

# **Capital Strategy and Treasury Management Strategy**

Including Minimum Revenue Provision Policy  
Statement and Annual Investment Strategy

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February 2020

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# 1. INTRODUCTION

## 1.1 Introduction

1.2 The Capital and Treasury Management Strategies are fundamental to the effective delivery of the Council's priorities and Vision 2025. The provision of the right asset in the right place at the right time will ensure the effective and efficient delivery of a comprehensive range of quality services.

1.3 This strategy document provides 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 and the implications for future financial sustainability.

1.4 It sets out an integrated plan for the future management of the Council's assets and its capital programme. It is a key document running alongside the Vision 2025 and the Medium-Term Financial Strategy (MTFS) and will provide the framework to facilitate a seamless interface between business planning and the management of assets and capital resources. This will ensure that the provision of resources and future investment are prioritised and ensures the effective and affordable management of the Council's assets.

1.5 The CIPFA 2017 Prudential Code and Treasury Management Code of Practice, sets out the new requirements in relation to the setting of a Capital Strategy. The new requirement asks local authorities to consider the longer term as well as the short and medium term to:

- Ensure that the capital expenditure plans of the council are affordable, prudent and sustainable.
- Support transparent options appraisal.
- Giving an outline of future commitments so that the affordability of both the long-term plan and any new proposals can be properly understood.
- Inform prioritisation and timing of projects to ensure that both financial and operational capacity is available for delivery.
- Provide an overview of risk so that projects and proposals can be viewed in the overall risk context of capital and treasury investments.
- Enable the ongoing capital and revenue implications of capital expenditure to be better understood and planned for in the Financial Resource Plan.

1.6 This Strategy document provides both the Capital Strategy and the Treasury Management Strategy as they are inherently linked through the activities they undertake. The document sets out the Capital Programme to 2029/30 and the funding approach through treasury management activities.

## 1.7 Capital Strategy

1.8 The key aims of the Capital Strategy are to:

- Provide a clear context within which proposals for capital expenditure are evaluated to ensure all capital investment is targeted to deliver the Council's priorities.
- Clarity about how the Council identifies and prioritises capital requirements and proposals arising from various strategies including the Vision 2025, Service Improvement Plans, and other corporate strategies, and how they will be managed within the limited capital resources available.
- Challenge our current estate, continue with the programme of asset rationalisation, ensuring that assets retained are effective, efficient and economically sustainable to deliver services.
- Identify and consider options available to fund capital expenditure that minimises the ongoing revenue implications of historic capital expenditure and of any new investments.

- Use partnerships, both public and private, more effectively to support our overall strategy.
- Establish effective arrangements for managing capital schemes including assessment of outcomes and achievement of value for money.
- Ensure there is a full understanding of the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

1.9 It is a requirement that the capital strategy demonstrates that the Local Authority takes both capital and investments decisions in line with service objectives. The capital strategy shows that the key drivers of the Council's Capital plans are captured through various plans across the authority. These includes;

- Highways Asset Management Plan (HAMP)
- Welsh Housing Quality Standard Plan (WHQS)
- Strategic Asset Management Plan
- Schools Transformation Plan
- Health and Care Strategy
- Service Plans

#### 1.10 **Treasury Management**

1.11 The Treasury Management Strategy and Annual Investment Strategy report is a requirement of the CIPFA Code of Practice on Treasury Management and a requirement under the Local Government Act 2003. It has regard to the Guidance on Local Government Investments issued by the Welsh Government which requires the Treasury Management Strategy and Annual Investment Strategy to be approved by Full Council.

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.”*

1.12 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

1.13 A key function of the treasury management service is arranging the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.14 The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

1.16 This authority has engaged in only minimal commercial investments and has no (or immaterial) non-treasury investments.

#### 1.17 **Treasury Management and Capital Reporting Arrangements**

- 1.18 The Council is currently required to receive and approve at Cabinet, as a minimum, three main treasury/capital reports each year, which incorporate a variety of policies, estimates and actuals.
- a) Prudential and treasury indicators and treasury and capital strategy (this report) - The first, and most important report is forward looking and covers:
- The capital plans, (including prudential indicators).
  - A minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time).
  - Capital strategy and capital programme
  - 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).
- b) A mid-year treasury management report – This is primarily a progress report and will update members on the capital position, amending prudential indicators if necessary, and whether any policies require revision. In addition, this Council will receive further quarterly update reports.
- c) Monthly capital reports to Cabinet – Providing an update on the capital spend, reprofiling and virement changes and funding that support delivery of the programme, with a year-end reflection of the actual against plan and reasons for the final month's changes from the forecast.
- d) An annual treasury report – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

1.19 The above Treasury reports are required to be adequately scrutinised before being recommended to the Cabinet and Council. This role is undertaken by the Audit Committee.

## **1.20 Treasury Management Strategy for 2020/21**

1.21 The strategy for 2020/21 covers two main areas:

### **a) Capital issues**

- The capital programme and funding regime and the associated prudential indicators;
- The minimum revenue provision (MRP) policy.

### **b) Treasury management issues**

- The current treasury position;
- Treasury indicators which limit the treasury risk and activities of the Council;
- Prospects for interest rates;
- The borrowing strategy;
- Policy on borrowing in advance of need;
- Debt rescheduling;
- The investment strategy;
- Creditworthiness policy; and
- Policy on use of external service providers.

1.22 These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, Welsh Government MRP Guidance, the CIPFA Treasury Management Code and Welsh Government Investment Guidance.

### **1.23 Training**

- 1.24 The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. The Authority holds two briefing sessions per year for members and members must ensure that they attend at least one of these. The training needs of treasury management officers are periodically reviewed.
- 1.25 Financial training in managing the financial aspects of capital projects is available for those that manage projects and takes place regularly throughout the year.

### **1.26 Treasury Management Consultants**

- 1.27 The Council uses Link Asset Services, Treasury solutions as its external treasury management advisors. They also support on Capital advice. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.
- 1.28 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.

## 2. CAPITAL STRATEGY

### 2.1 Background

2.2 Part 1, Section 3 of the Local Government Finance Act 2003 requires that the Authority shall determine and keep under review how much it can afford to borrow. The Act is supported by the Prudential Framework for local authority capital investment and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Code). The CIPFA Prudential Code was revised in December 2017. The revised Code introduced a new requirement that all authorities produce a capital strategy, which sets out the long-term context in which capital expenditure and investment decisions are made.

2.3 The Capital Strategy and Treasury Management Strategy (TMS) are closely linked and both are revised annually. The Capital Strategy defines the Council's spending and the TMS sets out how it will be funded and its impact on the overall financial standing of the Council.

### 2.4 Aims, Priorities and Principles

2.5 The purpose of this strategy is to set out the objectives, principles and governance framework to ensure that the Authority takes capital expenditure and investment decisions in line with service objectives that underpin the delivery of the Corporate Improvement Plan through Vision 2025. The Council's Vision sets out the key priorities and objectives of the Council for the period to 31 March 2025.

2.6 Vision 2025 sets out the long-term vision for the council under four priority areas (aligned to the Wellbeing of Future Generations Act 2015 objectives):



### 2.7 Programme Overview

2.8 The Capital Programme is a key enabler to deliver the Council's ambition set out in Vision 2025. Broadly the programme covers three areas of expenditure:

- a core programme of schemes that are regulatory / statutory in nature, and minimise legal challenge or revenue risk, these schemes are related to day to day activities that will ensure the Council meets its statutory requirements
- a retained asset programme to improve or enhance the life of existing assets, and
- an investment programme in schemes linked to the Council's strategic priorities, such as schemes to generate income and increase the diversification of the Council's property portfolio or reduce the revenue costs of running and maintaining the assets.

2.9 Vision 2025 will be delivered, in part, through its nine Transformation Programmes, as shown in the diagram below. The six Service Transformation programmes all require capital funding to deliver their transformation agenda.



