	10%
24 months and within 5 years	0%	30%
5 years and within 10 years	0%	50%
10 years and above	50%	100%

These limits will provide a high degree of long term stability whilst retaining the flexibility of being able to smooth out the maturity profile of the Authority's debt when interest rates are in our favour so that the Council is not over exposed to the risks of re-financing large amounts of borrowing in periods when interest rates might be high or uncertain.

F. Legal and regulatory risk

This policy is an up to date record of our powers, and as the content describes, we do adhere to the CIPFA Code of Conduct for Treasury Management, relevant Finance Acts and Local Government Acts. We do issue copies of this policy to our counterparties if requested. We also only enter into transactions with counterparties as defined in A above (credit and counterparty risk).

G. Fraud, error, corruption and contingency management

To combat fraud, error and corruption we use the following control environment to create and maintain an effective audit trail.

- (i) A full analysis of all transactions and processes are kept for 7 years.
- (ii) We report to the relevant committee every 6 months on the progress of Treasury Management to keep members informed.
- (iii) Members of Audit Committee and the Portfolio Holder for Business Change & Customer Services will be kept fully informed of appropriate issues in the Treasury Management function.

- (iv) There is a stringent delegation of duties in that one person initiates the transaction, a different person checks it and a third person authorises it. We also have back up staff in case of staff absence.
- (v) An electronic version (with back-ups) are kept of all transactions.
- (vi) Sufficient insurance arrangements have been made to cover the Authority in the event of fraud or corruption.
- (vii) An annual audit of Treasury Management is carried out by internal audit as part of their review of the Council's core financial systems. In addition there is a system of spot checking of the Council's investments to test compliance against the Treasury Management policy.

H. Market risk

The principal sums invested at present are set and are not subject to market fluctuations (apart from any investment in the CCLA Local Authority Property Fund and any investment in commercial properties).

I. Performance management

This Authority is committed to the pursuit of value for money in its Treasury Management activities, and to the use of performance methodology in support of that aim, within the framework set out in its Treasury Management policy statement.

J. Decision making and analysis

This Authority in respect of every decision made will:-

- (i) Be clear about the nature and extent of the risks to which the Authority may become exposed.
- (ii) Be certain about the legality of the decision reached and the nature of the transaction, and that all authorities to proceed have been obtained.
- (iii) Be content that the documentation (as contained in the daily treasury management working procedures) is adequate both to deliver the Authority's objectives and protect the Authority's interests, and to deliver good housekeeping.
- (iv) Ensure that third parties are judged satisfactory in the contexts of the Authority's creditworthiness policies, and that limits have not been exceeded.
- (v) Be content that the terms of any transaction have been fully checked against the market, and have been found to be competitive.

Approved instruments, methods and techniques

K. Raising Capital Finance

Apart from the use of leasing, no forms of finance shall be used other than the following.

- (i) From the National Debt Commissioners or the Public Works Loan Board (PWLB). This has been and will continue to be the main source of the Council's longer term borrowing.
- (ii) From any institution authorised under the Banking Act 1987 or from the Bank of England. This will take the form of both short term loans and also long term loans in the form of LOBO's which stands for Lenders Option Borrowers Option.
- (iii) From any other Local Authority or Public corporation along with any associated Pension funds. This will mainly take the form of short term loans.
- (iv) From an overdraft negotiated with the Council's own bankers. The current overdraft limit is £500,000 and interest is charged at 1% above the base rate. This facility is used sparingly either when temporary borrowing is difficult or when the sums involved are small (i.e. less than £500,000).
- (v) Loan instruments not transferable by delivery, such as Bonds, Mortgages or any other document acknowledgement that money has been lent to the Authority.

The Council does not currently engage in any other form of borrowing available to it.

L. Organisation, clarity and segregation of responsibilities and dealing arrangements

(i) Full Council

Responsible for the setting of and changes to the Treasury Management policy also receiving and approving the following reports, Treasury Management Strategy and Prudential indicators and borrowing limits in advance of the year.

(ii) Cabinet

Responsible for recommending a treasury management policy statement, treasury management capital, Investment & treasury management strategies and Prudential indicators and borrowing limits to Council for final approval.

(iii) Audit Committee

Scrutiny of Treasury Management policy and performance including a mid-year review and annual report after the close of the financial year.

