Body:	**Cabinet**
Date:	**6 February 2019**
Subject:	**Treasury Management and Prudential Indicators 2019/20, Capital Strategy & Investment Strategy**
Report of:	**Chief Finance Officer**
Cabinet member:	**Councillor Holt, Portfolio Holder for Financial Services**
Ward(s):	**All**
Purpose of the report:	**To approve the Council's Annual Treasury Management Strategy, Capital Strategy & investment Strategy together with the Treasury and Prudential Indicators for the next financial year.**
Decision type:	**Key Decision**
Recommendation:	**Cabinet is asked to recommend the following proposals to full Council :** **i) The Treasury Management Strategy and Annual Investment Strategy as set out in this report and Appendix 4.** **ii) The methodology for calculating the Minimum Revenue Provision set out at paragraph 2.3 and Appendix 2** **iii) The Prudential and Treasury Indicators as set out in this report.** **iv) The Specified and Non-specified Investment categories listed in Appendix 5** **v) Approve the Capital Strategy set out in Appendix 1.** **Cabinet is recommended to note the extended role of the Chief Financial Officer as set out in Appendix 7.**
Reasons for recommendations:	**It is a requirement of the budget setting process for the Council to review and approve the Prudential and Treasury indicators, Treasury Strategy, Capital Strategy and Investment Strategy.**
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1.0 Introduction

1.1 The Prudential and Treasury Indicators and Treasury Strategy covers:

- the capital prudential indicators;
- a Minimum Revenue Provision Policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed);
- Capital Strategy.

1.2 The Council adopted CIPFA's Treasury Management code of Practice on 18 May 2010. This code is supported by treasury management practices (TMPs) that set out the manner in which the council seeks to achieve the treasury management strategy and prescribes how it manages and controls those activities.

1.3 CIPFA defines treasury management as:

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

1.4 Revised reporting is required for the 2019/20 reporting cycle due to revisions of the MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is attached at Appendix 1.

The Capital Strategy provides the following:

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

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

2.0 THE CAPITAL PRUDENTIAL INDICATORS 2017/18 – 2021/22

2.1 Capital Expenditure

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

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

The capital expenditure forecasts for the Council are:

Capital Expenditure £m	**2017/18 Actual**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
Non-HRA	20.6	40.1	21.6	16.5	0.9
HRA	6.3	5.5	5.6	4.4	4.4
Commercial Activities/Non-financial investments	24.4	8.9	44.7	11.6	2.5
Total	51.3	54.5	71.9	32.5	7.8
Financed by:					
Capital receipts	1.4	2.3	3.7	0.2	0.4
Capital grants	9.9	3.6	8.2	0.3	0.0
Capital reserves	4.9	5.9	4.3	4.4	4.4
Revenue	0.0	0.1	0.5	0.0	0.0
Net borrowing needed for the year	**35.1**	**42.6**	**55.2**	**27.6**	**3.0**

The above figures include uncommitted borrowing i.e. borrowing which has been approved but schemes have not yet been identified and will only proceed if they are financially advantageous.

The net financing need for commercial activities / non-financial investments included in the above table against expenditure is shown below:

Commercial activities /non-financial investments £m	**2017/18 Actual**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
Capital Expenditure	24.4	8.9	44.7	11.6	2.5
Financing Costs	0.4	0.2	1.1	0.3	0.1
Net Financing Need for the Year	24.8	9.1	45.8	11.9	2.6
Percentage of total net financing need %	48.4%	16.3%	62.2%	35.7%	32.1%

2.2 The Council's Borrowing Need (the Capital Financing Requirement)

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

CFR.

The CFR includes other long term liabilities (e.g. Serco, finance leases) brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme already include a borrowing facility and the Council is not required to separately borrow for them. There are currently £0.5m of such schemes within the CFR.

The Council is asked to approve the CFR projections below:

£m	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Capital Financing Requirement					
CFR – non housing	55.6	112.5	130.8	189.9	200.1
CFR - housing	42.6	42.6	42.6	42.6	42.6
Commercial Activities/non-financial investments	24.4	8.9	44.7	11.6	2.5
Total CFR	**122.6**	**164.0**	**218.1**	**244.1**	**245.2**
Movement in CFR	**33.7**	**41.4**	**54.1**	**26.0**	**1.1**

Movement in CFR represented by					
Net financing needed for the year (above)	35.1	42.6	55.2	27.6	3.0
Less MRP/VRP and other financing movements	(1.4)	(1.2)	(1.1)	(1.6)	(1.9)
Movement in CFR	**33.7**	**41.4**	**54.1**	**26.0**	**1.1**

Note the MRP includes Serco repayments.

2.3 MRP Policy Statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP). Regulations require the Council to approve an MRP Statement in advance of each financial year. A variety of options are provided to councils, so long as there is a prudent provision. It is recommended that the following methodology is approved:

- For capital expenditure incurred before 1.4.2008 MRP is provided for at 4% of the CFR.
- For capital expenditure incurred since 1.4.2008 MRP be charged using the most appropriate of the following methods for the individual schemes as determined by the Chief Finance Officer under delegate powers:
    - Asset Life method – based on the estimated life of the asset,
    - Depreciation method – based on standard depreciation accounting procedures.
    - Annuity method – based on a straight line (EIP – Equal Instalment Payment) approach.

No revenue charge is currently required for the HRA. However if the HRA is required to charge depreciation on its assets, this would have a revenue effect. In order to address any possible adverse impact, regulations allow the Major Repairs Allowance to be used as a proxy for depreciation.

Repayments included in annual Serco payments and any finance leases are applied as MRP.

There is no requirement to set aside a prudent provision for capital expenditure by way of loan (e.g. Eastbourne Housing Investment Co Ltd (EHIC) or investments (e.g. LAMS) which will be repaid in full at a future date.

A comprehensive view of the Council's MRP Policy can be found at Appendix 2.

2.4 **Affordability Prudential Indicators**

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. Indicators are required to be prepared on the gross capital spend and do not include any resulting income contributions expected from the implementation of the capital scheme. The Council is asked to approve the following indicators:

2.5 **Actual and estimates of the ratio of financing costs to net revenue stream.**

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

%	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Non-HRA	10.3	12.1	13.2	17.2	22.6
HRA	12.3	13.0	13.0	10.3	9.0

The estimates of financing costs exclude uncommitted borrowing.