## 2.10 Capital Investment across Services

2.11 The Council has developed its capital strategy which sets out a ten year long-term plan and demonstrates that the capital / investments decisions are taken in line with priorities and gives consideration to both risk/reward and impact; as well as properly taking account of stewardship, value for money, prudence, sustainability and affordability.

2.12 The Council will continue to invest in services that underpin the priorities set out as part of Vision 2025, the key themes have clear service projects:

### a) Residents and the Community - We will support our residents and communities

- Housing** - The Council will continue to maintain the WHQS achieved in 2018, with an ongoing capital programme in part funded through Welsh Government Funding and Supported Borrowing. The HRA 30 Year Business Plan demonstrates an affordable capital strategy alongside delivering the day to day service and has key objectives linked to the Local Housing Strategy. Over the lifetime of the business plan the service has commenced the building of 250 new council dwellings using locally sourced materials, in addition to the improvement and management of its housing stock.
- Leisure and Recreation** - A number of libraries are already housed in open public locations, and self-service technology continues to be funded through capital allowing customers to make increased use of the resources available even when staff are not present. This provides a wider more cost effective service and is linked to improving learning and skills and health and wellbeing.



- **Waste Strategy** - Powys County Council faces stringent WG statutory recycling targets. These are 64% for 2019/20 through to 70% for 2024/25. In addition to this there is a target to reduce landfill to 10% by 2019/20 reducing to 5% by 2024/25. This has required a step change in the way all local authorities approach waste and recycling. The continued capital investment in the Waste and Recycling service will ensure that the Council is able to meet the targets whilst obtaining maximum value from the service. A network of assets under the Council's control allows flexibility to adapt to any changing requirements within the industry and Government policy and legislation. Some of these schemes will deliver efficiency savings in future years, whilst others ensure health and safety issues are minimised.

**b) Health and Care** – We will lead the way in effective, integrated rural health and care.

- **Social Care** - The capital programme focuses on supporting those who wish to remain in their own home rather than residential care and supports the integrated Health and Care Strategy for Powys. This strategy acknowledges that people in Powys live longer and healthier lives than elsewhere in Wales and that Powys is a place aspiring to help improve the wellbeing of all people. Capital funding mainly focus on accommodation options, including supporting the building and redevelopment of facilities to increase the stock of extra care housing, in collaboration with Powys Teaching Health Board and local Residential Social Landlords.
- **Assistive Technology** - has a key role to play in the modernisation of health and social care With ever increasing technological advances, it offers a range of possibilities for greater choice, not only of how people can access the support they need, but also where and when they access support. In doing so, assistive technology enables people to take greater control, and to live independently for longer by preventing hospital admissions and premature moves to residential care. Enabling access to better accommodation options is essential in order to support independent living and reduce demand for other types of care.

**c) Learning and Skills** – We will strengthen learning and skills

- **Schools Transformation** - The Council is investing £142m over the next ten years in its schools. It aims to provide learning environments that meet the aspirations of the WG's 21st Century Schools programme. Major capital investment in school buildings in Powys will continue to be taken forward through the WG's 21st Century Schools programme, and the authority's programme for Band B (2019 – 2024) will develop schools according to agreed strategic policy. Alongside this, capital funding through our major repairs programme will be focussed on where the need is greatest, as identified through the Schools Service's Asset Management Plan.
- The programme has a 65% capital intervention rate for mainstream schools, 75% for special schools and it also offers a new and innovative funding route where the intervention rate is 85% the Mutual Investment Model. The Council will develop its strategies to ensure maximisation of the potential investment opportunities that may be available via WG funding.

**d) The Economy** – We will develop a vibrant economy

- **Highways and Environment** - The Council has a statutory duty to maintain the adopted highway, maintained at public expense in a safe condition for the passage of the user. A strategic approach has been used to develop the HAMP in identifying and allocating resources for the management, operation, preservation and enhancement of the highway infrastructure to meet the needs of current and future customers. Current gross replacement cost of these assets are estimated at £4.4bn.

- **Property** - The vision is to ensure that the property and land assets are efficient, sustainable and in the right locations to support the delivery of services and the achievement of key priorities. The Strategic Asset Board and the Strategic Asset Management Plan are the mechanisms in place to help deliver these priorities. An escalated property disposals programme has been developed to help fund the transformation costs of the council until 2022 as part of a Welsh Government directive.
- **Regeneration, Property and Development** - The Council need to intervene where the private sector is not able to (for economic reasons) to create or facilitate investment in business units in order to keep and attract business to the County. The Abermule scheme is one such scheme that sees the Authority creating a business park on a former WG site which otherwise would not have been developed in the short to medium term.
- **County Farms** - It is essential that the Council manages its agricultural estate prudently, efficiently, and professionally. Effective management of County Farms estate will enable the continued opportunities already enjoyed by current tenant farmers and maintain an income stream. The financial demands of the Estate need to be evaluated against the competing demands across the council whilst noting the estate produces an annual surplus in its trading account and has made a considerable contribution in capital receipts.
- **Information Technology (IT)** - The service engages with change programmes so that investment and resource meets identified priorities. In respect of infrastructure, IT will seek to invest in up to date cloud based technologies including 'Azure' cloud technologies, improved telephony and mobile systems, WEB and share-point and improved wireless. In terms of applications IT is looking to rationalise the number of systems through investment in replacement of legacy corporate systems and improved integration between systems notably the WEB and Intranet.

### **2.13 Investment in Commercial Activity**

- 2.14 The commercial activity undertaken in the council relates to holding properties that are utilised by tenants, these include livestock markets, caravan park, restaurant and office space.
- 2.15 Around £240,000 in rental income is received each year.
- 2.16 The council has a trading company that is likely to become the vehicle that supports greater commercial activity, but any investment must evidence the following criteria:
- Support the strategic community objectives of the council
  - Have a balanced investment approach
  - Improve covenant strength
  - Drive income generation and maintain yield

### **2.17 Funding the Capital Strategy**

- 2.18 The cost of funding the capital programme is closely monitored due to the impact on the budget and the ongoing funding constraints of the MTFs. The Council aims to minimise the cost of borrowing on the Financial Resource Model (FRM) and other sources need to be maximized such as grant funding. Funding capital from borrowing incurs extra costs from interest on the loan and the minimum revenue provision, repayment of the principal. Capital projects are prioritised where they can evidence a reduction in the cost of revenue, such as digital technologies or generate income such as building council dwellings.
- 2.19 The Housing Revenue Account (HRA) supports its own capital expenditure and provision for this is included in the HRA Business Plan. The surplus on the HRA account (excess of rental income over expenditure) is used to fund capital expenditure. This does not impact on the Council Fund. Although the HRA operates separately from the Council Fund, the Council does not borrow separately for Council Fund and HRA expenditure, all borrowing is

combined and the costs apportioned to the two funds based on the level of expenditure funded from borrowing for the two funds. The apportionment method is kept under review to ensure that it remains the most equitable method.

2.20 The Capital programme detailed at Appendix A, sets out how the programme is funded, the sources are explained below:

- General Capital Grant – This is a sum of money which is provided by the Welsh Government as part of the annual settlement. The Council is free to use the capital grant on any capital project it wishes.
- Supported Borrowing – The Council will borrow from establishments including the Public Works Loans Board (PWLB) to fund the expenditure. The revenue costs arising from the borrowing (Interest Costs and Minimum Revenue Provision) are funded by the Welsh Government through the annual revenue settlement, hence the term “Supported Borrowing”.
- Unsupported Borrowing – Again, the Council borrows the funding but is required to finance the revenue costs from its own resources. Projects funded by means of unsupported borrowing tend to be projects which deliver revenue savings and these savings contribute to meet the additional revenue costs arising from the borrowing.
- Specific Capital Grants – The Council will be awarded capital grants which partly or fully fund the cost of a project. Capital grants usually come with restrictions surrounding the expenditure which can be funded and by when the expenditure must be incurred.
- Revenue Contribution – Services can make a contribution from their revenue budgets to fund projects. These contributions tend to be as a match funding to a project which is mainly funded from a specific capital grant.
- Capital Receipts – The funds generated from the sale of assets can be used to contribute to the funding of the capital programme. These are usually generated from the sale of surplus assets (normally land or buildings). The Councils’ Capital Receipts Policy is set out in Appendix B
- Reserves – Funding held in reserve, e.g. unapplied capital receipts, can be used to support the capital programme. Specific reserves can also be built up and set aside for this purpose.