(iv) Head of Finance

- a) Submitting and reviewing treasury management policy/practices
- b) Reviews the performance of the treasury management function.
- c) Make decisions on investments and borrowings exceeding 1 year.
- d) Report to elected Members as provided for in section M below.
- e) Ensure that Treasury management staff receive adequate training, and the effective division of responsibilities within the treasury management function.
- f) Ensure all treasury management staff are aware of and have access to a copy of the Bank of England's "London Code of Conduct".
- g) Ensure the adequacy of internal audit, and liaise with external audit.
- h) Recommends the appointment of any external service providers.

(v) Service lead for Accountancy

- a) Assess long term borrowing requirements.
- b) To manage debt in accordance with the Treasury Management Strategy.
- c) Manages the overall treasury management function.

(vi) Senior Finance Officer (Treasury Management)

- a) Ensure that the day to day activities are carried out in accordance with this statement.
- b) Decide and negotiates borrowings and investments on call or for fixed periods.
- c) In consultation with the Service lead for Accountancy, decides and negotiates borrowings and investments for fixed periods up to one year.
- d) Carries out the longer term borrowing and investments as approved by the Head of Finance.
- e) Negotiates and arranges leasing for the Council on various items of equipment.

In the absence of the Senior Finance Officer (Treasury Management), all duties will pass to the Service lead for Accountancy with the exception of the day to day activities, which will be carried out by the Finance Officer who has been delegated to cover for treasury management in consultation with the Service lead for Accountancy.

In the absence of the Service lead for Accountancy, all duties will pass to the Head of Finance.

M. Reporting Arrangements

The Head of Finance will submit the following reports to Committee:-

- a) Prior to the beginning of each financial year, a report to Cabinet and Council setting out the Capital strategy, Investment strategy, Debt limits, Prudential indicators and policy for the Treasury management function.
- b) A mid-term review report to Audit Committee for the 6 months to 30 September each year setting out the Council's activities in borrowing, investing and leasing with an assessment of the effects of the treasury management policy.
- c) An annual report to Audit Committee setting out the Council's activities in borrowing, investing and leasing with an assessment of the effects of the treasury management policy.
- d) Reports to Audit committee as appropriate, in consultation with the Chair of Audit Committee and Portfolio Holder for Business Change & Customer Services covering compliance of and improvements to the Treasury Management strategy and policies.

N. Budgeting, Accounting and Audit Arrangements

- a) The Authority will ensure that its auditors and those charged with regulatory review, have access to all information and papers supporting the activities of the treasury management function as are necessary for the proper fulfilment of their roles and that such information and papers demonstrate compliance with external and internal policies and approved practices. Internal audit will also carry out an annual review of loans and investments reporting any variance from normal practice.
- b) The Head of Finance will prepare as part of the revenue budget process an annual budget for treasury management and will exercise effective control over the budget and report to members via the Authority's overall revenue monitoring.

O. Cash Flow Management

- a) With the exception of petty cash imprests and money held in schools' own bank accounts, all money in the hands of the Council would be aggregated for the purpose of Treasury management. Cash flow projections will be prepared before the start of the financial year and updated on a regular basis.
- b) The main objectives to be achieved are:
 - (i) Borrowing

1. To manage the Council's debt maturity profile.
2. To forecast average future interest rates and to borrow accordingly.
3. To use predominantly fixed rate borrowing in order to maintain certainty and stability in the budgeting process.
4. To reschedule debt where appropriate in order to take greater advantage of interest rate movements.

(iii) Investments

1. To use the Council's balances to minimise external borrowings.
2. Only to externalise the Council's funds and balances where to do so would generate a level or return significantly greater than could be secured by internal investment.
3. When investing we will ensure that adverse market fluctuations on the Authority are minimised.

P. Money Laundering

This Authority is alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly, any suspicions will be reported to the Lead for Accountancy, the Head of Audit and upwards to the Head of Finance.

The Authority's Treasury Management function protects itself from the possibility of being involved in a money laundering transaction as follows:-

- (i) Treasury management transactions are not in physical cash and the Authority has a policy of not accepting cash of more than 15,000 Euros equivalent in one transaction. This is set in S151 Standards.
- (ii) The Authority restricts its transactions to the institutions of bodies listed in part II of the schedule to the Local Authorities Regulations 1990, the Bank of England, any other institution authorised under the Banking Act 1987 and Building Societies.
- (iii) Most transactions (apart from PWLB) are conducted through brokers who have their own procedures for identifying and recording third party identities.

Q. Staff Training and Qualifications

This Authority recognises the importance of ensuring that all staff involved in the Treasury Management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills. Any training needs will be identified informally as they arise and formally as part of the Council's Performance Appraisal Scheme.

