Report to Audit Committee

12 December 2018

By the Director of Corporate Resources

DECISION REQUIRED

Not exempt

Horsham District Council

Capital Strategy 2019/20 incorporating Investment and Treasury Management Strategy

Executive Summary

This report is a new report for 2019/20, required by changes in CIPFA and the Ministry of Housing, Communities and Local Government (MHCLG) guidance. It combines an overview of how capital expenditure, capital financing, treasury and other investment activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. The strategies set limits and indicators that embody the risk management approach that the Council believes to be prudent. The strategies are set against the mid-term financial strategy, the context of the UK economy and projected interest rates.

The new report sets treasury investment criteria and limits which are largely unchanged. The investment strategy in section 5 pulls together information on commercial property to explicitly show the Councils risk management approach in that area.

Recommendations

The Committee is asked to:

i) approve the Capital Strategy as an appropriate overarching strategy for the Council while leaving the full Council to approve the updated capital strategy that will accompany the 2019/20 budget to Council in early 2019.

ii) recommend that the full Council approve the Treasury Management Strategy for 2019/20 and the associated limits and specific indicators included in section 4 and appendix B of this report.

iii) recommend that the full Council approve the Investment Strategy for 2019/20 and the associated limits and specific indicators included in section 5 and appendix C of this report.

Reasons for Recommendations

i) The Council has is required to have regard to the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) and Prudential Code which requires the Council to approve Capital strategy, investment strategy and a treasury management strategy before the start of each financial year.

ii) The Ministry for Housing Communities and Local Government (MHCLG) issued revised guidance on local authority investments in 2017 that the Council is required to have regard to.

Background Paper
"Medium Term Financial Strategy 2019/20 to 2021/22" – Cabinet 22 November 2018

Consultation: Arlingclose Limited

Wards affected: All

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Background Information

1 Introduction

The purpose of this report

1.1 This is a new report responding to a revised set of Codes and guidance that the Council must, by statue, have regard to. Section 3 gives a high-level overview of:
- how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services
- how associated risk is managed and;
- the implications for future financial sustainability.

1.2 The Treasury Management Strategy at section 4 is the usual report that this Committee has traditionally considered. It covers management of the Council's cash flows, borrowing and investments, and the associated risks. The investment strategy at section 5 is a new requirement for 2019/20 and covers investments held for service purposes or for commercial profit which were not included in the Treasury Management Strategy.

1.3 The changes to guidance are designed to bring together areas which CIPFA and MHCLG consider should be regarded in the round. They are also a response to the increasing commercialisation of local government and especially the increasing investment in commercial property. The guidance requires the capital and investment strategies to be approved by the full Council while the treasury management strategy can now be approved by a subcommittee of the Council although here we follow the Council's existing Constitution that this Committee recommends the Treasury Management Strategy be approved by the full Council (Constitution 4e 30).

2 Background

Economic background

2.1 The Council's strategies must take account of expectations for the economy and specifically the finance sector. The Council receives advice on this from its advisors Arlingclose Ltd. Appendix A is a commentary by them on the current economic background, the outlook for creditworthiness and interest rates.

2.2 The forecast for the Bank Rate is that it rises gradually in the medium term but stays at levels that are below the historical average. For the purpose of the interest budget, any new investments are estimated to be on or about the Bank Rate.

2.3 The treasury management environment remains difficult with yields and quality counterparties still reduced in the aftermath of the financial crisis of 2008 with no return to pre-crisis rates in sight. Governments and regulators have put in place measures prompted by the crisis that restrict any government bail-out of individual financial institutions. This means an institution in difficulty may have to use its own resources and its deposits to continue to operate, exposing any depositor's capital.

Statutory background

2.4 This report is part of the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the Ministry for Housing, Communities and Local Government (MHCLG) Guidance.

2.5 The regulatory background has been complicated by the revision by both CIPFA and MHCLG codes and guidance. Both CIPFA and the MHCLG state they do not seek to prescribe precisely how councils invest but they clearly have concerns that some councils are taking increasing commercial risks using borrowed money. This approach means that Members are asked to look at a more extensive strategy so that more of the risks that the Codes and guidance highlight are apparent to Members.

Relevant Council policy

2.6 The Council's constitution requires that the Council approve Prudential Code indicators and Treasury Management Strategy. The Investment Strategy covering commercial property has been split from the traditional Treasury Management Strategy here for ease of understanding as it deals with a different type of investment but it can be considered to be encompassed in the definition of the Treasury Management Strategy as used by the Constitution.

2.7 The existing Treasury Management Strategy 2018/19 and Prudential indicators were approved by the Council on 21 February 2018 the former having been approved by the Audit Committee on 13 December 2017.

3 Capital Expenditure and Financing

3.1 Capital expenditure is where the Council spends money on assets, such as property or vehicles that 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. 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 or leasing).

3.2 Service managers bid annually in October to include projects in the Council's capital programme. Bids are collated by Finance who calculate the financing cost (which can be nil if the project is fully externally financed). The Senior Leadership Team appraises all bids based on a comparison of service priorities against financing costs and makes recommendations to the informal cabinet. The final capital programme is then presented to Cabinet in January and to Council in February each year.

3.3 The current projected capital programme and financing is shown below. It includes current estimates for capital bids for 2019/20 and beyond. The use of reserves is in line with the Medium Term Financial Strategy report to the Cabinet of 22 November 2018. It will be revised if necessary as the 2019/20 budget process develops and the final figures appear alongside the Budget in February 2019 will constitute one of the prudential indicators required by the CPIFA Prudential Code.