3.0 TREASURY MANAGEMENT STRATEGY

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 **Current Portfolio Position**

The Council's treasury portfolio position at 31 March 2018, with forward projections, are summarised below. The table shows the actual external borrowing (the treasury management operations), against the capital borrowing need (the Capital Financing Requirement - CFR), highlighting any under borrowing.

£m	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
External borrowing					
Borrowing at 1 April	66.2	101.2	143.8	199.0	226.6
Expected change in borrowing	35.0	42.6	55.2	27.6	3.0
Other long-term liabilities (OLTL)	0.8	0.5	0.1	0.0	0.0
Expected change in OLTL	(0.3)	(0.4)	(0.1)	0.0	0.0
Actual gross borrowing at 31 March	**101.7**	**143.9**	**199.0**	**226.6**	**229.6**
CFR – the borrowing need	122.6	164.0	218.1	244.1	245.2
Under borrowing	20.9	20.1	19.1	17.5	15.6

Within the above figures the level of debt relating to commercial activities/non-financial investments is:

	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Actual Debt at 31 March £m	24.4	8.9	44.7	11.6	2.5
Percentage of total external debt %	20%	5%	20%	5%	1%

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross borrowing does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

Whilst investment interest rates continue to be below that for borrowing, value for money can be best achieved by avoiding new borrowing and using internal cash balances to temporarily finance new capital expenditure or to replace maturing external debt, thus maximising short term savings. However this needs to be carefully considered to ensure borrowing is taken at advantageous rates, but not taken too long before the need to borrow to avoid the cost of carrying the debt.

3.2 Treasury Indicators: Limits to Borrowing Activity

3.2.1 **The Operational Boundary.** This is the limit beyond which external borrowing is not normally expected to exceed.

The Council is asked to approve the following operational boundary limits:

Operational boundary £m	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Borrowing	97.7	155.0	173.4	232.5	242.7
Other long term liabilities	0.5	0.1	0.0	0.0	0.0
Commercial activities / non-financial investments	24.4	8.9	44.7	11.6	2.5
Total	122.6	164.0	218.1	244.1	245.2

3.2.2 The Council is asked to approve the following authorised limit:

Authorised limit £m	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Borrowing	112.7	170.0	188.4	247.5	257.7
Other long term liabilities	0.5	0.1	0.0	0.0	0.0
Commercial activities / non-financial investments	24.4	8.9	44.7	11.6	2.5
Total	137.6	179.0	233.1	259.1	260.2

Separately, the Council was also limited to a maximum HRA CFR through the HRA self-financing regime of £42.6m, which is included in the authorised limits above.

In October 2018, Prime Minister Theresa May announced a policy change of abolition of the HRA debt cap. The Council has not yet reached a view of how this will change the Council's approach to borrowing and investment, beyond that it is likely to do so.

3.2.3 The Council has complied with these prudential indicators in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.3 **Prospects for Interest Rates**

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

Link Asset Services Interest Rate View	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.50%	1.75%	1.75%	2.00%
3 Month LIBID	0.80%	0.80%	0.90%	1.10%	1.10%	1.20%	1.40%	1.50%	1.60%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	0.90%	0.90%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%
12 Month LIBID	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.60%	1.70%	1.80%	1.80%	1.90%	2.00%	2.10%	2.20%
5yr PWLB Rate	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%
10yr PWLB Rate	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.20%
25yr PWLB Rate	2.90%	3.00%	3.00%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%	3.60%	3.70%
50yr PWLB Rate	2.70%	2.80%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.40%	3.50%

The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. However, the MPC emphasised again, that future Bank Rate increases would be gradual and gave an indication that rates may be around 2.5% in ten years' time but they declined to give a medium term forecast.

It is unlikely that the MPC will increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Similarly, the MPC is more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, the cautious pace of even these limited increases is dependent on a reasonably orderly Brexit.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently.

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

A detailed view of the Economic forecast is set out at Appendix 3.

3.4 **Borrowing Strategy**

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

There is an underlying need to borrow in the future to support capital expenditure and new external borrowing will be required by the end of this year. Rates are currently being monitored and new borrowing will be taken when the rates are advantageous either as long term debt or temporary borrowing. Against the current econcomic background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Chief Finance Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

The Council will maintain a balanced, affordable and sustainable maturity profile as set out below and all new borrowing will be undertaken in line with this policy.

3.5 **Treasury Management Limits on Activity**

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates.

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

	2019/20	2020/21	2021/22
Interest rate Exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	25%	25%	25%
Maturity Structure of fixed interest rate borrowing 2019/20			
		Lower	**Upper**
Under 12 months		0%	75%
12 months to 2 years		0%	75%
2 years to 5 years		0%	75%
5 years to 10 years		0%	100%
10 years and above		0%	100%

3.6 **Policy on Borrowing in Advance of Need**

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

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

3.7 **Debt Rescheduling**

As short term borrowing rates are currently considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt.
Debt scheduling will only be considered under the following circumstances:

- the generation of cash savings and /or discounted cash flow to produce sufficent savings to cover the costs;
- it helps to fulfil the treasury strategy; and
- the balance of the portfolio (amend the maturity profile and/or the balance of volatility) is maintained.

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.
All rescheduling will be reported to Cabinet, at the earliest meeting following its action.

3.8 **Municipal Bond Agency**

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

4.0 ANNUAL INVESTMENT STRATEGY

4.1 **Investment Policy**

The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. Non-financial investments are essentially the purchase of income yielding assets, are covered in the Investment Strategy see Appendix 4.

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

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

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

After this main principle the Council will ensure:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment at appendix 5 and

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

4.2 **Creditworthiness Policy**

In order to minimise the risk to investments, the Council has clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list as set out in at Appendix 6. The aim is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk.

Credit rating information is supplied by Link, the Council's treasury consultants, on all active counterparties that comply with the criteria at Appendix 6. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing.

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AAA from Fitch, as well as UK, even if the UK rating falls below AAA.

4.3 The Chief Finance Officer will maintain a counterparty list in compliance with the criteria set out in Appendix 6 and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either Specified or Non-Specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

4.4 **Time and monetary limits applying to investments.**

The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both Specified and Non-Specified Investments):

	Money Limit	Time Limit
Banks 1 category high quality	£5.0m	1 yr
Banks 2 category – part nationalised	£5.0m	1 yr
Limit 3 category – Council's banker (not meeting Banks 1)	£10.0m	1 day
Other institutions limit	£5.0m	1 yr
DMADF	Unlimited	6 months
Local authorities	£5.0m	2 yrs
Money market Funds	£10.0m	Liquid
Property funds	£10.0m	

4.5 The proposed criteria for Specified and Non-Specified investments are shown in Appendix 5 for approval.

Property Funds - The use of these instruments can be deemed capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using. Appropriate due diligence will also be undertaken before investment of this type is undertaken.