The Head of Finance will ensure that the Council member tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and those responsibilities.

Those charged with governance recognise their individual responsibility to ensure that they have the necessary skills to complete their role effectively.

R. Policy on External Service Providers

This Authority only makes use of external service providers for money-broking who act as intermediaries, making introductions between ourselves and the Banks and Building societies etc. who we borrow or lend to. No other external managers will be used without prior to approval of cabinet/council.

S. Corporate Governance

This Authority is committed to the pursuit of proper corporate governance accordingly the Treasury Management function will be undertaken with openness and transparency, honesty, integrity and accountability.

- (i) We will adopt the principles and policies promoted by CIPFA in their code of practice which will deliver the framework for demonstrating openness and transparency in the Authority's treasury management function.
- (ii) The Authority will publish and give free access to information about its Treasury Management transactions and any other documents connected with its Treasury management activities.
- (iii) The Authority will establish clear treasury management policies, the separation of roles in treasury management and the proper management of relationships both within and outside the Authority to establish the integrity of the function.
- (iv) The Authority will establish robust treasury management dealings and an absence of business favouritism, which will create keen competition in treasury management, this will lay the groundwork for fairness.

Minimum Revenue Provision Policy

1. Background
 - 1.1 Capital expenditure incurred by the Council can be paid for from grants or capital receipts, but sometimes the expenditure is financed by “credit arrangements” such as borrowing or leasing. Local authorities are required each year to set aside some of their revenues to pay off these credit arrangements (or debt) over time. This is called the Minimum Revenue Provision (MRP).
 - 1.2 The annual amount to repay was originally prescribed in law as a minimum of 4% of the outstanding balance of capital expenditure (CFR). This was replaced in 2008 with a requirement to make “prudent provision”, though in practice many authorities, including Calderdale, simply continued repaying an annual 4% charge.
 - 1.3 The full significance of the relaxation of the rules at that time surrounding MRP payments was not appreciated and further guidance issued by DCLG in 2012 states “that debt ought to be repaid over a period that is either commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Revenue Support Grant, it is reasonably commensurate with the period implicit in the determination of the grant”. The guidance goes on to say that, while councils are required to have regard to the previous guidance, they are allowed to set their own policy outside of the options given if it can be demonstrated that this would be prudent.
 - 1.4 The new relaxed rules on MRP were explained in a previous year’s report to Cabinet on the 15th January 2018 whereby Council approved the re-scheduling of MRP payments to link them more closely to the average expected life of Council assets.
2. Recommendations for the annual set aside of MRP
 - 2.1 For supported borrowing, prudential borrowing and PFI and similar lease deals the Council has the option of charging 1) on a straight-line Equal Instalment of Principal (EIP) basis or 2) Annuity basis
 - 2.2 EIP, as the name suggests, involves simply dividing the outstanding financing, i.e. CFR, by the number of years chosen generating a series of equal annual amounts over the estimated life of the asset. This method is easy to understand and produces a regular charge against revenues.
 - 2.3 The annuity basis is more complicated and depends on the interest rate chosen. The method is similar to a standard repayment mortgage where the principal element is smaller in the earlier years and increases as more principal is paid off due to a resultant drop in the interest portion. The main disadvantage of the annuity basis is that it defers settlement of the debt until later years. This may be appropriate for some types of spend, e.g.

regeneration schemes where benefits may be delayed until later in their life, but is not necessarily the most equitable way to charge for the majority of Council assets where the benefit is just as much in year one as in year thirty.