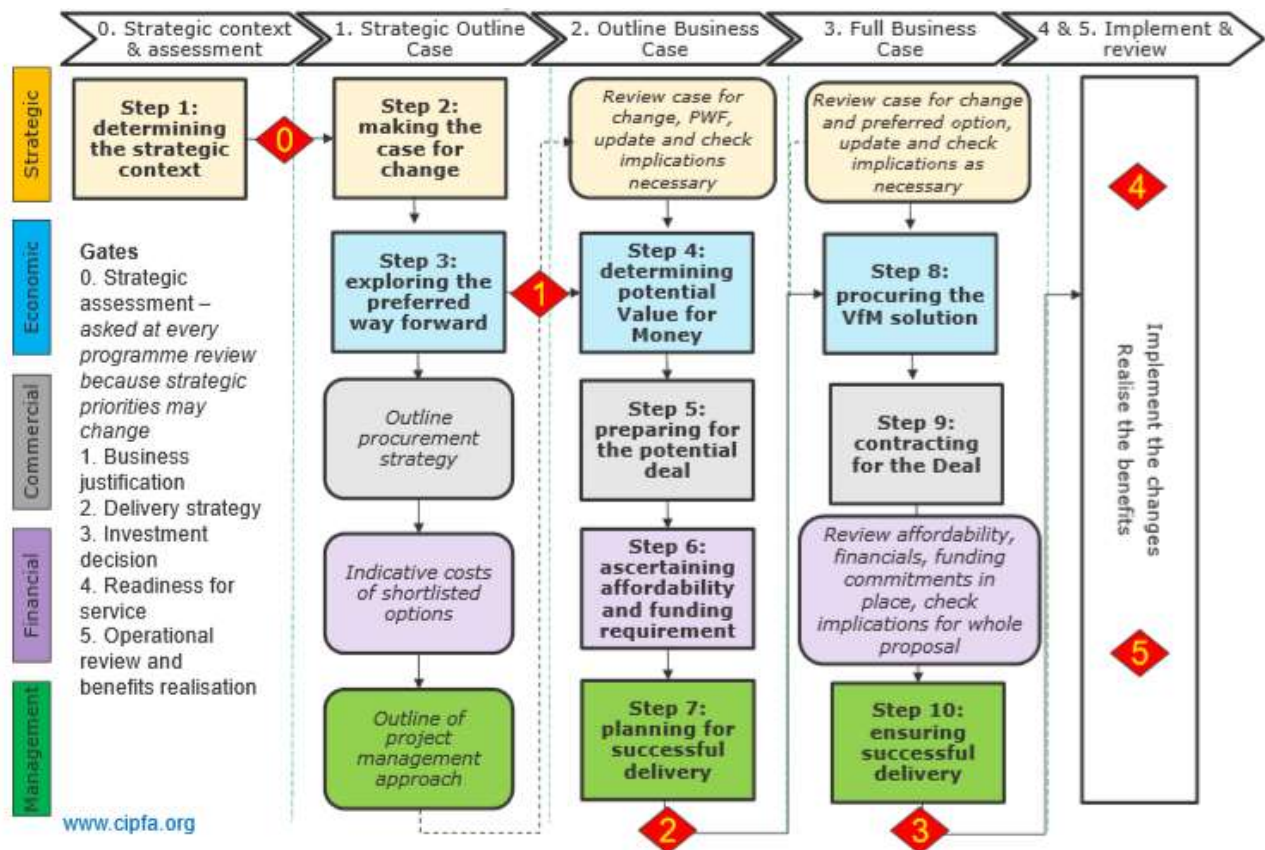
## **2.21 Capitalisation Direction and Transformation**

2.22 In December 2017 the Secretary of State announced the continuation of the capital receipt flexibility programme for a further three years up to financial year 2021/22. This is significant as it gives authorities the continued freedom to use capital receipts from the sale of their own assets (excluding Right to Buy receipts) to help fund the revenue costs of transformational work and the release of savings.

2.23 Realisable capital receipts will be used to fund the cost of the transformation projects for the next two years. The capital receipts policy is provided at Appendix B and forms a key element of the MTFS.

## **2.24 Governance and Approval Approach**

2.25 Welsh Government have adopted the Better Business Case approach to building, reviewing and agreeing business cases. These principles have been adopted in the Councils’ Capital Governance Framework. This approach introduces a more formal regime to follow and ensures consistency and a robust approach to developing each project. The diagram below sets out the gates and steps necessary to develop a capital from proposal through to a successful delivery. There has been an urgency in adopting this new regime to evidence stronger governance based on robust business cases from services.



- 2.26 The governance of this Capital Strategy follows the same process as the Revenue Budget Setting Process and is presented to the Cabinet as part of the MTFs which is then recommended to full Council for approval.
- 2.27 The three stages of the Governance Framework are:
- a) **Stage 1 - The Strategic Outline Case (SOC)**, these must be completed for the new bids and have necessary approval.
  - b) **Stage 2** - Once the SOC is approved, managers will need to complete more detailed work, particularly on the economics of the case, finances (detailed costings) and submit the **Outline Business Case (OBC)** for approval through the Strategic Asset Board, who provide challenge and then make recommendation to EMT / Cabinet to approve.
  - c) **Stage 3 - The Final Business Case (FBC)** is the final gateway and the project would move to the procurement stage. At this point the tender price for the project would be known and the risks quantified. Only when the FBC becomes a live project does the capital budget get allocated, which will improve our budget forecasting and profiling. Any revenue contributions including MRP costs would need to be built into the budget at stage 3.
- 2.28 For business cases between £75k and £1m a less formal business justification case will be adopted, being more simple and quicker to develop and proceed to project.
- 2.29 Each year there is a small bids programme funded by an allocation in the Capital Programme for capital projects under £75k, these are dealt with through the Strategic Asset Board.
- 2.30 The Council is moving away from an annual capital cycle and using the new framework will have an ongoing process of projects in development through to approval through Cabinet and Council as needed with the necessary prudential indicators updated and presented.