£millions	2017/18 Actual £000	2018/19 Revised £000	2019/20 Revised £000	2020/21 Revised £000	2021/22 Estimate £000
Projected Capital Expenditure	28.2	18.2	15.6	10.8	11.8
Financed by:					
External resources	1.7	3.9	2.8	6.3	5.3
Internal Resources *	11.1	7.9	11.5	3.9	4.0
Debt	15.4	6.4	1.3	0.6	2.5
Total Financing	28.2	18.2	15.6	10.8	11.8

* Includes use of New Homes Bonus

3.4 The term Debt used above does not automatically lead to external borrowing as the Council may be able to use cash it holds in reserves and as working capital which is usually termed internal borrowing. Over time all debt whether it be internal or external borrowing must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP). The Council is required to make an annual MRP statement and this will be included in the Budget report in January 2019 and the methodology will be on the same basis as 2018/19. The current planned MRP payments are as follows:

£millions	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget
MRP	0.924	0.870	0.881	0.941	0.940

3.5 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 any capital receipts used to replace debt. The CFR is expected to increase by £1.3m during 2019/20. The Council's estimated CFR is as follows:

£millions	31.3.2018 actual	31.3.2019 forecast	31.3.2020 budget	31.3.2021 budget	31.3.2022 budget
CFR	30.4	36.0	36.3	36.0	37.5

3.6 **Asset disposals:** 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. Repayments of capital grants, loans and investments also generate capital receipts. The Council projects capital receipts as follows:

	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget
Asset sales	1.719	1.350	1.625	3.300	5.775
Loans repaid	0	0.053	0.028	0.029	0.030
TOTAL	**1.719**	**1.403**	**1.653**	**3.329**	**5.805**

4 **Treasury Management**

4.1 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 typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing. The Council currently has £4m borrowing at an average interest rate of 3.4% and £46.4m treasury investments at an average rate of 1.9%.

4.2 **Borrowing strategy**: The Council's only borrowing is £4m which is being repaid on 31 March 2019. No further borrowing is planned next financial year but the Council could find itself in a position which calls for some borrowing. In that circumstance the main objectives when borrowing would be to achieve a low but certain cost of finance while retaining flexibility. These objectives are often conflicting, and the Council therefore would seek 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%).

4.3 Projected levels of the Council's total outstanding debt (which comprises borrowing and leases) are shown below, compared with the Capital Financing Requirement. Statutory guidance is that debt should remain below the Capital Financing Requirement, except in the short-term. As can be seen from the table the Council expects to comply with this in the medium term.

£millions	**31.3.2018 actual**	**31.3.2019 forecast**	**31.3.2020 budget**	**31.3.2021 budget**	**31.3.2022 budget**
Debt (incl. leases)	4	4	2	2	2
CFR	30.4	36.0	36.3	36.0	37.5

4.4 The table above demonstrates that the Council is relying on internal borrowing i.e. using reserves and other cash resources that it holds rather than borrow from external sources. From projections of the capital programme and use of reserves this strategy is seen as sustainable in the medium term although the Director of Corporate Resources will monitor the actual position against the projections in order to be ready to respond should external borrowing become advisable. In this the Council will use advice from Arlingclose as to the best course of action.

4.5 **Affordable borrowing limit**: Irrespective of plans to borrow or not 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. The increase in lease figures from 2019/20 reflects the fact that the accounting treatment of leases changes from that year. Although no borrowing is planned, limits are set in case a need develops in 2019/20. Further details on borrowing are in appendix B.

£millions	2018/19 limit	2019/20 limit	2020/21 limit	2021/22 limit
Authorised limit – borrowing	17	15	15	15
Authorised limit – leases	1	3	3	3
Authorised limit – total external debt	18	18	18	18
Operational boundary – borrowing	9	0	0	0
Operational boundary – leases	0	2	2	2
Operational boundary – total external debt	9	2	2	2

4.6 **Investment strategy:** 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 and will be dealt with in the Investment Strategy in section 5 and Appendix C.

4.7 The Council's policy on treasury investments is to prioritise security and liquidity over yield, that is to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Council may request its money back at short notice. The future longer term investments in the table below are strategic pooled funds that the council intends to hold for the longer term although they can be sold if required.

	31.3.2018 actual	31.3.2019 forecast	31.3.2020 budget	31.3.2021 budget	31.3.2022 budget
Near-term investments	20.0	12	2	4	12
Longer-term investments	17.6	17	17	17	17
TOTAL	**37.6**	**29**	**19**	**21**	**23**

4.8 The projections show cash balances increasing from 2020/21 as the major capital spends of the Bridge and Pirie's Place car park have finished and developers' contributions and New Homes Bonus flow in faster than they are spent. The New Homes Bonus projection used assumes that it reduces but does not end in the medium term. Further detail on treasury investments are in Appendix C including limits and indicators which the Committee is asked to consider.

4.9 **Governance:** Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Corporate Resources and staff, who must act in line with the Treasury Management Strategy as approved by the Council following this committee's scrutiny and recommendation. The Audit Committee receives a midyear and full year report and is responsible for scrutinising treasury management decisions made.