- 2.4 Due to the issue of equity; the removal of any difficulty in choosing an appropriate interest rate; the simplicity of understanding the concept; and the regularity of the charge, it is recommended that the Council adopts an EIP approach to MRP calculations.
- 2.5 The policy prior to 2015/16 was that MRP started to be charged into the accounts the financial year following the one in which the expenditure was incurred. However, when borrowing to provide an asset, the authority is also allowed to treat the asset life as commencing in the year in which the asset first becomes operational. This postponing of MRP repayments on capital schemes is a logical step to take as the benefits of most projects are only realised after they have finished (for example within Town Centre Office Strategy, savings from the completion and occupation of Princess Buildings were only generated once staff are decanted from other buildings which are then closed/sold) and therefore the policy agreed in last year's prudential report will continue to be followed.
- 2.6 Some local authorities have offset overpayments of MRP in previous years against charges in future years. Calderdale has made similar overpayments and will consider whether to adopt these measures as long as they are allowable within the regulations in place at the time. It is therefore being recommended that the Head of Finance be given the authority to carry out such transactions if they are found to be in the best interests of the Council subject to the outcome of any regulatory reviews and following discussion with the Council's external auditors.
- 2.7 The MRP policy that is being recommended for approval is that the Council:-
- sets aside 2% of its Capital Financing Requirement (CFR) each year on an Equal Instalment of Principal (EIP) basis as its MRP on outstanding capital expenditure previously supported by Government
 - sets aside equal instalments of MRP based on the life of the assets financed for prudentially borrowed capital expenditure
 - sets aside equal instalments of MRP based on the life of the assets financed for PFI and similar lease deals
 - sets aside MRP from the year in which a capital asset first becomes operational
 - delegates authority to the Head of Finance to use overpayments of MRP in previous years to charge a lower amount of MRP than would otherwise be the case under the policy set out above. This will have immediate effect.

PRUDENTIAL INDICATORS 2019/20-2021/22

This section of the report sets out the prudential indicators and outlines how expenditure will be financed by borrowing in an affordable, prudent and sustainable way.

1. Introduction and Background
 - 1.1 It is required by Part 1 of the Local Government Act 2003 and related Prudential Code for Capital Finance in Local Authorities that the Council set these borrowing limits and indicators before the forthcoming year.
 - 1.2 The Authority is also required under the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 to prepare an annual statement of their policy on making MRP for submission to full Council.
 - 1.3 Calderdale has been required to operate within the new Capital Finance regulations, contained within the Local Government Act since 2004/05.
 - 1.4 The regulations created some relaxation of the capital control regime (prudential borrowing) and require authorities to set and monitor a number of indicators referred to in the prudential code.
 - 1.5 Following an extensive consultation exercise in 2008 the Prudential Code was reviewed to identify practical implementation issues in relation to the impact of International Financial Reporting Standards (IFRS), the impact of the Housing review and the credit crunch. The prudential code was then revised to take into account these issues and was approved by CIPFA's treasury management panel on the 5th October 2009.
 - 1.6 The prudential code has now been revised again in 2017 and the major change is the requirement for local authorities to look at capital expenditure and investment plans in light of overall organisational strategy and resources and ensure that decisions are being made with sufficient regard to the long run financing implications and potential risks to the authority.

Changes to the new Prudential Code from last year's report

- 2.1 The main change from last year's report to Members on the 15th January 2018 is the requirement for authorities to determine a Capital Strategy which is included in this report above as Appendix 1.
- 2.2 The principle that prudential borrowing will only be undertaken where it is funded by savings or existing budgets has already been firmly established within the Council's medium term financial planning framework.
- 2.3 Therefore, the purpose of this report is to set the required prudential indicators for Calderdale for a three year period beginning 2019/20.

Process for Setting the Prudential Indicators

- 2.4 Before the start of each financial year the Head of Finance must submit a report to Cabinet, for recommendation to Council, setting prudential indicators for the forthcoming and following two years. The process for setting, reporting and reviewing prudential indicators was recommended to Council by Cabinet on the 26 January 2004 and subsequently approved.

Nature of the Prudential Indicators

- 2.5 Apart from the CIPFA Code of Practice for Treasury Management in the Public Services (which has already been adopted by Calderdale) there are three other categories of prudential indicators:
- 1) Estimates (which are calculated as part of the budget setting process).
 - 2) Actuals (which have their source in the latest audited financial statements).
 - 3) Limits (i.e. parameters that should not be breached without management action).
- 2.6 Estimates and limits are rolling and re-set each year. Actuals are fixed as they use figures contained within the Authority's statement of accounts.

Monitoring and Review of Prudential Indicators

- 2.7 The Head of Finance will monitor against all forward looking indicators (i.e. estimates) and these forecasts will be updated and reported as appropriate within the current reporting and budgeting framework. There should be no need to amend actuals once they have been included within this prudential indicators report.
- 2.8 Limits will be monitored constantly throughout the year. Where, in the Head of Finance's opinion, there is a danger the limits will be breached, a report will be brought to Members. If this situation arises the basic options available are to raise the limits already set or instigate management action to ensure that the current limit is not breached.
- 2.9 The Head of Finance will highlight any unusual deviations from estimates and limits in the mid-term and outturn Treasury Management reports to Audit Committee.