### 2.31 Capital Programme 2020-2029

- 2.32 The overall capital programme for the Council in 2020/21 is £132.87 million, which includes £35.23 million for the HRA. Appendix A provides a full list of all the schemes.
- 2.33 The General Fund includes schemes have previously been approved or are schemes in progress and expected to continue into future years. These schemes total £85.12 million. In addition, the programme includes a list of schemes that have had their Strategic Outline Case approved and have been progressed to Outline Business case. Providing the economic and financial justification stacks up these schemes are likely to develop to Final Business Case stage and become live projects, totaling £15.29 million. Split over three years, £6.52 million in 2020/21, £3.32 million in 2021/22 and £5.45 million in 2022/23.
- 2.34 The need to maintain the highways infrastructure through the HAMP has been highlighted at strategic level as a critical area of the council's long-term strategy. The ten-year programme now includes £5.00 million per annum for the HAMP and an additional £1.00 million per annum for street lighting column upgrades.
- 2.35 Overall borrowing requirements are estimated at £64.70 million in 2020/21, but it is likely that this figure will be significantly less based on previous years slippage on spend and grants received in year. A prudent estimate has been made for borrowing based on 70% in-year spend and 30% roll forward into future years, to ensure the borrowing budget remains affordable and realistic
- 2.36 The capital programme remains within budget for 2020/21, but may require a call on growth monies in future years, already highlighted through the FRM. The impact of the capital programme is set out through the following prudential indicators:

### 2.37 Capital Prudential Indicators 2020-2029

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

### 2.39 Capital Expenditure

- 2.40 This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

Capital expenditure £'000	2019/20 Forecast	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate	2027/28 Estimate	2028/29 Estimate
Non-HRA	52,604	97,642	80,873	44,999	27,139	22,559	17,638	16,579	18,877	16,182
HRA	20,876	35,230	42,626	27,550	10,263	9,804	7,773	9,509	7,153	14,848
<b>Total</b>	<b>73,480</b>	<b>132,872</b>	<b>123,498</b>	<b>72,549</b>	<b>37,402</b>	<b>32,363</b>	<b>25,411</b>	<b>26,088</b>	<b>26,030</b>	<b>31,030</b>

- 2.41 Other long-term liabilities - The financing need set out in the table above excludes other long-term liabilities, such as leasing arrangements that already include borrowing instruments.
- 2.42 The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a requirement to fund through borrowing, this figure is shown as the net financing need.

Financing of capital expenditure £'000	2019/20 Forecast	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate	2027/28 Estimate	2028/29 Estimate
Capital receipts	4,082	3,956	3,248	0,418	0,248	0,248	0,248	0,248	0,248	0,248
Capital grants	23,785	51,712	53,504	31,525	14,033	10,244	9,258	6,462	6,642	6,462
Revenue/Reserves	6,444	12,534	9,786	10,437	5,511	9,106	7,211	7,726	7,332	10,995
<b>Net financing need for the year</b>	<b>39,169</b>	<b>64,670</b>	<b>56,961</b>	<b>30,169</b>	<b>17,609</b>	<b>14,318</b>	<b>11,490</b>	<b>11,652</b>	<b>11,988</b>	<b>13,325</b>

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

2.44 This 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 indebtedness and so its underlying borrowing need. Any capital expenditure which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

2.45 The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset life, and so charges the economic consumption of capital assets as they are used.

2.46 The greater the CFR the larger the impact will be on the revenue budget, therefore in the long-term there will be a need to keep capital expenditure funded by borrowing at a level below the MRP budget in order to maintain the revenue budget at a sustainable level.

2.47 The Council is asked to approve the CFR projections below:

Capital Financing Requirement £'000	2019/20 Forecast	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate	2027/28 Estimate	2028/29 Estimate
CFR – non HRA	292,126	340,022	375,249	391,722	399,638	403,127	407,820	411,257	414,686	418,106
CFR – HRA	94,080	107,445	121,945	125,567	124,797	122,378	121,593	119,402	117,627	117,229
<b>Total CFR</b>	<b>386,206</b>	<b>447,468</b>	<b>497,194</b>	<b>517,289</b>	<b>524,435</b>	<b>525,506</b>	<b>529,413</b>	<b>530,659</b>	<b>532,312</b>	<b>535,335</b>
<b>Movement in CFR</b>	<b>36,676</b>	<b>61,262</b>	<b>49,726</b>	<b>20,095</b>	<b>7,146</b>	<b>1,071</b>	<b>3,907</b>	<b>1,246</b>	<b>1,654</b>	<b>3,023</b>
<b>Movement in CFR represented by:</b>										
Net financing need for the year (above)	39,169	64,670	56,961	30,169	17,609	14,318	11,490	11,652	11,988	13,325
Less MRP/VRP and other financing movements	2,493	3,408	7,234	10,075	10,463	10,419	10,411	10,406	10,335	10,302
<b>Movement in CFR</b>	<b>36,676</b>	<b>61,262</b>	<b>49,726</b>	<b>20,095</b>	<b>7,146</b>	<b>1,071</b>	<b>3,907</b>	<b>1,246</b>	<b>1,654</b>	<b>3,023</b>

## 2.48 Minimum Revenue Provision Policy Statement

2.49 MRP is an annual charge that Councils are required to pay for their debt liability in respect of capital expenditure funded by borrowing, for both the general fund and the Housing Revenue Account debt. This capital expenditure is set out as part of the CFR calculation and updated regularly to reflect borrowing need changes and the resultant costs, it is important to ensure that the debt is repaid over a period commensurate with that over which the capital expenditure provides benefit.

2.50 The debt repayment is a revenue charge, the minimum revenue provision (MRP), although additional voluntary payments are allowed if required voluntary revenue provision (VRP).

2.51 Welsh Government regulations have been issued which require the Council to approve the **MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision set out.

### 2.52 **Recommendation - The Council is recommended to approve the following MRP Statement for the 2020/21 financial year:**

- a) For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:
  - To continue to calculate the MRP on a 2% on a straight-line basis for borrowing Council Fund debt.
- b) From 1 April 2008 for all unsupported borrowing (including PFI and finance leases), the MRP policy is:
  - To charge MRP over the asset life on an annuity basis.
- c) Estimated life periods will be determined under delegated powers. Whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the components of expenditure and will only be divided up in cases where there are two or more major components with substantially different economic lives.

2.53 These options provide for a reduction in the borrowing need over approximately the asset's life.

- d) There is a requirement on the HRA to make a minimum revenue provision of 2% of the reducing balance. The HRA MRP for prudential debt IS calculated using the asset life method.
- e) Repayments included in annual PFI or finance leases are applied as MRP.
- f) In addition the guidance allows for MRP to be deferred for assets under construction and this part of the guidance is adopted because the asset is not used by the authority until it is operational and therefore the MRP will match the life of the asset.
- g) MRP Overpayments - A change introduced by the revised Welsh Government 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<sup>st</sup> March 2019 the total VRP utilised was £8.4m, with the expected total overpayments being £19.5m.

## 2.54 Risk Management

- 2.55 All large capital projects are managed under the Council's Project Management Methodology, which incorporates risk identification and risk management. The Council also has a Risk Management Policy which is applied to all its projects and activities.
- 2.56 For all capital projects, project managers update financial forecasts on a monthly basis identifying any areas subject to risk of overspend, underspend or slippage. The monthly report is reviewed by the officer Resources Working Group, where any issues are discussed and, if necessary, referred for action.
- 2.57 There is also a degree of funding risk in the Capital Programme, reliant as it is on future capital receipts, and the ability to be able to afford borrowing if necessary. These risks need to be managed and monitored on a regular basis, and action taken where necessary.
- 2.58 Risk appetite in this context is the level of risk that the Council is prepared to accept to be exposed to at any point in time in relation to its activities. It involves knowing what risks the Council wishes to avoid, what risks it is willing to accept and what risks it is willing and able to manage (including by transferring them to a third party, e.g. through insurance).
- 2.59 The risks are regularly monitored and managed both financially and operationally in accordance with council processes. The financial performance is reported on a monthly basis to the Resources Working Group and on a quarterly basis to Portfolio Holders as part of the revenue budget monitoring.
- 2.60 The Council is willing to accept the risks set out in this Strategy for projects that have Council approval provided that the project management ensures the appropriate mitigations are put in place to bring the project within acceptable risks margins.
- 2.61 The key financial risks inherent in the Council's Capital Programme include:

Description of Risk	Potential Impact
The longer a project takes to come to fruition, the greater the risk that the financial cost of the project will have increased, both due to the additional staff time spent on the project and the inflationary impact on the costs involved in bringing the asset into operation.	May result in financial pressures on the other projects/ programmes and service delivery.
There is a degree of correlation between the length of time a project spends in the feasibility and development stage and an increased risk of project failure or abandonment. Should a project fail for any reason, the regulations require all capital costs to be returned to revenue, which may create significant pressures, depending on the level of spend at that point.	May result in additional revenue pressures on delivery/services.
Project expenditure is higher than forecast estimates	May result in increased financial pressures/ limitations on future investment options.
Once a project has been delivered successfully the cash expended is then bound in the asset. In the case of the assets that are for service delivery and do not generate a rental income stream, the money invested in the asset is only recovered if and when the asset is sold at a future date. This carries inherent financial risks in that the asset may have decreased in value, depending on market conditions, or may not have increased in value sufficiently to mitigate the effects of inflation.	May result in increased financial pressures/ limitations on future investment options.