5 **Investment Strategy (loans, shares and property)**

5.1 This section is the disclosure newly required by CIPFA and MHCLG guidance. Both bodies have concerns over the increasing risks that they see in the sector as councils start their own companies and make large commercial property purchases.

Investments for Service Purposes

5.2 The Council has the ability to makes investments to assist local public services, including making loans to local service providers and any Council subsidiaries that provide services although at the time of writing there are no subsidiaries. In light of the public service objective, the Council is willing to take more risk than with treasury investments. However it still plans for such investments to generate a profit after all costs to offset risk.

5.3 **Governance:** Decisions on service investments are made by the full Council after the relevant Head of Service has submitted a comprehensive analysis in consultation with the Director of Corporate Resources and must meet the criteria and limits. Most loans and shares are capital expenditure and purchases will therefore also be approved as part of the capital programme in the Budget report or by full Council. Further details on service investments are in appendix C with a new limit of £1m on the total exposure to loans for service purposes and no exposure permitted for shares being held.

Commercial Activities

5.4 With central government financial support for local public services declining, the Council invests in commercial property purely or mainly for financial gain. Total commercial investments are currently valued at £47m, with the largest being the Forum Retail Unit at £12m. These provide a net return after direct costs of 6.6% based on the last set of final accounts which value the assets at market value rather than historical value.

5.5 As financial return is the main objective, the Council recognises the higher risk on commercial investment compared with treasury investments. The principal risk exposures include individual vacancies, falls in market value, changes in the overall and local economy. Individual property risks are constantly monitored and managed by the Head of Property. In order that commercial investments remain proportionate to the financial capacity of the Council, these are subject to an overall maximum investment limit which is set at £60m. Should income not meet expectations the Council holds £6m of general reserves available to balance the revenue budget in the short term while the Head of Property reviews the performance of the portfolio.

5.6 **Governance:** Decisions on new commercial investments are made by the Cabinet after recommendation from the Cabinet Advisory Sub-Committee (Property Investment) in line with the criteria and limits approved by the Council in this strategy. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme. Further details on commercial investments and limits on their use are in appendix C.

Other Liabilities

5.7 The Council has set aside £1.8m to cover risks of Business Rates Appeals. The Council is also at risk of having to pay for historic insurance claims but has not put aside any money because there is no reasonable assessment of the amount required. The Council is also committed to making future payments to cover its pension fund deficit should it arise.

5.8 **Governance:** Decisions on incurring new discretional liabilities are taken by the relevant Director whose directorate budget would cover the crystallisation of a liability. These would be discussed at the quarterly corporate risk management meeting and final decisions as to recognition taken by the Director of Corporate Resources. New liabilities exceeding £1m are reported to full Council for approval or notification as appropriate. Further details on liabilities are in note 18 of the 2017/18 statement of accounts.

Revenue Budget Implications

5.9 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. The table below shows the proportion is small.

	2017/18 actual	**2018/19 forecast**	**2019/20 budget**	**2020/21 budget**	**2021/22 budget**
Financing costs (£m)	0.1	0.25	0.01	0.06	-0.04
Proportion of net revenue stream	1%	2%	0%	1%	0%

5.10 **Sustainability:** Due to the long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 40 years into the future. The Director of Corporate Resources is satisfied that the proposed capital programme is prudent, affordable and sustainable because the net budget demand on the Council and the risks in the programme have been reviewed and fall within the Council's tolerances.

Knowledge and Skills

5.11 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Director of Corporate Resources and S151 Officer is a qualified accountant with over 25 years' experience and the Head of Property is a fellow of RICS with over 30 years' of experience in commercial property. The Council will support junior staff to study towards relevant professional qualifications.

5.12 Where Council staff do not have the knowledge and skills required, use is made of external advisers that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers and for any significant property investment would use property consultants with specialist knowledge of the appropriate property sector. This approach ensues access to right knowledge and skills and can be more cost effective than employing such staff directly. The overarching requirement is that the Council has access to knowledge and skills commensurate with its risk appetite.

6 Other courses of action considered but rejected

6.1 The MHCLG Investment Guidance and the CIPFA Codes of Practice do not prescribe any particular strategies for local authorities to adopt. The above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below:

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses will be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses will be smaller
Borrow additional sums at long-term fixed interest rates using less internal funds	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Invest more in service loans	Interest income will be higher and service benefits will accrue	Increased risk of losses from credit related defaults or service body being unable to pay loan and provide service
Reduce investment in property	Income will be lower	Lower chance of losses from non-paying tenants or falling property values.
Invest additional sums in property	income will be higher	Increased chance of losses from vacancies or falling property values. Reputational and regulatory risk if Council incurs large loss

7 Staffing consequences

7.1 There are no staffing consequences apart from the need for appropriate training.

8 Financial consequences

8 .1 The budgeted treasury investment income in 2019/20 is £0.89m (2018/19 £0.7m), which is equivalent to an average investment portfolio of £40m at an interest rate of 2.2%. The budget for debt interest paid in 2019/20 is £0.02m which is a contingency for possible short term borrowing. The budget for commercial property net income is £3.5m which is a yield of 7% from an investment portfolio of £47m.

9 Other considerations

9.1 Risks such as security of funds, liquidity, and interest rate risk are considered in the report. There are no consequences of any action proposed in respect of Crime & Disorder; Human Rights; Equality & Diversity and Sustainability.

Appendix A Economic background and interest rate forecast

Economic background

The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2019/20.