3 OPTIONS CONSIDERED

- 3.1 The Code does not include suggested indicative limits or ratios. These are for each Local Authority to decide itself (subject to any overriding powers retained by Central Government). The following are the indicators recommended by the Head of Finance and are based on the principles agreed in the Medium Term Financial Strategy and the associated consideration of clear affordability constraints:

4 ESTIMATES AND ACTUALS

Capital Expenditure

- 4.1 The Prudential system requires the inclusion of an estimate of future years' capital expenditure. The majority of the Council's capital spend was previously financed by Central Government either directly through grants or by supported borrowing via the revenue support grant. Following the Local Government Settlement announced on the 13 December 2010, supported borrowing allocations from Central Government have now been abolished, which means that capital expenditure can only be incurred where it is financed from grants/contributions, capital receipts or via prudential borrowing. The estimates of future Capital expenditure set out below reflect this loss of supported borrowing.
- 4.2 As the Council's strategy is to fully utilise all funding available to it, any forecasts made will vary in line with Government allocations, if any, and so the forecast below will be updated as the funding base changes via the capital monitoring report to Members during the year.
- 4.3 The actual capital expenditure that was incurred in 2017/18 was £52.6m and estimates of capital expenditure to be incurred for the current and future years are:-

Capital Expenditure	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
Per Capital Monitor *	51.5	56.5	56.3	36.1

*This covers the approved schemes within the agreed Capital Programme.

- 4.4 The above estimates will be monitored and the Programme adjusted in line with actual allocations to ensure that the forecast remains prudent and consistent with overall budget strategies.

Ratio of Financing Costs to Net Revenue Stream

- 4.5 Financing costs are made up of interest payments, investment income and the statutory amount required for the repayment of debt (MRP). The net revenue stream is the amount to be met from Government Grants and local taxpayers.
- 4.6 From 2006/07 onwards the Revenue Support Grant (RSG) received from Central Government is split between original RSG and Dedicated Schools Grant (DSG). The DSG grant is for specific school related expenditure and is not available for the servicing of debt other than prudential borrowing for schools related spend.

- 4.7 This indicator is intended to show the proportion of the Authority's resources that are used to finance capital assets and is based on estimates of capital expenditure contained within this report.
- 4.8 The actual ratio of financing costs to net revenue stream for 2017/18 was 5.2%. The estimates of the ratio of financing costs to net revenue stream for the current and future years (excluding DSG grant) are:-

	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %	2021/21 Estimate %
Finance costs as a % of net revenue stream (excl. DSG)	6.5	7.1	7.9	8.1

- 4.9 What this indicator highlights is that the ratio is increasing mainly due to increased Minimum Revenue Provision (MRP) charges and higher interest costs due to long term borrowing from the Public Works Loan Board (PWLB). There is a big increase from 2017/18 to 2018/19 due to the Council's policy of only charging MRP into the accounts when the scheme becomes operational. In 2018/19 this is the first year that we are charging MRP for the three big schemes (Piece Hall, Central Library and Town centre office strategy). Then the steady increase in the next three years is also due to the MRP as a number of major capital schemes are due to come into the Capital Programme including Street Lighting, Northgate House 6th form, Asset Management Programmes and replacement of part of the Council's transport fleet.

The Capital Financing Requirement (CFR)

- 4.10 The capital financing requirement includes all relevant capital expenditure already incurred and due to be incurred over the period, and reflects the Authority's underlying need to borrow for capital purposes.
- 4.11 The actual capital financing requirement as at 31 March 2018 was £199.1m. Estimates of the end of the year capital financing requirements for the Authority for future years are:

2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
205.4	227.2	233.2	227.6

- 4.12 The Capital financing requirement shows an increase over 2017/18 as the three major prudentially financed schemes (Central Library, Piece Hall and Town Centre Office Strategy) are progressed to completion. We then have a number of new schemes coming into the capital programme including Street Lighting and the new 6th form college at Northgate house which will increase CFR in 2018/19. As most of the new capital expenditure is in 2019/20 and 2020/21 the CFR in 2021/22 onwards starts to fall.

Incremental Impact of Prudential Borrowing on Council Tax

- 4.13 The Council's current strategy is that any borrowing carried out under prudential powers will firstly need identified budget in place unless it relates to a self-financing scheme. It is therefore anticipated that there will be no specific direct impact on Council Tax for prudential schemes over and above capital investment decisions that have previously been taken by the Council.
- 4.14 Part of the new Prudential Code is for Local Authorities to develop their own Prudential Indicators, with this in mind one of the areas that could be of interest to members is the amount approved for prudential schemes, (excluding schools which have now become academies) and the amount that is still outstanding on this debt. This will give an indication of the current exposure the Council has to these schemes. Prior to 2018/19 approximately £56.5 million has been spent which includes Brighouse and Sowerby Bridge pools, the Shay Stadium, and the works on the big three schemes which are Halifax Town Centre Office strategy, New Central Library & the Piece Hall and of this £48 million is still outstanding.