4.6 **Non treasury management investments**

This Council invests in non treasury management (policy) investments. These do not form part of the treasury management strategy. However, Members are advised that the following non treasury investments are currently in place as at 31.12.18:

Investment	Facility	Int Rate
CloudConnX	357,000	1.5%+Base
WEL (Excl capitalised interest)	1,150,000	8%-10%
EHIC – Loan Facility	9,522,150	4.50%
EHIC - Credit Facility	250,000	2%+Base
Aspiration Homes Loan Facility	3,188,000	4.50%
Aspiration Homes – Credit Facility	100,000	2%+Base
Seachange (Site 6 Sov Harbour) (Excl capitalised interest)	850,000	3.00%
Seachange (Sov Harbour Innovation Mall) (Excl capitalised interest)	1,400,000	3.00%

4.7 **Investment Strategy**

Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

4.8 **Investment returns expectations.**

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

- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.50%
- 2021/22 2.00%

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

	Now
2018/19	0.75%
2019/20	1.00%
2020/21	1.50%
2021/22	1.75%
2022/23	1.75%
2023/24	2.00%
Later years	2.75%

The overall balance of risks to economic growth in the UK is probably neutral.

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

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

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

Upper limit for principal sums invested for longer than 365 days			
£m	2018/19	2019/20	2020/21
Principal sums invested for longer than 365 days	£2.0m	£2.0m	£2.0m

For its cash flow generated balances, the Council will seek to utilise its current account, call accounts and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

4.10 **End of year investment report**

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

4.11 **Policy on the use of external service providers**

The Council uses Link as its external treasury management advisors.
The Council recognises that responsibility for treasury management decisions remains with the organisation at all times.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

5.0 Outcome expected and performance management

5.1 Loans, Investments and Prudential Indicators will be monitored regularly during 2019/20 and performance will be reported to members quarterly.

6.0 Financial appraisal

6.1 These are included in the main body of the report.

7.0 Legal implications

7.1 This report covers the requirements of the Local Government Act 2003, the CIFPA Prudential Code, the CLG MRP Guidance, the CIPFA Treasury Management Code and the CLG Investment Guidance.

8.0 Equality analysis

8.1 The equality implications of decisions relating to Treasury Management covered in this report are addressed within other relevant Council reports or as part of programmed equality analysis.

9.0 Conclusion

9.1 Capital prudential indicators have to be set to demonstrate plans for borrowing are affordable. The movement in the Capital Financing Requirement (CFR) forecasts for 2019/20, 2020/21 & 2021/22 have been set as £54.1m, £26.0m and £1.1m respectively. This borrowing has been reflected in the Capital Financing Requirement, which sets out the Council's outlining requirement for borrowing, and includes both the use of internal resources and external borrowing.

9.2 The proposed Minimum Revenue Provision Policy is updated in accordance with Appendix 2 and ensures that prudent provision is made for the repayment of borrowing.

9.3 All Treasury indicators have been set to reflect the treasury strategy and funding requirements of the capital programme.

9.3 The Council's treasury management advisors are predicting a gradual rise in interest rates of 0.25% going forward to reach 2.00% by March 2022. Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.

9.4 The investment strategy has been set to maintain the Council's main priorities in the order of Security, Liquidity and Yield.

9.5 The proposed criteria for Specified and Non-Specified investments is shown in Appendix 5 for approval and remains unchanged from 2018/19.

9.6 CIPFA issued a revised Treasury Management Code of Practice in December 2017 which expanded the role of the Chief Finance Officer's responsibility for treasury management activities, as set out in Appendix 7. These revisions have particularly focused on non-treasury investments and introduces the requirement to produce a detailed Capital Strategy, which will be prepared in 2018/19 in partnership with other services.

Appendices

- 1 - Capital Strategy
- 2 - Minimum Revenue Provision (MRP) Policy Statement
- 3 – Economic Background
- 4 – Investment Strategy
- 5 – Specified and Non-Specified Investments and limits
- 6 – Creditworthiness Policy
- 7 – The Treasury Management Role of the Section 151 Officer

Background papers

The background papers used in compiling this report were as follows:

- CIPFA Treasury Management in the Public Services code of Practice (the Code)
- Cross-sectorial Guidance Notes
- CIPFA Prudential Code
- Treasury Management Strategy and Treasury Management Practices adopted by the Council on 18 May 2010.
- Council Budget 6 February 2019
- Finance Matters and Performance Monitoring Reports 2018.
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To inspect or obtain copies of background papers please refer to the contact officer listed above.

APPENDIX 1 Capital Strategy

1) Introduction

1.1 This Capital Strategy is a new report for 2019/20, giving a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services in Eastbourne Borough Council (EBC), along with an overview of how associated risk is managed and the implications for future financial sustainability. It has purposely been written in an accessible style to enhance understanding of what can be very technical areas.

2. Capital Expenditure and Financing

2.1 Expenditure

2.1.1 Capital expenditure occurs when the Council spends money on assets such as property or vehicles, which will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. The Council has some limited discretion on what counts as capital expenditure, for example assets costing below a de minimis level are not capitalised and are charged to revenue in year.

2.1.2 Further details on the Council's capitalisation policy can be found in the 2017/18 Statement of Accounts.

2.1.3 In 2019/20, EBC is planning capital expenditure of £71.9 million (and £40.3 million over the next two years) as summarised in Table 1 below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure

	2017/18 actual	**2018/19 forecast**	**2019/20 budget**	**2020/21 budget**	**2021/22 budget**
	£m	**£m**	**£m**	**£m**	**£m**
General Fund Services	20.6	40.1	21.6	16.5	0.9
Council Housing (HRA)	6.3	5.5	5.6	4.4	4.4
Commercial Activities/ non-financial investments	24.4	8.9	44.7	11.6	2.5
TOTAL	**51.3**	**54.5**	**71.9**	**32.5**	**7.8**

2.1.4 The main General Fund capital projects scheduled for 2019/20 are as follows:

Scheme		**£m**
Loan Facility to EHICL		22.2
Sovereign Centre		11.9
Hampden Retail Park		6.7
Loan Facility to Aspiration Homes		5.7
Disabled Facilities Grants		2.6
Devonshire Park		2.5
Bedfordwell Road		1.9
JTP		1.7
Other schemes		11.1
Total		**66.3**

2.1.5 The Housing Revenue Account (HRA) is a ring-fenced account which ensures that the Council's housing does not subsidise, or is itself subsidised, by other local services. HRA capital expenditure is therefore recorded separately, and includes

£1.3 million allocated to the New Build Programme over the (three-year) forecast period, which is expected to deliver 7 new homes.