Following a weak reading in the first quarter of 2018 attributed to weather-related factors, UK GDP growth rebounded in the second quarter to 0.4%, but at an annual rate of only 1.2% this remains below trend. As economic growth had evolved broadly in line with its May Inflation Report forecast, the Bank of England's Monetary Policy Committee (MPC) voted unanimously for a rate rise of 0.25% in August, taking Bank Rate to 0.75%. In November 2018 the MPC maintained Bank Rate at 0.75% while the Inflation Report showed that compared to the August report further interest rate increases may be required to bring inflation down to the 2% target over the forecast horizon.

The headline rate of UK Consumer Price Inflation fell back to 2.4% year-on-year in September 2018 from 2.7% in August, as higher import and energy prices continued to hold inflation above the BoE target. Labour market data is positive. The ILO (International Labour Organization) unemployment rate fell to 4%, its lowest level since 1975. The 3-month average annual growth rate for pay excluding bonuses rose to 3.1% in August providing some evidence that a shortage of labour is supporting wages. However, adjusting for inflation this means real wages were only up by 0.7% and only likely to have a moderate impact on household spending.

While external inflationary pressures from energy costs and import prices are expected to subside, domestic pressures are projected to build over the forecast horizon with the balance of these effects likely to keep inflation above the Bank of England's target throughout most of their forecast horizon, meaning that strong real income growth is unlikely to materialise any time soon.

As the US economy has continued to perform well, the Federal Reserve maintained its monetary tightening stance and pushed up its target range for the Fed Funds Rate in September 2018 by 0.25% to 2% - 2.25%. One further rise is expected in 2018 and two more in 2019.

The fallout from the US-China trade war continues which, combined with tighter monetary policy, risks contributing to a slowdown in global economic activity in 2019. Despite slower growth in the region, the European Central Bank has started conditioning markets for the end of quantitative easing as well as the timing of the first interest rate hike, currently expected in 2019, and the timing and magnitude of increases thereafter.

Credit outlook

The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ring-fencing legislation. Bank of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank are the ring-fenced banks that now only conduct lower risk retail banking activities. Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and NatWest Markets are the investment banks. Credit rating agencies have adjusted the ratings of some of these banks with the ring-fenced banks generally being better rated than their non-ring-fenced counterparts.

European banks are considering their approach to Brexit, with some looking to create new UK subsidiaries to ensure they can continue trading here. The credit strength of these new banks remains unknown, although the chance of parental support is assumed to be very high if ever needed. The uncertainty caused by protracted negotiations between the UK and EU is weighing on the creditworthiness of both UK and European banks with substantial operations in both jurisdictions.

Interest rate forecast:

Following the increase in Bank Rate to 0.75% in August 2018, the Authority's treasury management adviser Arlingclose is forecasting two more 0.25% hikes during 2019 to take official UK interest rates to 1.25%. The Bank of England's MPC has maintained expectations for slow and steady rate rises over the forecast horizon. The MPC continues to have a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose believes that MPC members consider both that ultra-low interest rates result in other economic problems, and that higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise when rate cuts will be required.

The UK economic environment remains relatively soft, despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. Whilst assumptions are that a Brexit deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" Brexit still hangs over economic activity (at the time of writing this commentary in early November). As such, the risks to the interest rate forecast are considered firmly to the downside.

Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected based on Arlingclose's interest rate projections, due to the strength of the US economy and the ECB's forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.5% and 2% respectively over the interest rate forecast horizon, however volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.

A more detailed economic and interest rate forecast provided by Arlingclose is shown below.

For the purpose of setting the budget, it has been assumed that new investments will be made at the prevailing central case forecasted bank rate.

	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	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.17**
Arlingclose Central Case	**0.75**	**1.00**	**1.00**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.17**
Downside risk	0.00	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	**0.65**
3-mth money market rate														
Upside risk	0.10	0.10	0.10	0.10	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	**0.17**
Arlingclose Central Case	**0.80**	**1.00**	**1.10**	**1.20**	**1.30**	**1.30**	**1.25**	**1.20**	**1.20**	**1.20**	**1.20**	**1.20**	**1.20**	**1.17**
Downside risk	0.20	0.50	0.60	0.70	0.80	0.80	0.75	0.75	0.75	0.75	0.75	0.75	0.75	**0.68**
1-yr money market rate														
Upside risk	0.20	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.33**
Arlingclose Central Case	**1.05**	**1.25**	**1.35**	**1.40**	**1.50**	**1.45**	**1.40**	**1.40**	**1.40**	**1.40**	**1.40**	**1.40**	**1.40**	**1.37**
Downside risk	0.35	0.50	0.60	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	**0.69**
5-yr gilt yield														
Upside risk	0.15	0.20	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.32**
Arlingclose Central Case	**1.15**	**1.20**	**1.25**	**1.35**	**1.40**	**1.40**	**1.35**	**1.35**	**1.30**	**1.30**	**1.30**	**1.30**	**1.30**	**1.30**
Downside risk	0.30	0.35	0.45	0.50	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	**0.54**
10-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.32**
Arlingclose Central Case	**1.60**	**1.65**	**1.65**	**1.70**	**1.75**	**1.75**	**1.75**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**
Downside risk	0.30	0.45	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	**0.55**
20-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.32**
Arlingclose Central Case	**1.90**	**1.95**	**1.95**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**1.98**
Downside risk	0.30	0.40	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	**0.43**
50-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.32**
Arlingclose Central Case	**1.80**	**1.85**	**1.85**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.88**
Downside risk	0.30	0.40	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	**0.43**