5 LIMITS

Net Borrowing and the Capital Financing Requirement

- 5.1 In contrast to the day to day cash flows of the Authority, the Capital Financing Requirement (CFR) reflects the Authority's underlying need to borrow for capital purposes.
- 5.2 In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council needs to ensure that net external borrowing does not, except in the short term, exceed the total of the Capital Financing Requirement in the preceding year plus the estimates of any additional Capital Financing Requirement for the current and next three financial years.
- 5.3 The Head of Finance reports that the authority had no difficulty meeting this requirement in 2017/18 as the Capital Finance Requirement was £199.1 million and external borrowing stood at £118.9 million (incl. the PFI liability), and no difficulties are envisaged for the current or future years. This view takes into account current commitments and existing plans.

Operational Boundary for Debt

- 5.4 The operational boundary reflects the Head of Finance's estimate of the most likely, but not worst case scenario, of external debt levels taking into account estimates for planned capital expenditure and cash flow requirements for all purposes.
- 5.5 Sustained breaches of the operational boundary limit would be used by the Head of Finance to alert the Authority to the possibility of an imminent breach of the authorised limit. Council is asked to approve the following normal operational boundary for external debt for the next three financial years.

	2019/20 £m	2020/21 £m	2021/22 £m
Borrowings	143	151	146
Other Long term Liabilities (ie PFI)	30	28	26
Total Operational Boundary	173	179	172

Authorised Limit for Debt

- 5.6 In respect of its external debt, it is recommended that the Council approves the following maximum authorised limits for its total external debt gross of investments for the same time period.

	2019/20 £m	2020/21 £m	2021/22 £m
Borrowings	151	159	154
Other Long term Liabilities (ie PFI)	30	28	26
Total Authorised Limit	181	187	180

- 5.7 These limits are based on the operational boundary with the addition of sufficient headroom for unusual cash movements.
- 5.8 Within the figures, borrowing and other long term liabilities are separately identified. Members have delegated authority to the Head of Finance to effect movement between borrowing and other long term liabilities in order to retain flexibility and best value for money for both the operational boundary and the authorised limit. However any changes deemed necessary by the Head of Finance will be reported to the Council at its next meeting following the change.
- 5.9 The Council's actual external debt at 31 March 2018 was £86.6m (in addition to the PFI scheme expenditure) and is estimated to increase by £13.5 million during 2018/19 due to new borrowings of £16 million and repayment of existing debt for £2.5 million. It should be noted that actual external debt is not directly comparable to the authorised limit and operational boundary since the actual external debt reflects the position at one point in time.
- 5.10 Loans – as part of the investment strategy the Council will be required to publish the total amount of loans it is prepared to make in any one year and how it will deal with any credit losses. These loans could be to community organisations but also local authority wholly owned companies. This will need to incorporate the planned loans to the Council's development company. The strategy should also include the basis for determining the rate of interest which should be charged on these loans which need to reflect the level of risk and liquidity of them. Given the proposals which have already been agreed by Council for the development company it is recommended that a limit on the total amount of loans be set at £10 million and that the minimum rate of interest should be at least 1% above the rate at which the Council can borrow from the PWLB for the appropriate period. The limit to be applied to loans and

the minimum interest rate to be charged will be reviewed and agreed each year as part of this report

6. Conclusion and Summary

- 6.1 The Authority is required to abide by the prudential code and the resulting limits it sets itself. Calderdale is not, however, bound to the indicators set in this report if they are subsequently found not to be in the interests of the Authority. In these circumstances a report will be brought to Members to either amend the limits already set or to recommend the instigation of management action to ensure that the current limits are not breached.
- 6.2 The prudential code supports the system of capital investment and Local Government in a publicly accountable manner. The report sets revised prudential indicators and recommends a general continuation of Council policy. An Operational Boundary for external debt of £173m, £179m and £172m and an Authorised Limit for external debt of £181m, £187m and £180m for the financial years 2019/20, 2020/21 and 2021/22 are recommended.

Maturity profile of long term debt as at 31 December 2018