2.2 Governance

2.2.1 The evaluation, prioritisation and acceptance of capital schemes onto the Capital Programme is carried out in accordance with strict criteria that ensures that added schemes reflect Council priorities and can be delivered within available resources (e.g. due priority is given to schemes yielding savings and/or generating income as well as meeting a Council priority).

2.2.2 The draft Capital Programme is then subject to formal Scrutiny prior to setting the budget (followed by Cabinet and full Council approval).

2.3 Financing

2.3.1 All capital expenditure must be financed, either from external sources (Government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing and leasing). The planned financing of the above expenditure is presented in Table 2 below.

Table 2: Capital Financing

	2017/18 actual	**2018/19 forecast**	**2019/20 budget**	**2020/21 budget**	**2021/22 budget**
	£m	**£m**	**£m**	**£m**	**£m**
External sources	10.8	3.5	8.2	0.3	-
Own resources	5.5	8.3	8.5	4.6	4.0
Debt	35.0	42.7	55.2	27.6	3.0
TOTAL	**51.3**	**54.5**	**71.9**	**32.5**	**7.8**

2.3.2 Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as "Minimum Revenue Provision" (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and use of capital receipts are presented in Table 3 below.

Table 3: Replacement of Debt Finance

	2017/18 actual	**2018/19 forecast**	**2019/20 budget**	**2020/21 budget**	**2021/22 budget**
	£m	**£m**	**£m**	**£m**	**£m**
Own resources	1.3	1.3	1.1	1.6	2.0

2.3.3 The Council's annual MRP statement can be found at Appendix 2 below.

2.3.4 The Council's cumulative outstanding amount of debt finance is measured by the Capital Financing Requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt. The CFR is expected to increase by £54.1 million in 2019/20. Based on the above figures for expenditure and financing, the Council's estimated CFR is presented in Table 4 below.

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement (CFR)

	31.3.2018 actual	31.3.2019 forecast	31.3.2020 budget	31.3.2021 budget	31.3.2022 budget
	£m	£m	£m	£m	£m
General Fund services	55.6	112.5	130.8	189.9	200.1
Council housing (HRA)	42.6	42.6	42.6	42.6	42.6
Capital investments	24.4	8.9	44.7	11.6	2.5
TOTAL CFR	**122.6**	**164.0**	**218.1**	**244.1**	**245.2**

3. Asset Management

3.1 Asset Management Strategy

3.1.1 The Council recognises the importance of ensuring that capital assets continue to be of long-term use especially in a rapidly changing operational and technological backdrop. Consequently, at the time of preparing this Capital Strategy, a new Asset Management Strategy (AMS) is under development. Led by the Asset Management team and backed by a comprehensive review of Council assets, the AMS will take a longer-term view comprising:

- 'Good' information about existing assets;
- The optimal asset base for the efficient delivery of Council objectives;
- The gap between existing assets and optimal assets;
- Strategies for purchasing and constructing new assets, investment in existing assets, transferring of assets to other organisations and the disposal of surplus assets; and
- Plans for individual assets.

3.2 Asset Disposals

3.2.1 When a capital asset is no longer needed, it may be sold so that the proceeds(known as capital receipts) can be spent on new assets or to repay debt. The Council is also permitted to spend capital receipts on service transformation projects until 2021/22. Repayments of capital grants, loans and investments also generate capital receipts. The Council takes a prudent approach of assuming future capital receipts only when there is a high probability of realisation.

4. Treasury Management

4.1 Introduction

4.1.1 Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Council is not cash rich as it utilises all of its available cash before borrowing which in the current climate is more economic.

4.1.2 As at 31 December the Council had borrowing of £109.0 million at an average interest rate of 2.83% and cash balances of £5.0 million held on an interest bearing current account at a rate of 0.65%.

4.2 Borrowing

4.2.1 The Council's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in the future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.75%) and long-term fixed rate loans where the future cost is known but higher (currently 2.0 to 3.0%).

4.2.2 Projected levels of the Council's total outstanding debt (which comprises borrowing and leases) are shown below in Table 6, compared with the Capital Financing Requirement (Table 4 above).

Table 6: Prudential Indicator: Gross Debt and the Capital Financing Requirement

	31.3.2018 actual	31.3.2019 forecast	31.3.2020 budget	31.3.2021 budget	31.3.2022 budget
	£m	£m	£m	£m	£m
Debt (incl. leases)	101.7	143.9	199.0	226.6	229.6
Capital Financing Requirement	122.6	164.0	218.1	244.1	245.2

4.2.3 Statutory guidance is that debt should remain below the Capital Financing Requirement, except in the short-term. As can be seen from Table 6, the Council expects to comply with this in the medium term.

Affordable Borrowing Limit

4.2.4 The Council is legally obliged to set an affordable borrowing limit (also termed the "Authorised Limit" for external debt) each year. In line with statutory guidance, a lower "Operational Boundary" is also set as a warning level should debt approach the limit.

Table 7: Prudential Indicators: Authorised Limit and Operational Boundary for External Debt

	2018/19 limit	2019/20 limit	2020/21 limit	2021/22 limit
	£000's	£000's	£000's	£000's
Authorised limit – total external debt	179.0	233.1	259.1	260.2
Operational boundary – total external debt	164.0	218.1	244.1	245.2

4.2.5 Further details on borrowing are contained in the Treasury Management Strategy.

4.3 Investments

4.3.1 Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management.

(Treasury Management) Investment Strategy

4.3.2 The Council's Investment Strategy is to prioritise security and liquidity over yield; focussing on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely in selected high-quality banks, to minimise the risk of loss.

4.4 Governance

4.4.1 Treasury management decisions are made on a daily basis and are therefore delegated to the CFO, who must act in line with the Treasury Management Strategy approved by the Council. Annual outturn reports on treasury management are also approved by the Council (following recommendation from Audit and Governance Committee), whereas mid-year updates are reported exclusively to the Audit and Governance Committee. Quarterly performance reports are also submitted to Cabinet.