**Appendix A**

**CAPITAL PROGRAMME 2020/21 to 2029/30**

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	Total
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
<b>Education</b>												
Major Improvements	3,284	2,908	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	15,193
Crickhowell High School Extension	447	434	0	0	0	0	0	0	0	0	0	881
Crickhowell High School Sports Centre	65	51	0	0	0	0	0	0	0	0	0	117
Child Care	858	2,859	0	0	0	0	0	0	0	0	0	3,717
	<b>4,655</b>	<b>6,253</b>	<b>1,000</b>	<b>1,000</b>	<b>1,000</b>	<b>1,000</b>	<b>1,000</b>	<b>1,000</b>	<b>1,000</b>	<b>1,000</b>	<b>1,000</b>	<b>19,907</b>
<b>Band A</b>												
Brecon High School	6,775	0	0	0	0	0	0	0	0	0	0	6,775
Gwernyfed Catchment Primary Schools	151	0	0	0	0	0	0	0	0	0	0	151
Carno, Glantwymyn Federation	1,083	0	0	0	0	0	0	0	0	0	0	1,083
Welshpool CinW School	755	5,135	0	0	0	0	0	0	0	0	0	5,890
Gwernyfed High School	270	5,700	1,000	0	0	0	0	0	0	0	0	6,970
Ysgol Calon Cymru	151	2,409	3,372	0	0	0	0	0	0	0	0	5,932
	<b>9,185</b>	<b>13,244</b>	<b>4,372</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>26,801</b>
<b>Band B</b>												
Ysgol Bro Hyddgen	250	14,114	8,077	0	0	0	0	0	0	0	0	22,442
Ysgol Brynllwarch	200	800	2,000	4,753	900	0	0	0	0	0	0	8,653
Newtown Development	0	0	0	0	0	0	0	0	0	0	0	0
Cedewain	100	8,955	13,591	0	0	0	0	0	0	0	0	22,645
New WM High School	0	0	8,150	16,000	7,941	0	0	0	0	0	0	32,091
EM Primary School (North Powys Wellbeing)	250	1,500	7,212	0	0	0	0	0	0	0	0	8,962
Welshpool HS Refurbishment	1,564	0	0	0	0	0	0	0	0	0	0	1,564
Ysgol Gymraeg y Trallwng	441	0	3,500	2,268	0	0	0	0	0	0	0	6,209
Refurbishment - School A	0	0	1,948	1,674	1,449	0	0	0	0	0	0	5,071
Refurbishment - School B	0	0	0	0	873	3,429	0	0	0	0	0	4,302
	<b>2,805</b>	<b>25,369</b>	<b>44,478</b>	<b>24,695</b>	<b>11,163</b>	<b>3,429</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>111,939</b>
	<b>16,645</b>	<b>44,865</b>	<b>49,850</b>	<b>25,695</b>	<b>12,163</b>	<b>4,429</b>	<b>1,000</b>	<b>1,000</b>	<b>1,000</b>	<b>1,000</b>	<b>1,000</b>	<b>158,648</b>
<b>Highways, Transport and Recycling</b>												
Highways Core Allocation	0	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	15,000
Structural Maintenance	1,586	1,500	1,500	1,500	1,500	0	0	0	0	0	0	7,586
HAMP	0	5,575	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	50,575
Public Highway Refurbishment Grant (Surface Dressing)	1,575	1,576	0	0	0	0	0	0	0	0	0	3,150
Tallerddig Works for Network Rail	72	0	0	0	0	0	0	0	0	0	0	72
Electric Charge Points (Integrated Transport)	140	60	0	0	0	0	0	0	0	0	0	200
Other Integrated Transport	230	238	0	0	0	0	0	0	0	0	0	469
Street Lighting	100	1,250	1,250	1,250	1,250	1,000	1,000	1,000	1,000	1,000	1,000	11,100
Major Remedial Earthworks	162	150	0	0	0	0	0	0	0	0	0	312
Structural Drainage	263	0	0	0	0	0	0	0	0	0	0	263
Highways Strengthening (Resurfacing)	3,149	0	0	0	0	0	0	0	0	0	0	3,149
Structural Repairs - Footways	194	0	0	0	0	0	0	0	0	0	0	194
Bridge Renewal/Strengthening	1,110	600	500	500	500	0	0	0	0	0	0	3,210
Surface Dressing	225	0	0	0	0	0	0	0	0	0	0	225
Residential Estates	100	0	0	0	0	0	0	0	0	0	0	100
Road Safety and Small Schemes	58	0	0	0	0	0	0	0	0	0	0	58
Flood Alleviation	911	0	0	0	0	0	0	0	0	0	0	911
Depot Storage Bays	90	0	0	0	0	0	0	0	0	0	0	90
Strategic Salt Reserve	834	0	800	0	0	0	0	0	0	0	0	1,634
Recycling Bulking Facility - North Powys	1,858	1,042	103	0	0	0	0	0	0	0	0	3,003
HWRC Newtown	226	0	0	0	0	0	0	0	0	0	0	226
HWRC Brecon	20	480	0	0	0	0	0	0	0	0	0	500
Relocation to Cwrt y Plyffin	75	1,038	50	0	0	0	0	0	0	0	0	1,163
Llandrindod HWRC H&S works	25	0	0	0	0	0	0	0	0	0	0	25



Sharepoint	33	67	0	0	0	0	0	0	0	0	0	100
ICT System Rationalisation	160	361	0	0	0	0	0	0	0	0	0	521
Hwb In School Infrastructure Grant	360	0	0	0	0	0	0	0	0	0	0	360
Finance System	83	0	0	0	0	0	0	0	0	0	0	83
	<b>1,231</b>	<b>1,000</b>	<b>649</b>	<b>250</b>	<b>370</b>	<b>350</b>	<b>350</b>	<b>350</b>	<b>350</b>	<b>350</b>	<b>350</b>	<b>5,600</b>

### Children Services

Flying Start - Open Door, Welshpool	0	292	0	0	0	0	0	0	0	0	0	292
Flying Start - Brecon Golwyg y Bannau Refurbishment	20	800	0	0	0	0	0	0	0	0	0	820
	99	0	0	0	0	0	0	0	0	0	0	99
	<b>119</b>	<b>1,092</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>1,211</b>

### Adult Services

PCC Care Homes (Shaw Healthcare) -	0	190	100	100	110	0	0	0	0	0	0	500
Community Equipment e.g. profile beds	126	100	100	0	0	0	0	0	0	0	0	326
Telecare	100	0	0	0	0	0	0	0	0	0	0	100
Innovative use of robotics e.g. Pepper	0	200	200	0	0	0	0	0	0	0	0	400
Castell y Dail	67	98	0	0	0	0	0	0	0	0	0	165
The Rhyd	78	0	0	0	0	0	0	0	0	0	0	78
SMAF Old Bank Welshpool	366	0	0	0	0	0	0	0	0	0	0	366
Arlais/Lant Avenue ODC	176	0	0	0	0	0	0	0	0	0	0	176
Mobile Working and Transformation	0	100	0	0	0	0	0	0	0	0	0	100
Powys ASC Smart Technology	45	0	0	0	0	0	0	0	0	0	0	45
Dom Care System	14	0	0	0	0	0	0	0	0	0	0	14
	<b>973</b>	<b>689</b>	<b>400</b>	<b>100</b>	<b>110</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>2,271</b>