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB Local Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Appendix B Treasury Management Strategy

Present position and forecast

1 On 31 October 2018 the Council held £4m of borrowing and £46.4m of investments at market value; broken down as follows:

	Principal £m	Average Interest Rate %
Call accounts	0.6	0.20
Money Market Funds	18.4	0.61
Short-term deposits	10.5	1.11
Pooled Funds	16.9	3.83
Total Investments	**46.4**	**1.9**
Long-term PWLB loans	4.0	3.38
Short term borrowing	0	0
Total Borrowing	**4.0**	**3.38**
Net Investments	**42.4**	**1.75**

2 Taking the forecasts within the capital strategy, the balance sheet of the Council can be projected to estimate the amounts available for investments. Below is the current projected analysis of the balance sheet to illustrate the trajectory of the Council's funds.

All figures at year-end £m	**Actual 17/18**	**Estimate 18/19**	**Estimate 19/20**	**Estimate 20/21**	**Estimate 21/22**
CFR	30.5	36.0	36.3	36.0	37.5
Less external borrowing	4.0	4.0	0	0	0
Internal borrowing	26.5	32.0	36.3	36.0	37.5
Useable reserves, receipts, contributions held	56.2	53.8	49.4	50.2	53.9
Working capital/other balances	7.9	6.7	6.3	6.4	6.4
Estimated Investments	37.6	28.5	19.4	20.6	22.8

3 The Council's strategy has been to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. In spite of the continuation of this, the Council is projected to hold significant investment balances even at the end of the financial year which is the low point for cash.

Borrowing Strategy

4 As shown above the Council is not expecting to borrow long term funds although it may need short term money if short term cash flow issues require it.

5 **Sources of borrowing:** The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board and any successor body
- Any institution approved for investments (see below)
- Any other bank or building society authorised to operate in the UK

- UK public and private sector pension funds (except West Sussex County Council Pension Fund)
- Capital market bond investors
- UK Municipal Bond Agency and other special purpose companies created to enable joint local authority bond issues.

6 In addition, capital finance may be raised by the use of leases and hire purchase that are not borrowing, but may be classed as other debt liabilities.

7 The Council has previously raised its long-term borrowing from the PWLB, but it will, if required, investigate other sources of finance amongst the sources listed above, that may be available at more favourable rates.

8 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

9 Short-term and variable rate loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

Investment Strategy

10 The Council holds significant funds, representing income received in advance of expenditure plus balances and reserves held. In the past year, the Council's total investments have ranged between £33m and £60m and although the level of reserves is expected to reduce in the longer term, there will still be significant short to medium-term cash flow surpluses leading to larger sums being held than the core reserves of the Council would indicate. The current projections show year-end balances in the region of £20m for the next three years

11 Both the CIPFA Code and the MHCLG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

12 **Negative interest rates:** If the UK enters into a recession in 2019/20, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

13 Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to further diversify into more secure and/or higher yielding asset classes during 2019/20. This is especially the case for the estimated £20m cash balances that are available for longer-term investment. This diversification will represent a continuation of the present strategy that has moved investment into pooled funds and other local authorities.

14 **Business models:** Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows rather than buying and selling investments and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

15 **Approved counterparties**: The Council may invest with any of the counterparty types in the table below; subject to the cash limits (per counterparty) and the time limits shown (these are unchanged from 2018/19 strategy):

Credit Rating	**Banks Unsecured**	**Banks Secured**	**Government**	**Corporate**	**Registered Providers**
AAA	*£2.5m 5 years*	*£4m 20 years*	*£4m 50 years*	*£2.5m 10 years*	*£4m 20 years*
AA+	*£2.5m 5 years*	*£4m 10 years*	*£4m 25 years*	*£2.5m 7 years*	*£4m 10 years*
AA	*£2.5m 4 years*	*£4m 5 years*	*£4m 15 years*	*£2.5m 5 years*	*£4m 10 years*
AA-	*£2.5m 3 years*	*£4m 4 years*	*£4m 10 years*	*£2.5m 4 years*	*£4m 10 years*
A+	*£2.5m 2 years*	*£4m 3 years*	*£4m 5 years*	*£2.5m 3 years*	*£4m 5 years*
A	*£2.5m 13 mons*	*£4m 2 years*	*£4m 5 years*	*£2.5m 2 years*	*£4m 5 years*
A-	*£2.5m 6 mons*	*£4m 13 months*	*£4m 5 years*	*£2.5m 1 year*	*£4m 5 years*
None	*£1m 6 months*	*n/a*	*n/a*	*£50,000 5 years*	*£2m 1 year*
UK Govt	*Central government £unlimited 50 years UK Local Authority £4m 10 years*				
Pooled funds and real estate investment trusts		*£5m per Fund or Trust*			

This table must be read in conjunction with the notes below.

16 **Credit Rating**: Investment limits are set with reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

17 **Banks Unsecured**: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

18 **Banks Secured**: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

19 **Building Societies:** Although the regulation of building societies is no longer any different to that of banks the Council takes additional comfort from building societies' business model. The Council will therefore consider investing with unrated building societies where independent credit analysis shows them to be suitably creditworthy. A minimum asset size of £250m applies and limits of £1m per Society and £8m in total apply for unrated societies

20 **Government**: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years and with a UK local government body up to £4m for up to 10 years. The Council is confident that as a sector local authorities are secure investments in the context of support from Central Government and the legal surcharging framework that guarantees debts will be paid. However, for any investment over six months the financial resilience of the relevant council will be assessed.