5. Investments for Service Purposes

5.1 The Council will sometimes make investments for service delivery purposes where there is a strategic case for doing so, for example the new Waste Company. Given its public service objectives, the Council is willing to take more risk than with treasury investments, nevertheless the arrangements feature cost reduction incentives, from which the Council will benefit.

Governance

5.2 Decisions on service investments are made by the Council's Cabinet and require the support of a full business case.

6. Commercial Investments

6.1 Current Investments

6.1.1 In recent years, the Council has invested in commercial property in the borough on a selective basis, usually where there is a fit with corporate priorities and a positive financial return that can be used to contribute towards the protection of local services. As at 31st March 2018, the commercial property portfolio comprised a retail park, sports complex, members club and commercial units with an estimated Fair Value of £23.9 million. Estimated gross income for 2018/19 is £1.8 million.

6.2 Commercial Investment Strategy

6.2.1 However, in recognition of the continued shortfall in local government funding and commitments made in the, the Council will be preparing a Commercial Investment Strategy in the next financial year with a view to achieving a step change increase in commercial investment and trading by the Council.

6.2.2 CIPFA's guidance on borrowing to invest follows MHCLG's concern at what they perceive to be, the increasing risk taken on by local authorities following a sharp increase in Public Works Loan Board (PWLB) borrowing by councils to invest in commercial property. CIPFA has made it clear that Councils should not borrow to invest commercially and their Capital Investment Strategy must make it clear as to where they depart from this principle and why. However, it has been recognised that local investments that are primarily designed for regeneration or service delivery purposes and which have a knock-on positive impact to the revenue budgets are not intended to covered by this principle.

6.2.3 Councils have to demonstrate that such investments are "proportionate" to their resources. The Council's approach will incorporate the CIPFA guidance when it is published; this will enhance the other risk management features that are being developed; this includes a strict governance framework, the use of real estate investment experts and diversified portfolios. The aim is to offset principle risks such as falling capital values and ‘voids’. However, (within a tightly controlled framework) the Council ultimately accepts a higher risk on commercial investments compared to its prudent treasury investment that have primarily focused to date on protecting the principal.

6.2.4 The Council considers investing in housing properties and commercial investments within the borough to be related to its temporary accommodation strategy and local regeneration. It will invest commercially but in relation to the services it provides or to build and strengthen the local economy, with the related benefit of increased business rates.

6.3 Governance

6.3.1 At the time of preparing this Strategy, the Governance arrangements are being developed as part of the Commercial Investment Strategy.

7. Other Liabilities

7.1 Outstanding Commitments

7.1.1 The Council also has the following outstanding commitments:

- The Council has also set aside £1.2 million (as at 31st March 2018) to cover the financial risk associated with Business Rates appeals lodged with the Valuation Office Agency (VOA); and

7.2 Guarantees

7.2.1 Eastbourne Homes Ltd (EHL) is a wholly owned subsidiary of the Council. The Council guarantees the company and as at 31 March 2018 EHL had net assets of £1.6m.

7.2.2 The Council’s investment company, ICE, is guaranteeing a property deal in Leicester, for which the Council will act as second guarantor. It will guarantee a private organisation the rental stream. It has had expert advice on the legality of the deal and the ability of the Council to invest into the deal, as well as received advice on the Treasury and accounting implications. In simple terms, the Council is taking on another organisation’s risk with the deal and as such has a contingent liability that it will recognise in its accounts.

7.2.3 The Council also commissioned specialist advice on the tenancies and the likelihood of default to determine was to whether the risk was acceptable. ICE is receiving an appropriate continuing payment for this guarantee and it will pass these monies on to the Council. It is also receiving a 50% share of the proceeds of the capital receipts from the disposal of the asset that is expected 30 years after the start of the contract.

7.2.4 This is a non-financial commercial investment, involving no borrowing in advance of need. The Council monitors the risks and returns on a regular basis. It will mitigate against the risks by reserving monies from the income stream.

7.3 Governance

7.3.1 Decisions on incurring new discretionary liabilities are taken by Directors and Heads of Service in consultation with the CFO. For example, in accordance with the Financial Procedure Rules credit arrangements, such as leasing agreements, cannot be entered into without the prior approval of the CFO.

8. Revenue Implications

8.1 Financing Cost

8.1.1 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, Business Rates and general Government grants.

Table 8: Prudential Indicator: Proportion of Financing Costs to Net Revenue Stream (General Fund)

	2017/18 actual	**2018/19 forecast**	**2019/20 budget**	**2020/21 budget**	**2021/22 budget**
	£m	**£m**	**£m**	**£m**	**£m**
Financing Costs (£)	1.5	1.8	2.0	2.6	3.4
Proportion of Net Revenue Stream	10.3	12.1	13.2	17.2	22.6

Table 9: Prudential Indicator: Proportion of Financing Costs to Net Revenue Stream (HRA)

	2017/18 actual	**2018/19 forecast**	**2019/20 budget**	**2020/21 budget**	**2021/22 budget**
	£m	**£m**	**£m**	**£m**	**£m**
Financing Costs (£m)	1.8	1.9	1.9	1.5	1.3
Proportion of Net Revenue Stream	12.3	13.0	13.0	10.3	9.0

8.1.2 Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for many [occasionally up to 50] years into the future.

8.2 "Prudence, Affordability and Sustainability"

8.2.1 The CFO is satisfied that the proposed Capital Programme (Section 2) is prudent, affordable and sustainable based on the following:

<u>*Prudence*</u>

- Prudential indicators 8 and 9 presented above (Paragraph 8.1.1) are within expected and controllable parameters. Thus:
  - *Prudential Indicator 8 (General Fund) - Proportion of Financing Costs to Net Revenue Stream* – the growth in financing costs reflects the Council's ambitions for capital investment in its strategic priorities over the medium-term.
  - *Prudential Indicator 9 (HRA) - Proportion of Financing Costs to Net Revenue Stream* – the indicator profile mirrors the HRA 30-Year Business Plan.
- *Underlying Prudent Assumptions* – a prudent set of assumptions have been used in formulating the Capital Programme. This is illustrated in the approach to capital receipts whereby the proceeds are not assumed within projections until the associated sale is completed and the money received by the Council; and
- *Repairs and Maintenance* – the approach to asset maintenance is professionally guided with assets maintained in a condition commensurate with usage and expected life, addressing those items that could affect ongoing and future maintenance, in the most appropriate and cost effective manner.