### Legal Services

Congress System	22	0	0	0	0	0	0	0	0	0	0	22
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Capital Bids Awaiting Approval	0	6,521	3,320	5,456	0	0	0	0	0	0	0	15,296
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Local (small) Capital Schemes	0	500	500	500	500	500	500	500	500	500	500	5,000
Capitalisation Direction	3,640	3,000	3,000	0	0	0	0	0	0	0	0	9,640
Unallocated Resources	419	0	0	0	865	2,815	2,815	2,815	2,815	2,815	2,815	18,174

<b>Total</b>	<b>52,604</b>	<b>97,642</b>	<b>80,873</b>	<b>44,999</b>	<b>27,139</b>	<b>22,559</b>	<b>17,638</b>	<b>16,579</b>	<b>18,877</b>	<b>16,182</b>	<b>16,642</b>	<b>411,733</b>
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### Financed By

Supported Borrowing	8,465	7,979	5,825	4,548	4,548	4,548	4,548	4,548	4,548	4,548	4,548	58,653
Prudential Borrowing	17,874	40,955	33,779	18,614	10,404	7,200	6,000	6,000	6,000	6,000	6,000	158,826
General Capital Grant	4,327	4,560	2,782	2,782	2,782	2,782	2,782	2,782	2,782	2,782	2,782	33,925
Grants	15,337	34,274	32,125	17,536	7,571	2,229	0	0	0	0	0	109,072
Capital Receipts	4,082	3,956	3,248	248	248	248	248	248	248	248	248	13,271
Revenue/Reserves	2,520	5,917	3,114	1,271	1,585	5,552	4,060	3,001	5,299	2,604	3,064	37,987
<b>Total</b>	<b>52,604</b>	<b>97,642</b>	<b>80,873</b>	<b>44,999</b>	<b>27,139</b>	<b>22,559</b>	<b>17,638</b>	<b>16,579</b>	<b>18,877</b>	<b>16,182</b>	<b>16,642</b>	<b>411,733</b>

### Housing Revenue Account

WHQS	12,173	12,489	8,368	10,661	5,295	5,336	4,975	7,140	5,380	13,041	12,270	97,128
New Builds/Purchases	4,859	17,726	29,536	11,672	362	377	385	392	400	408	416	66,534
Fit for Life	1,991	2,725	2,218	2,444	2,295	2,193	557	570	0	0	0	14,993
Adaptions	464	250	256	261	267	273	279	285	291	298	250	3,173
Energy Efficiency	0	250	332	339	347	355	362	285	291	298	0	2,859
Estate Improvements	445	250	434	606	406	415	368	199	209	208	0	3,540
Compliance One Hundred	0	390	460	470	491	447	457	239	175	179	0	3,308
Water Supply and Sewage Works Renewal	80	50	51	52	160	109	111	114	116	119	0	963
Damp Prevention Strategy	743	100	153	209	213	191	167	171	175	179	0	2,301
Ystragynlais Regeneration	0	300	715	731	320	0	0	0	0	0	0	2,067
Rapid Response Fund	0	100	102	104	107	109	111	114	116	119	0	983
Community Alarms	0	600	0	0	0	0	0	0	0	0	0	600
Mobile Solution	60	0	0	0	0	0	0	0	0	0	0	60
Vehicles	60	0	0	0	0	0	0	0	0	0	0	60
<b>Total</b>	<b>20,876</b>	<b>35,230</b>	<b>42,626</b>	<b>27,550</b>	<b>10,263</b>	<b>9,804</b>	<b>7,773</b>	<b>9,509</b>	<b>7,153</b>	<b>14,848</b>	<b>12,936</b>	<b>198,569</b>

### Financed By

Prudential Borrowing	12,830	15,736	17,357	7,008	2,657	2,570	942	1,104	1,440	2,777	2,085	66,505
Grant	4,121	12,878	18,597	11,207	3,680	3,680	3,680	3,680	3,680	3,680	3,680	72,563
Capital Receipts	0	0	0	170	0	0	0	0	0	0	0	170
Revenue/Reserves	3,925	6,616	6,672	9,166	3,926	3,554	3,151	4,725	2,033	8,391	7,171	59,330
<b>Total</b>	<b>20,876</b>	<b>35,230</b>	<b>42,626</b>	<b>27,550</b>	<b>10,263</b>	<b>9,804</b>	<b>7,773</b>	<b>9,509</b>	<b>7,153</b>	<b>14,848</b>	<b>12,936</b>	<b>198,569</b>

## **Appendix B                      Capital Receipt Policy**

### **Introduction**

This policy is introduced to provide guidance to Senior Managers on the rules governing the application of Capital Receipts in Powys County Council. This guidance has been drafted in line with the two codes of practice issued by the Chartered Institute of Public Finance and Accountancy (CIPFA). These publications are:

- The Prudential Code for Capital Finance in Local Authorities
- The Code of Practice on Local Authority Accounting

The two publications referred to above contain guidance on capital receipts and local authority accounting that complements guidance issued by the Welsh Government.

In England and Wales, capital receipts are defined by Section 9(1) of the Local Government Act 2003 to include all instances where property, plant or equipment is disposed of for cash (subject to a £10,000 de minimis). All references to Capital Receipts in this policy therefore refers to this definition.

### **Application**

- This guidance should be read alongside the relevant direction issued by Welsh Ministers.
- This guidance applies with effect from 1 April 2018 and for each subsequent financial year to which the use of capital receipts applies.
- The direction makes it clear that local authorities cannot borrow to finance the revenue costs of service reform. Local authorities can only use capital receipts from the disposal of property plant and equipment assets received in the years in which this flexibility is offered. Officers must therefore not use stock of capital receipts to finance the revenue costs of qualifying projects.

### **Costs of Disposal**

The statutory arrangements for capital receipts in England and Wales permit costs of disposals to be financed from the receipts generated, although there is a cap of 4% of the Capital Receipt for costs incurred in relation to non-housing disposals.

### **Qualifying Expenditure**

The accounting process for disposals is complicated by the fact that proceeds from the sale of property, plant and equipment are generally subject to statutory restrictions over their use. Income that meets the definition of capital receipts is reserved for new capital investment or for the reduction of an authority's indebtedness. This definition has however been extended by a Capitalisation directive (April 2018) on the Flexible Use of Capital Receipt by the Welsh Cabinet Secretary for Local Government and Public Services, in the exercise of his powers under section 16(2)(b) and 20 of the Local Government Act 2003), that the local authorities in Wales treat as capital expenditure, any expenditure which:

- (a). Is incurred by the Authorities that is designed to generate ongoing revenue savings in the delivery of services and/or transform service delivery in a way that reduces cost or demand for services in future years for any of the public sector delivery partners; and
- (b). Is properly incurred by the authorities for the financial years that begin in 1 April 2016, 1 April 2017, 1 April 2018, 1 April 2019, 1 April 2020 and 1 April 2021."

While this directive extends the scope of expenditure that qualify for the use of Capital Receipts, it also restricts the period during which the flexibility can be applied. Therefore, any decision to apply Capital Receipt, must meet the conditions of both the qualifying period and the qualifying expenditure.

The qualifying period during which flexibility can be applied is the financial years that begin from 1 April 2016 and end on 31 March 2022. This means that any Capital Expenditure received prior to 1 April 2016 or received after 31 March 2022 cannot be applied under the exemptions of the Capitalisation Directive. Capital Receipts received during the directive period can also not be applied with the same flexibility once the directive term has expired.

Qualifying expenditure is expenditure on any project that is designed to generate ongoing revenue savings in the delivery of public services and/or transform service delivery in a way that reduces costs or demand for services in future years for the Authority or any of the delivery partners. This includes investment which supports economic growth projects which are also designed to reduce revenue costs or pressures over the longer term. Within this definition, it is for individual local authorities to decide whether or not a project qualifies for the flexibility.