21 **Corporates**: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either

following an external credit assessment or to a maximum of £50,000 per company as part of a diversified pool in order to spread the risk widely.

22 **Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services; they retain the likelihood of receiving government support if needed.

23 **Pooled Funds:** Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

24 Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly. These types of funds were introduced in 2016/17 and have provided increased yield although their capital value has shown some volatility requiring continued monitoring. This class of pooled funds are subject to their own specific limits and in view of the possible level of investments in the longer term they have been increased to give the Council reasonable investment options.

25 **Real estate investment trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. This is a new category that sits alongside Pooled Funds. It is added on the advice of Arlingclose to give the Council greater options in investment in property should it require it. The Council will carry out detail appraisal and take advice before any possible investment. As these trust are subject to volatility and are new instrument to the Council a limit of £2m is set for them.

26 **Operational bank accounts:** The Council may incur exposure though its current accounts to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but still subject to the risk of a bank bail-in and balances will therefore be kept below £2.5m. The

Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity. The Council currently banks with NatWest rated A-.

27 **Long Term investments**: Alongside pooled funds the Council may use long term investments when they are appropriately secure over the term of the investment. Currently the balance between security and yield is not thought to make this type of investment superior to pooled funds but there may be suitable investments so the Council sets a limit of £12m on the total long term (over a year) investments.

28 **Risk Assessment and Credit Ratings:** Credit ratings are monitored by the Council's treasury advisors, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be ended at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty

29 Where a credit rating agency announces that a rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then no investments other than call investments will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

30 **Other Information on the Security of Investments**: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the Council's credit rating criteria.

31 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or

with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

32 **Investment limits**: The Council's revenue reserves available to cover investment losses are forecast to be in the region of £10m on 31 March 2019 but are set at a long term target of £6m. In order that no more than 2/3 of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £4m. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries. Where the limit has changed the new and old limits are shown

	Cash limit
Any single organisation, except the UK Central Government	£4m each
UK Central Government	Unlimited
Any group of organisations under the same ownership	£4m per group
Any group of pooled funds under the same management	£10m per manager
Money Market Funds	£30m in total
Property Invested Pooled Fund	£7m in total was £5m
Other Pooled Funds incl. Equity, Unrated Bond Funds, Diversified assets funds	£15m in total was £12m
Real estate investment trusts (New category in 2019/20)	£2m in total
Negotiable instruments held in a broker's nominee account	£20m per broker
Foreign countries	£10m per country
Registered Providers	£8m in total
Unsecured investments with Building Societies	£8m in total
Loans to unrated corporates	£2m in total

Cash flow management

33 The Council's officers maintain a detailed cash flow forecast for each coming year revising it as more information is available. This informs the short term investments such as those to cover precept payments. The forecast is compiled on a prudent basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Long term investment strategy is based on the Council's medium term financial strategy.

Treasury Management Indicators

34 **Security benchmark: average credit rating** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk. The benchmark for 2019/20 will be an average credit rating of A unchanged from last year.

35 **Liquidity benchmark The** Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing. For 2019/20 the benchmark amount available will be £3m unchanged from 2018/19.

Interest rate exposures

36 This indicator is set to control the Council's exposure to interest rate risk. New CIPFA guidance has led to a change in this indicator which is now an upper limits on the one year revenue impact of a 1% rise or fall in interest rates. The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

	Limit
Upper limit on one-year revenue impact of a 1% rise in interest rates	£200,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	£200,000

Maturity structure of borrowing

37 This indicator is set to control the Council's exposure to refinancing risk and is really most useful for councils with a portfolio of loans. The upper and lower limits on the maturity structure of fixed rate borrowing are shown below. The Council is not planned to have any debt as 2019/20 begins but will set limits to allow flexibility of term and maturity date for any new borrowing.

	Upper	Lower
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within five years	100%	0%
Five years and within 10 years	100%	0%
10 years and above	100%	0%

Principal sums invested for periods longer than a year

38 The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total long-term principal sum invested to final maturities beyond the period end will be:

	2019/20	2020/21	2021/22
Limit on principal invested beyond year end	£12m	£10m	£8m

Other Treasury Management issues

39 The CIPFA Code requires the Council to include the following in its treasury management strategy.

40 **Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

41 The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

42 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

43 **Markets in Financial Instruments Directive**: The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Director of Corporate Resources believes this to be the most appropriate status.

Appendix C Investment Strategy

1. 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 support of local public services by lending to or buying shares in other organisations or its own subsidiaries (service investments) and commercial property investment income.

Service Investments: Loans

2. The Council can lend money to local bodies or its subsidiaries to support local public services and stimulate local economic growth. Historically the Council has only done this in very limited circumstances where a significant service outcome is expected. At present only one £300,000 loan is outstanding with a community run leisure centre for it to develop a specific local service.

3. There is no intention to increase the use of loans to local bodies and they are expected to be infrequent. The Council could lend to a potential subsidiary in its possible housing company but this has not been subject to Council approval so the Council report that approves the setting up of any subsidiary would also amend the Investment Strategy limit.

4. The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Council, upper limits on the outstanding exposure has been set at £1m.

5. Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's statement of accounts from 2018/19 onwards will be shown net of this loss allowance. However, the Council makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

6. **Risk assessment**: The Council assesses the risk of loss before entering into service loans by assessing the counterparty's resilience, the service users' needs that the loan is designed to help meet and how theses will evolve over time. During the life of the loan any change in original assumptions will be monitored. The Council will use external advisors if felt appropriate by the Director of Corporate Resources. All loans will be subject to contract agreed by Head of Legal. All loans must be approved by full Council and will be monitored by Director of Corporate Resources.

Service Investments: Shares

7. The Council does not currently invest in any shares and has no agreed plans to do so. There have been discussions on the setting up of a local housing company which may mean that the Council would need to invest as the shareholder of its subsidiary. As details are not known the limit on investment in this type of share will be set at zero and any change to the limit would be addressed in the report to the Council to setting up any subsidiary.

8. **Security:** One of the risks of investing in shares is that they potentially fall in value meaning that the initial outlay may not be recovered. In order to limit this risk upper limits on the sum invested in local subsidiaries will be set at the lowest practical level if and when exposure is allowed.

9. **Risk assessment:** The Council would assess the risk of loss before entering into and whilst holding shares by going through an extensive process of risk analysis. The risk analysis will include an assessment of the market that the subsidiarity will be active in including the nature and level of competition, how the market/customer needs will evolve over time, the barriers to entry and exit and any ongoing investment requirements. The Council will use external advisors as thought appropriate by Director of Corporate Resources.

10. **Liquidity:** Although this type of investment is fundamentally illiquid, in order to limit this the Council, when it sets a limit in this area, will initially set out the maximum periods for which funds may prudently be committed and how the Council will ensure it stays within its stated investment limits.

11. **Non-specified Investments:** Shares are the only investment type that the Council has identified that meets the definition of a non-specified investment in the government guidance. The limits above on share investments are therefore also the Council’s required upper limits on non-specified investments. The Council has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

Commercial Investments: Property

12. The Council invests in local commercial property with the intention of making a profit that will be spent on local public services. These include retail units, business centres, and commercial leisure facilities. They contributed £3.1m of net income in 2017/18 and provide a significant revenue stream to support the Council’s finances.

13. The table below lists the property by major category and by whether they are 'legacy' properties, which is taken as having been on the Council's books on 31st March 2007, and the acquisitions and developments since then. The reason for the choice of 31st March 2007 is twofold: firstly, this was the date of the implementation of asset accounting under International financial reporting standard that required the Council to keep detail records of historic asset values and secondly it separates out the last decade where the recent purchases are reported. It is these more recent purchases which were made to provide commercial income to support the Council's budget as Central Government support reduced that is the main concern of the new guidance. For the recent purchases the cost records are available whereas the Council does not have comprehensive records of actual purchase costs so the 31st March 2007 values are used.

Property by type £millions	**Actual**	**31.3.2018 actual**		**31.3.2019 expected**	
	Purchase cost / 31st March 2007 value	**Gains or losses**	**Value in accounts**	**Gains or losses**	**Value in accounts**
Retail – legacy	2.6	1.5	4.1	1.5	4.1
Retail – Swan Walk	8.4	-6.2	2.2	-6.2	2.2
Light industrial - legacy	9.3	1.9	11.2	1.9	11.2
Healthcare – legacy	6.5	1.0	7.5	1.0	7.5
Office - legacy	1.0	0.3	1.3	0.3	1.3
Retail - recent	14.1	-0.3	13.8	-0.2	14.3
Light industrial – recent	4.1	-0.8	3.3	-0.8	3.3
Healthcare – recent	0.6	0.2	0.8	0.2	0.8
Education -recent	1.8	-0.3	1.5	-0.3	1.5
Leisure - recent	1.5	-0.6	0.9	-0.6	0.9
Total	**49.9**	**-3.3**	**46.6**	**-3.2**	**47.1**

14. In the table above the Swan Walk Centre has been taken out of the legacy retail category as it has a significant effect and has its own distinct history. The loss in value is due to the movement of the valuation of the Council's equity share in Swan Walk from £8.4m in 2007 to a current value of £2.2m. An authentic separable purchase price for the Swan Walk equity share is not available as the Swan Walk development was a complex set of multiparty arrangements rather than a simple purchase. The additions to commercial property in 2018/19 is a retail purchase of £0.5m.

15. **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.

16. The fair value assessment of the Council's investment property portfolio is below the purchase cost which, following the government guidance to the letter, expects the Council to provide detail of the mitigating actions that the local authority is taking or proposes to take to protect the capital invested. However, without the Swan Walk £6m reduction in value, which is not of a nature than the guidance was meant to apply to, the whole portfolio does provide security.

17. If we look only at 'recent' property the fair values are £1.8m below purchase price so the Head of Property has considered mitigating actions to take to protect the capital invested. The Head of Property concludes that the best course of action at the moment is to hold the assets as he believes the values will increase in the long term as they are sound assets with dependable income streams.

18. The commercial properties are revalued each year-end by external valuers so the Council will each year consider whether the underlying assets provide security i.e. are not below their purchase cost. Should this be the case the Head of Property will consider whether his current course of action of holding the assets is appropriate and bring any alternative actions to Council in an update to the Investment Strategy for that year.