Affordability

- The estimated 'revenue consequences' of the Capital Programme (£7.9 million over three years) have been included in the 2019/20 Budget and Medium-Term Financial Strategy (MTFS), extending to 2021/22; and
- The MTFS includes a reserves strategy, which includes contingency funds in the event that projections are not as expected (further supported by CFO report to Council under Section 25 of the Local Government Act 2003 on the robustness of estimates and the adequacy of financial reserves and balances).

Sustainability

- Capital schemes that are expected to deliver long-term revenue savings/generate income are given due priority. For example, the Hampden Retail Park.
- As explained in Section 3.1 above, the Asset Management Strategy will represent an enhancement to the Council approach to asset planning through (especially) taking a longer-term view. This includes providing for future operational need, balancing the requirement to achieve optimal performance, whilst taking account of technological change and managing the risk of obsolescence.

9. Knowledge and Skills

9.1 Officers

9.1.1 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. Most notably:

- *Finance* - the Chief Finance Officer (CFO) is a qualified (ACCA/ CIPFA) accountant with many years of public and private sector experience. The Council sponsors junior staff to study for relevant professional qualifications including AAT, CIPFA and ACCA. The Council also supports training courses and conferences across all aspects of accounting.
- *Property* – the Head of Property and Facilities Shared Service (PFSS) – a qualified property expert - is responsible for Asset Management within the Council. PFSS comprises the Asset Development, Building and Maintenance, Corporate Landlord and development functions of the Council. Each area has appropriately qualified professionals within their individual specialism. The Head of PFSS plays a key role in the Council's approach to commercial investment and trading (highlighted above in Section 6).

9.1.2 The Council also has a separate Housing team that is responsible for overseeing social housing developments within the borough.

9.2 External Advisors

9.2.1 Where the Council does not have the relevant knowledge and skills required, judicious use is made of external advisers and consultants that are experts/specialists in their field. The Council currently employs Link Asset Services as Treasury Management advisers, and the Asset Management team will commission property advisors as appropriate (e.g. development managers, valuers etc.) to support their work where required to ensure that the Council has access to knowledge and skills commensurate with risk.

9.3 Councillors

9.3.1 May 2019 will see the election for some new councillors. Duly elected councillors will therefore all receive training appropriate to their role in the new Council.

9.3.2 Specifically with regard to Treasury Management, the Council acknowledges the importance of ensuring that members have appropriate capacity, skills and information to effectively undertake their role. To this end, newly elected Eastbourne councillors with Treasury Management responsibilities will receive tailored training sessions from the Council's Treasury Management advisors (Link Asset Services).

10. CFO Statement on the Capital Strategy

10.1 Prudential Code

10.1.1 Paragraph 24 of the recently updated Prudential Code determines that….”the Chief Finance Officer should report explicitly on the affordability and risk associated with the Capital Strategy”.

10.1.2 Accordingly, it is the opinion of the CFO that the Capital Strategy as presented is affordable, and associated risk has been identified and is being adequately managed.

10.2 Affordability

10.2.1 The Capital Strategy is affordable and there is a range of evidence to support this assertion, including:

- *Capital Programme* – the Programme as presented above (in Section 2.1) is supported by a robust and resilient MTFS extending through until 2021/22 that contains adequate revenue provision, including sufficient reserves in the event that plans and assumptions do not materialise as expected.
- *Asset Management* – as presented above (in Section 3.1) a new Asset Management Strategy is under development, which is taking a strategic longer-term (i.e. beyond 2021/22) view of the Council's asset base. A fundamental aim of the Strategy is to achieve the optimum balance between future operational need and affordability, which will be reflected in its component parts including strategies for purchasing and constructing new assets, investment in existing assets, transferring of assets to other organisations and the disposal of surplus assets.
- *Commercial Investment* – as presented above (in Section 6.2) the Commercial Investment Strategy is also under development. The primary aim of the Strategy long-term is income generation to replace the shortfall in Government funding. The Strategy is progressing positively towards the delivery stage and its success will be critical to the long-term affordability of the Capital Strategy.

10.3 Risk

10.3.1 The risk associated with the Capital Strategy has been identified and is being adequately managed. Evidence to support this assertion includes:

- *Treasury Management Strategy* – the Council will formally approve a Treasury Management Strategy for 2019/20, at the Council meeting on 20 February 2019, in accordance with CIPFA's "Treasury Management in the Public Services: Code of Practice 2017". That Strategy was developed by the Council's (professionally qualified and experienced) Finance team and informed by specialist advisors Link Asset Services and other relevant and extant professional guidance.
- *Investment Strategy* – the Council will also formally approve an Investment Strategy for 2019/20, at the Council meeting on 20 February 2019, in accordance with MHCLG's "Statutory Guidance on Local Government Investments (3rd Edition) 2017". As with the Treasury Management Strategy, the Investment Strategy was developed by the Finance team and informed by specialist advisors Link Asset Service and other relevant and extant professional guidance.
- *Commercial Activities* – as noted above (in Paragraph 6.2) the Council is committed to significantly expanding the scale of its commercial activities in the medium-term as part of its Commercial Investment Strategy. It is recognised and accepted that increased commercial activity brings with it additional risk. The Strategy is therefore being developed in accordance with contemporary best practice. This includes the engagement of professional advisors on the commercial, financial and legal aspects of the project and the preparation of full supporting business cases prior to the commencement of both in-house and arm's length trading activities, strictly in accordance with HM Treasury's 'five-case model' ("The Green Book: Central Government Guidance on Appraisal and Evaluation").

11. Capital Strategy Updates

11.1 The Capital Strategy is a 'living document' and will be periodically, usually annually, updated to reflect changing local circumstances and other significant developments. However, the development of the Asset Management Strategy and the Commercial Investment Strategy (explained above in Sections 3 and 6) are both major initiatives that could have a material impact on the Strategy as early as 2019/20, once full details are known. In the event that this happens, the Capital Strategy will be updated and re-presented to full Council.

Appendix 2 Minimum Revenue Provision (MRP) Policy Statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the Capital Financing Requirement - CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

MRP represents the minimum amount that must be charged to an authority's revenue account each year for financing capital expenditure, which will have initially been funded by borrowing. This is to ensure an authority can pay off the debts it has from investing in capital assets. Where there are opportunities to reduce the borrowing requirements from more certain and guaranteed capital receipts, the Council's MRP is appropriately reduced.