The set up and implementation costs of any new processes or arrangements can be classified as qualifying expenditure. The ongoing revenue costs of the new processes or arrangements cannot be classified as qualifying expenditure.

### **Examples of qualifying expenditure**

There are a wide range of projects that could generate qualifying expenditure and the list below is neither prescriptive nor exhaustive. Examples of projects include:

- Preparatory work necessary to support local authority mergers as part of the programme to reform local government in Wales;
- Sharing back-office and administrative services with one or more other council or public sector body;
- Investment in service reform feasibility work, e.g. setting up pilot schemes;
- Collaboration between local authorities and central government to free up land for economic use
- Funding the cost of service reconfiguration, restructuring or rationalisation (staff or non-staff), where this leads to ongoing efficiency savings or service transformation;
- Sharing Chief Executives, management teams or staffing structures;
- Driving a digital approach to the delivery of more efficient public services and how the public interacts with constituent authorities where possible;
- Aggregating procurement on common goods and services where possible, either as part of local arrangements or using the National Procurement Service, Crown Commercial Services or other central purchasing bodies which operate in accordance with the Wales Procurement Policy Statement;
- Improving systems and processes to tackle fraud and corruption in line with the Local Government Fraud and Corruption Strategy – this could include an element of staff training;
- Setting up alternative delivery models to deliver services more efficiently and bring in revenue (for example, through selling services to others); and
- Integrating public facing services across two or more public sector bodies (for example children's social care, trading standards) to generate savings or to transform service delivery.
- Investment which supports economic growth projects which are also designed to reduce revenue costs or pressures over the longer term, across one or more local authorities and/or other public sector bodies.

### **Use of Capital Receipts**

The current policy for the use of Capital Receipts is contained in the Corporate Asset Policy.

Capital Receipts will normally be credited to the Central Fund and will be used to progress the Council's principal objectives defined in the Corporate Improvement Plan. However, up to 4% of the capital receipt may be reclaimed by Property as permitted and approved costs of sale.

Capital receipts from the sale of Farm or Agricultural land under the County Farm Estate and property vested in the HRA will be subject to the following apportionment:

This policy proposes the use of Capital Receipts to continue to be based on the following:

<b>Type</b>	<b>Service Area</b>	<b>Corporate</b>
Agricultural	0%	100%
HRA Dwellings and Land	100%	
Homefinder Receipts	100%	
Vehicles	100%	

## **3. TREASURY MANAGEMENT STRATEGY**

### **3.1 Background**

3.2 The Council is required to operate a balanced budget which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned with cash being available when it is needed.

3.3 The second main function of the treasury management service is the funding of the Council's capital plans. These plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash involves arranging short or long-term loans or using longer-term cash flow surpluses.

3.4 The contribution the treasury management function makes to the authority is critical as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects.

3.5 Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities as they usually arise from capital expenditure and are separate from the day-to-day treasury management activities. The IRFS16 Leases accounting standard will from April 2020 require leases in, with the exception of low value and short term leases to be included on the balance sheet. These arrangements are not included in this report.

### **3.6 Borrowing Strategy**

3.7 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 still an issue that needs to be considered.

3.8 Against this background and the risks within the economic forecast, caution will be adopted with the 2020/21 treasury operations. The Head of Financial Services will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp fall in borrowing rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then borrowing will be postponed.
- if it was felt that there was a significant risk of a much sharper rise in borrowing rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

3.9 Any decisions will be reported to the appropriate decision making body at the next available opportunity.

### **3.10 Policy on Borrowing in Advance of Need**

3.11 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.

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

### 3.13 Debt rescheduling

3.14 Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100 bps increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates. If rescheduling was done, it will be reported to the Cabinet at the earliest meeting following its action.

### 3.15 New Financial Institutions as a source of Borrowing and / or types of Borrowing

3.16 Following the decision by the PWLB on 9 October 2019 to increase their margin over gilt yields by 100 bps to 180 basis points on loans lent to local authorities, consideration will also need to be given to sourcing funding at cheaper rates from the following:

- Local authorities (primarily shorter dated maturities)
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of spot or forward dates)
- Municipal Bonds Agency

3.17 The degree which any of these options proves cheaper than PWLB Certainty Rate is still evolving at the time of writing but our advisors will keep us informed.

### 3.18 Approved Sources of Long and Short term Borrowing

On Balance Sheet	Fixed	Variable
PWLB	●	●
Municipal bond agency	●	●
Local authorities	●	●
Banks	●	●
Pension funds	●	●
Insurance companies	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Market (LOBOs)	●	●
Stock issues	●	●
Local temporary	●	●
Local Bonds	●	
Local authority bills		●
Overdraft		●
Negotiable Bonds	●	●
Internal (capital receipts & revenue balances)	●	●
Commercial Paper	●	
Medium Term Notes	●	

### 3.19 The Capital Prudential and Treasury Indicators 2020/21 – 2022/23 and MRP Statement

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



### 3.21 Ratio of financing costs to net revenue stream

3.22 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. The estimates of financing costs include current commitments and the proposals in this budget report.

Ratio of financing costs to net revenue stream	Revised 2019/20	Estimate 2020/21	Estimate 2021/22	Estimate 2022/23	Estimate 2023/24	Estimate 2024/25	Estimate 2025/26	Estimate 2026/27	Estimate 2027/28	Estimate 2028/29	Estimate 2029/30
£'000											
Financing Costs	7,816	9,745	15,947	20,139	21,254	21,422	20,639	21,350	21,854	22,503	23,176
Net Revenue Stream	255,408	269,600	270,179	271,046	272,209	273,678	273,678	273,678	273,678	273,678	273,678
Council Fund	3.72%	3.06%	3.61%	5.90%	7.43%	7.81%	7.83%	7.54%	7.80%	7.99%	8.22%
Financing Costs	5,593	5,641	6,631	7,906	8,224	8,107	8,205	8,082	7,963	7,875	7,910
Net Revenue Stream	24,883	25,650	26,409	27,190	27,995	28,824	29,678	30,557	31,463	32,396	33,357
HRA	22.48%	21.99%	25.11%	29.08%	29.38%	28.13%	27.65%	26.45%	25.31%	24.31%	23.71%

### 3.23 Maturity structure of borrowing

3.24 These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing and are required for upper and lower limits.

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

Maturity structure of borrowing 2020/21		
	Lower	Upper
Under 12 months	0%	40%
12 months to 2 years	0%	40%
2 years to 5 years	0%	40%
5 years to 10 years	0%	40%
10 years to 20 years	0%	40%
20 years to 30 years	0%	40%
30 years to 40 years	0%	40%
40 years to 50 years	0%	40%

### 3.26 Affordability prudential indicators

3.27 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. The Council is asked to approve the following borrowing indicators:

### 3.28 Borrowing Indicators

3.29 The capital expenditure plans set out in the capital strategy 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 and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing

facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

- 3.30 The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

### Change in External Debt

£'000	Estimate 2020/21	Estimate 2021/22	Estimate 2022/23	Estimate 2023/24	Estimate 2024/25	Estimate 2025/26	Estimate 2026/27	Estimate 2027/28	Estimate 2028/29
<b>Council Fund</b>									
<b>External Debt</b>									
Debt at 1st April	180,159	281,067	332,387	335,028	352,967	375,297	378,987	409,118	412,217
Expected change in Debt	100,908	51,320	2,641	17,939	22,331	3,690	30,131	3,099	-27,734
Estimated Gross Debt at 31st March	281,067	332,387	335,028	352,967	375,297	378,987	409,118	412,217	384,483
CFR	340,022	375,249	391,722	399,638	403,127	407,820	411,257	414,686	418,106
Under / (Over) Borrowing	58,956	42,863	56,694	46,671	27,830	28,833	2,138	2,469	33,624
<b>HRA</b>									
<b>External Debt</b>									
Debt at 1st April	94,080	107,445	121,945	125,567	124,797	122,378	121,593	119,402	117,627
Expected change in Debt	13,366	14,499	3,622	-770	-2,419	-785	-2,191	-1,776	-398
Estimated Gross Debt at 31st March	107,445	121,945	125,567	124,797	122,378	121,593	119,402	117,627	117,229
CFR	107,445	121,945	125,567	124,797	122,378	121,593	119,402	117,627	117,229

- 3.31 Within the range of 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 debt 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 2020/21 and the following two financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue or speculative purposes.
- 3.32 The Head of Financial Services reports that the Council complied with this prudential indicator 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.
- 3.33 Treasury Indicators: limits to borrowing activity**
- 3.34 The operational boundary is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.
- 3.35 The council has a long term liability of £19.50 million for a section 106 obligation. This is not factored into any repayment plans at present, and borrowing is likely to be needed for this at some point in the future.