19. **Risk assessment:** The Council assesses the risk of loss before entering into and whilst holding property investments by :
    a. assessing the relevant market sector including the level of competition, the barriers to entry and exit and future market prospects;
    b. using advisors if thought appropriate by the Director of Corporate Resources;
    c. consulting Council's Cabinet Advisory Subcommittee (Property Investment)
    d. taking final comprehensive report on all new investments to Cabinet
    e. continually monitoring risk in the whole portfolio and any specific assets

20. **Liquidity:** Clearly 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 the Head of Property ensures that at least £5m of commercial property could be sold as a going concern within a six month period.

Loan Commitments and Financial Guarantees

21. Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Council and are included here for completeness. The Council does not provide

such commitments and guarantees and this strategy does not include them for 2019/20. As noted above there is a potential subsidiary which may, or may not, require commitments or guarantees dependent on its legal structure. Should they be required limits will be set as a part of the Council report on the setting up of a subsidiary.

Proportionality

22. The Council is dependent on profit generating investment activity to achieve a balanced revenue budget. The table below shows the extent to which the expenditure planned to meet the service delivery objectives is dependent on achieving the expected net profit from investments over the lifecycle of the Medium Term Financial Strategy. Should it fail to achieve the expected net profit, the Council has general reserves to cover the immediate shortfall in income and Head of Property would review the cause of any shortfall and identify any actions needed to ensure the income shortfall is remedied.

Proportionality of Investments £m	**2017/18 Actual**	**2018/19 Forecast**	**2019/20 Budget**	**2020/21 Budget**	**2021/22 Budget**
Gross service expenditure	33	33	33	33	34
Investment income	3.1	3.4	3.5	3.7	3.8
Proportion	9%	10%	11%	11%	11%

23. **Capacity, skills and culture**

Elected Members and statutory officers: The Council recognises that those elected Members and statutory officers involved in the investments decision making process must have appropriate capacity, skills and information to enable them to:

- take informed decisions as to whether to enter into a specific investment;
- to assess individual assessments in the context of the strategic objectives and risk profile of the Council; and
- to enable them to understand how new decisions have changed the overall risk exposure of the Council.

The Council will ensure that the relevant officers and the Members of Audit Committee and Cabinet Advisory Subcommittee (Property Investment) have appropriate skills, providing training and advisor support where there is a skills gap.

24. **Commercial deals**: The Council will ensure that the Audit Committee, Cabinet Advisory Subcommittee (Property Investment), Cabinet, and officers negotiating commercial deals are aware of the core principles of the prudential framework and of the regulatory regime within which local authorities operate.

25. **Corporate governance:** Any investment decisions will be scrutinised by Senior Leadership Team, Cabinet Advisory Subcommittee (Property Investment), and Cabinet before final approval. The Overview and Scrutiny committee review all decisions made by the Cabinet. Although after the event the Committee can make any recommendations to the Council if it sees fit.

Investment Indicators

26. The Council has set the following quantitative indicators to allow elected Members and the public to assess its total risk exposure as a result of its investment decisions.

27. **Total risk exposure:** The first indicator shows the total exposure to potential investment losses.

Total investment exposure	31.03.2018 Actual	31.03.2019 Forecast	31.03.2020 Forecast
Treasury management investments	37	29	19
Service investments: Loans	0.3	0.2	0.2
Service investments: Shares	0	0	0
Commercial investments: Property	46.6	47.1	50.1
TOTAL INVESTMENTS	83.9	76.3	69.3
Commitments to lend	0	0	0
Guarantees issued on loans	0	0	0
TOTAL EXPOSURE	83.9	76.3	69.3

28. **How investments are funded:** Government guidance is that these indicators should include how investments are funded. Since the Council does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by the borrowing. The remainder of the Council's investments are funded by usable reserves and income received in advance of expenditure.

Investments funded by borrowing	31.03.2018 Actual	31.03.2019 Forecast	31.03.2020 Forecast
Treasury management investments	0	0	0
Service investments: Loans	0	0	0
Commercial investments: Property*	3.2	3.1	0
Total funded by borrowing	3.2	3.1	0

**£4m borrowed reduced by MRP to date*

29. **Rate of return received**: This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Investments net rate of return	**2017/18 Actual**	**2018/19 Forecast**	**2019/20 Forecast**
Treasury management investments	1.6%	1.8%	2.2%
Service investments: Loans	3.0%	3.0%	3.0%
Service investments: Shares	0	0	0
Commercial investments: Property	6.6%	7.2%	7.0%
ALL INVESTMENTS	4.4%	5.1%	5.7%

30. The MHCLG guidance lists other indicators and the Council has selected the indicators below as appropriate.

Indicator	**2017/18 Actual**	**2018/19 Forecast**	**2019/20 Forecast**
Debt to net service expenditure ratio	37%	37%	0%
Commercial income to net service expenditure ratio	29%	32%	34%
Investment cover ratio – net income excl revaluation over interest expense	23	25	175
Benchmarking of returns – ratio of property income yield to IPD property yield index averaged over 5 year period	1.3	1.3	1.3
Net income return target	6.6%	7.2%	7.0%
Operating overheads of property section attributable to commercial property as a proportion of net property income	7.4%	6.8%	6.7%
Average Vacancy levels	0.8%	1%	2%
Tenant over 5%	5	5	5
Weighted Average Unexpired Lease Term (WAULT)	11y 5m	11yr 2m	11yr
Bad debts written off	£0	£10,000	£10,000