MHCLG regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. There are four primary options:

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP options are:

Either

- Existing practice - MRP will follow the existing practice outlined in former MHCLG regulations (option 1); or
- Based on CFR – MRP will be based on the CFR (option 2);

These options provide for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy options are:

- Asset life method – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3);
- Depreciation method – MRP will follow standard depreciation accounting procedures (option 4);

These options provide for a reduction in the borrowing need over approximately the asset's life. There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place). Repayments included in annual PFI or finance leases are applied as MRP. It is important to note that changes in the Local Government Financial Regulations means that in the future operating leases will be treated in a manner consistent with financial leases.

Recommendations

The Council is recommended to approve the following MRP Statement:

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be based on the CFR and use the 4% reducing balance method.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be the Asset life method – MRP will be based on the estimated life of the assets, in accordance with the regulations (commonly referred to as option 3).

Furthermore, the Council intends to use the default position of an annuity model for all capital projects except for transformation and ICT projects, which will use a straight line (EIP – Equal Instalment Payment) approach, as the benefit is more immediate and where an annuity method would not be appropriate.

The Council reserves the right to make voluntary MRP contributions, those charges over and above the statutory minimum levels, where it deems appropriate or to use capital receipts to reduce the Capital Financing Requirement. This is intended to reflect the situation, but not limited to, if the asset is significantly impaired or the asset life is now viewed as likely to be shorter than was originally anticipated.

A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2019, there were no VRP overpayments.

The Council does not charge MRP till the year following the Capital scheme is complete and the first year in which the asset is in full operation.

Appendix 3 Economic Background

Overview

The UK economy appears to have started Q4 growing at a more modest pace than seen in Q3. The business surveys are suggestive of almost flat output in November, while household spending has succumbed and weakened, which is no great surprise, given that Brexit is weighing heavily on activity. It is possible that the surveys may be a touch on the glum side and overstate the slowing, as was the case post-referendum. Analysts suggest that Q4 growth will still slow, but at 0.3% would put growth at 1.3% for the year.

Europe is suffering internally from a two pronged political threat. On the one hand is the ongoing uncertainty of Brexit which seems set to continue into the New Year, while on the other is the shenanigans in Italy, where the economy is on the brink of recession and the government is under pressure to revise its budget plans to bring them in line with bloc policy. On top of this, Donald Trump's weekly meanderings over his trade strategy does little to alleviate the concerns of exporters, particularly auto-makers, in the EZ region.

US economic strength should ensure that the Fed raises interest rates again in December, but the weakening global economic backdrop, noted by the central bank, could result in a shallower upcurve for US rates if persistent. The strong dollar and softer global demand will dent the manufacturing sector in the coming months but the domestic economy remains healthy and falling oil prices will be supportive. The labour market remains extremely tight and core inflation is running at target level, which should give the Fed the option to continue to gradually ratchet up interest rates.

There was contraction in the Japanese economy in Q3 but this should prove short lived. The latest income figures could be more worrying for the Bank of Japan, which had indicated that the pace of wage growth offered signs of inflationary pressures. However, worker compensation slowed in Q3 and that for Q2 was revised lower, thus the uptrend in wages looks less optimistic. Regular earnings figures are also slowing, with annual growth running below 1% and thus well short of the level needed to generate 2% inflation.

UK

The first Q3 GDP growth estimate offered a healthy figure of 0.6%, but early data points to a sharp slowing in Q4. The November composite PMI points to just 0.1% growth but that does not include high street activity which is known to be having a tough quarter as the summer spending spree is replaced by winter belt tightening. It should, though, be remembered that the Brexit impact has been reflected with over-pessimism by previous PMIs and the CBI's view of the broader economy is more optimistic. Analysts suggest that the economy will expand by just 1.3% over the calendar year, which would be the weakest since the financial crisis.

The hot summer boosted household spending to more than offset weaker car sales in Q3, but that is not expected to be sustained despite car sales remaining soft in November. The British Retail Consortium indicates a sharp slowing of high street sales growth. Brexit uncertainty remains a drag on spending decisions, with November consumer confidence falling to the lowest level since 2013. Annual consumer credit growth eased further in October but is running at a more sustainable level. However, with real wages improving, household spending should be supported in the near term.

The full Q3 trade deficit of £2.3bn was the smallest quarterly deficit for five years, as the September deficit came in at nearly zero. Net trade offered a healthy contribution to Q3 growth on strong export growth against near flat import growth. The latter was probably impacted by changes in EU emission tests so Q4 could see an import drag as car sales recover. Recent export strength may not continue as the post-Brexit benefit of sterling weakness dissipates. To date, Q4 surveys are suggestive of weak goods export growth.

A dip in part time work was in part offset by increased full time employment in September which left total employment slightly higher. Annual employment growth improved to 1.1% and surveys indicate that steady growth should continue. However, expansion of the workforce also saw unemployment increase. Employment growth comes as the numbers of non-UK workers is on the decline, which has seen employers competing for workers, reflected by a pickup in pay growth to the fastest rate in ten years, with survey indicators in line with current 3.25% growth being maintained.

CPI inflation was unchanged at 2.4% in October as rising energy costs offset declining imported inflation. Core inflation remained just below 2%. Imported inflation is likely to continue to soften, while falling oil prices in recent months will see the fuel impact on inflation weaken. As a consequence, forecasters expect inflation to move back towards the 2% level.

Monetary Policy

In the UK the interest rate view remains slightly misted by the ongoing uncertainty surrounding a Brexit deal with the EU. The Bank of England gives all the signs that the MPC would like to push the button on another hike, but will hold back until after the break has become official and a deal has been agreed/approved. However, a “no deal” would bring a new dimension to market thoughts and would likely see the Bank hold back until the impact of such an outcome becomes clearer. Over the course of the month, market expectations have proved fairly volatile with the markets now less confident that there will be a rate hike in Q1 2019.

Markets

- After strengthening in early November, Sterling suffered a sharp reverse in fortunes as the month progressed as the uncertainty over Brexit ebbed and flowed, with the Prime Minister’s Brexit deal set to be resoundingly rejected by Parliament.

- Interest rate expectations remain volatile, but have been pared back, with a pre-Brexit hike highly unlikely.

- Gilt yields have eased back as a reaction.

- Brent crude slid through the month, as supply looks set to increase at a time when there are concerns about global growth slowing.

- The end of the month saw Sterling post gains against both the US$ and €uro on the back of heightened confidence of a Brexit deal and, at the beginning of November, a hawkish tone to the MPC meeting minutes and Inflation Report, as interest rate expectations increased. Rates are, though, not seen as rising prior to Brexit.

Appendix 4 Investment Strategy

Introduction

The Council invests its money for two broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as treasury management investments), and
- to earn investment income (known as commercial investments where this is the main purpose).

This investment strategy is a new report for 2019/20, meeting the requirements of statutory guidance issued by the government in January 2018, and focuses on the second of these categories.

Treasury Management Investments

The Council typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and Central Government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy. The balance of treasury management investments is expected to fluctuate between £0m and £10m during the 2019/20 financial year.

Contribution: The contribution that these investments make to the objectives of the Council is to support effective treasury management activities.

Further details: Full details of the Council's policies and its plan for 2019/20 for treasury management investments are covered within the body of this report.

Commercial Investments: Property

Contribution: The Council invests in local commercial property with the intention of making a profit that will be spent on local public services.

Table 1: Property held for investment purposes in £ millions as at 31 March 2018

Property type	Purchase cost	Gains/ (Losses)	Value in Accounts
Acquired before 31.12.13	Not available	Not available	2.07
Acquired after 31.12.13	22.65	(0.82)	21.83

Security: In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

The fair value of the Council's investment property portfolio is no longer sufficient to provide security against loss. However, the Council fully expects the fair value to increase following significant works to the site at the Retail Park, with the fair values expected to increase to that exceeding the original purchase price.

Risk assessment: The Council assesses the risk of loss before entering into and whilst holding property investments by assessing the viability of the cost of financing the investment against the return on investment in terms of receivable income. Investments that are subject to short leases are unlikely to be considered due to the high risk of potential voids.

Liquidity: Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed; the Council ensures that borrowing is on an equal instalment basis and that revenue budgets cover the cost of the loan repayment.

Loan Commitments and Financial Guarantees

The following table provides the loan facilities that have been made available to Eastbourne Housing Investment Company Ltd (EHICL) and Aspiration Homes LLP subject to individual scheme appraisals. Loans are provided on a secured basis and interest charged at a commercial rate. Currently most loans are charged interest at 4.5%.

Company	**Total Facility**	**Agreed/Drawndown**	**Available for schemes**
	£m	**£m**	**£m**
EHICL	39.17	6.04	33.13
AH	10.00	4.52	5.48
Total	**49.17**	**10.56**	**38.61**

For full details of guarantees see Appendix 1 para. 7.2.

Capacity, Skills and Culture

Elected members and statutory officers: It is important that the members and officers involved in the Treasury Management function have appropriate capacity, skills and information to enable them to take informed decisions on specific investments, to assess the risk and strategic objectives and to ensure that the Council's risk exposure is managed. Periodically the Council's external Treasury advisors, Link Asset Services will hold member training sessions which will provide members with a raft of technical advice specifically designed for the Council's environment. Additionally, Officers have a wide range of information available to them from various sources such as the Charted Institute of Public Finance and Accountancy (CIPFA), Link Asset Services and Room 151. Officers will also attend a number of courses/seminars throughout the year and have periodical strategic meetings with the Council's treasury advisors.

Commercial deals: Officers negotiating commercial deals are aware of the core principles of the prudential framework and of the regulatory regime within which local Authorities operate and have access to a number of external bodies who can provide specific advice and direction.

Corporate governance: All of the Council's procedures provide a corporate governance arrangement that ensure accountability and for decision making on investment activities and ensure that the Council's Chief Finance Officer/Section 151 Officer is fully briefed on the Council's investment position at any one time.

APPENDIX 5 - Specified and Non-Specified Investments and Limits

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

	*** Minimum 'High' Credit Criteria**
Debt Management Agency Deposit Facility	--
Term deposits – local authorities	--
Term deposits – banks and building societies (See appendix 5 for approved Counties)	Green - See note below
Collateralised deposit	UK sovereign rating
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	UK sovereign rating
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	UK sovereign rating
UK Government Gilts	UK sovereign rating
Bonds issued by multilateral development banks	AAA
Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government (refers solely to GEFCO – Guaranteed Export Finance Corporation)	UK sovereign rating
Sovereign bond issues (other than the UK govt)	AAA
Treasury Bills	UK sovereign rating

Term deposits with nationalised banks and banks and building societies

	Minimum Credit Criteria	**Max % of total investments**	**Max. maturity period**
UK part nationalised banks	Blue - See note below	£5.0m	1 year

Eastbourne Borough Council uses Link's credit worthiness service which overlays colour bandings to determine the maximum length of any investment. See Appendix 3 for further detail.

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

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the Specified Investment criteria. A maximum of 25% will be held in aggregate in non-specified investment.

Maturities in excess of 1 year

	Minimum Credit Criteria	**Max % of total investments**	**Max. maturity period**
Term deposits – local authorities	--	£2m with any institution	2 years
Term deposits – banks and building societies	Green	£2m with any institution	2 years
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	UK sovereign rating	£2m with any institution	2 years
Certificates of deposit issued by banks and building societies	Green	£2m with any institution	2 years
UK Government Gilts	UK sovereign rating	£2m with any institution	2 years
Bonds issued by multilateral development banks	AAA	£2m with any institution	2 years
Sovereign bond issues (other than the UK govt)	AAA	£2m with any institution	2 years
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)			
1. Bond Funds	Long-term AA- volatility rating	£2m with any institution	2 years
2. Gilt Funds	Long-term AA- volatility rating	£2m with any institution	2 years
3. Property Funds	Long-term AA- volatility rating	£5m with any institution	

Local Authority Mortgage Scheme.

Under this scheme the Council is required to place funds of £1,000,000, with the Lender for a period of 5 years. This is classified as being a service investment, rather than a treasury management investment, and is therefore outside of the specified / non specified categories.

APPENDIX 6 – Creditworthiness Policy

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

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

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

- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No Colour not to be used.

This methodology does not apply the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties. The Link creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of Short Term rating F1, Long Term rating A-, Individual of Viability ratings of C- (or BB+), and a Support rating of 3. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Link creditworthiness service. If a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately. In addition to the use of credit ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

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

Appendix 7 – The Treasury Management Role of the Section 151 Officer

The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.

Role extended by the revised CIPFA Treasury Management and Prudential Codes 2017as set out below.

preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe;

- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money;
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority;
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing;
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees;
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority;
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above.