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2022/30
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Borrowing	404.0	480.0	523.0	546.0	569.0	581.0	593.0	605.0	618.0	618.0
<b>Total</b>	<b>404.0</b>	<b>480.0</b>	<b>523.0</b>	<b>546.0</b>	<b>569.0</b>	<b>581.0</b>	<b>593.0</b>	<b>605.0</b>	<b>618.0</b>	<b>618.0</b>

### 3.36 The authorised limit for external debt.

3.37 This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

- a) This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
- b) The Council is asked to approve the following authorised limit:

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Borrowing	434.0	510.0	553.0	576.0	599.0	611.0	623.0	635.0	648.0	648.0
<b>Total</b>	<b>434.0</b>	<b>510.0</b>	<b>553.0</b>	<b>576.0</b>	<b>599.0</b>	<b>611.0</b>	<b>623.0</b>	<b>635.0</b>	<b>648.0</b>	<b>648.0</b>

### 3.38 Annual Investment Policy

3.39 Management of risk - The Welsh Government and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This strategy deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy.

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

- Welsh Government's Guidance on Local Government Investments 2019 ("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

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

3.42 The above guidance from the Welsh Government and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means:

- a) Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
- b) Other information: ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which

institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.

- c) Other information sources used will include the financial press, share price and other such information pertaining to the financial sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
- d) This authority has defined the list of types of investment instruments that the treasury management team are authorised to use. There are categories of ‘specified’ and ‘non-specified’ investments.
  - I. Specified investments are those with a high level of credit quality and subject to a maturity limit of one year except deposits with local authorities which can be for any period
  - II. Non-specified investments are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. Once an investment is classed as non-specified, it remains non-specified all the way through to maturity i.e. an 18 month deposit would still be non-specified even if it has only 11 months left until maturity.
- e) Lending limits (amounts and maturity), for each counterparty will be set in conjunction with Link’s matrices.
- f) This authority will set a limit for the amount of its investments which are invested for longer than 365 days
- g) Investments will only be placed with counterparties from countries with a specified minimum sovereign rating
- h) All investments will be denominated in sterling.
- i) As a result of the change in accounting standards for 2019/20 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund.

3.43 The council will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance

### **3.44 Creditworthiness policy**

3.45 This Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach, utilising credit ratings from the three main credit rating agencies - Fitch, Moody’s and Standard & Poor’s. The credit ratings of counterparties are supplemented with the following overlays:

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

3.46 This modelling approach combines credit ratings, and any assigned Watches and Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads. The end product of this 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 suggested duration for investments. The Council will, therefore, use counterparties within the following durational bands:

- Yellow 5 years \*
- Dark pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
- Light pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5

- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

*Please note: the yellow colour category is for UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt.*

*Please note: "fund" ratings are different to individual counterparty ratings, coming under either specific "MMF" or "Bond Fund" rating criteria.*

- 3.47 The Link Asset Services' creditworthiness service uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.
- 3.48 Typically, the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of F1 and a long term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances, consideration will be given to the whole range of ratings available, or other topical market information, to support their use.
- 3.49 Credit ratings will be monitored daily through use of the Link Asset Services' 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 spreads against the iTraxx European Financials benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.
- 3.50 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, as well as information on any external support for banks to help support its decision making process.
- 3.51 UK banks – ring fencing**
- 3.52 The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.
- 3.53 Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

3.54 While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

### 3.55 Country limits

3.56 Due care will be taken to consider the exposure of the Council's total investment portfolio to non-specified investments, countries, groups and sectors.

3.57 The Council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of AA- from Fitch. The list of countries that qualify using this credit criteria as at the date of this report are shown in paragraph 3.75. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

### 3.58 Investment strategy

3.59 **In-house funds** - 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). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

3.60 **Investment returns expectations** – Post Brexit, then Bank Rate is forecast to increase only slowly over the next few years to reach 1.25% by quarter 1 2023. Bank Rate forecasts for financial year ends (March) are:

- Q1 2021 0.75%
- Q1 2022 1.00%
- Q1 2023 1.25%

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

2019/20	0.75%
2020/21	0.75%
2021/22	1.00%
2022/23	1.25%
2023/24	1.50%
2024/25	1.75%
Later years	2.25%

3.62 The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening global economic picture, this is fully explained at Appendix A. The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside. In the event that a Brexit deal is agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

**3.63 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.

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

<b>Upper limit for principal sums invested for longer than 365 days</b>			
<b>£m</b>	<b>2020/21</b>	<b>2021/22</b>	<b>2022/23</b>
Principal sums invested for longer than 365 days	£m 10	£m 10	£m 10
Current investments as at 17.02.20 in excess of 1 year maturing in each year	Nil	Nil	Nil

3.65 For its cash flow generated balances, the Council will seek to utilise its business reserve instant access accounts, money market funds and short-dated deposits.

**3.66 Investment performance / risk benchmarking** – The council will use an investment benchmark to assess the investment performance of its investment portfolio of 3 month LIBID un compounded.

**3.67 Interest Rate Forecasts** - The interest rate forecasts provided by Link Asset are predicated on an assumption of an agreement being reached on Brexit between the UK and the EU. In the event of an orderly non-agreement exit, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall. If there was a disorderly Brexit, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. Quantitative easing could also be restarted by the Bank of England. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

**3.68 The balance of risks to the UK**

- The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening global economic picture.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.
- In the event that a Brexit deal was agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

3.69 One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

**3.70 Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:**

- Brexit – if it were to cause significant economic disruption and a major downturn in the rate of growth.

- Bank of England takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the Eurozone sovereign debt crisis. In 2018, Italy was a major concern due to having a populist coalition government which made a lot of anti-austerity and anti-EU noise. However, in September 2019 there was a major change in the coalition governing Italy which has brought to power a much more EU friendly government; this has eased the pressure on Italian bonds. Only time will tell whether this new coalition based on an unlikely alliance of two very different parties will endure.
- Weak capitalisation of some European banks, particularly Italian banks.
- German minority government. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The CDU has done badly in recent state elections but the SPD has done particularly badly and this has raised a major question mark over continuing to support the CDU. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until 2021.
- Other minority EU governments. Austria, Sweden, Spain, Portugal, Netherlands and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- Austria, the Czech Republic, Poland and Hungary now form a strongly anti-immigration bloc within the EU. There has also been rising anti-immigration sentiment in Germany and France.
- In October 2019, the IMF issued a report on the World Economic Outlook which flagged up a synchronised slowdown in world growth. However, it also flagged up that there was potential for a rerun of the 2008 financial crisis, but this time centred on the huge debt binge accumulated by corporations during the decade of low interest rates. This now means that there are corporates who would be unable to cover basic interest costs on some \$19trn of corporate debt in major western economies, if world growth was to dip further than just a minor cooling. This debt is mainly held by the shadow banking sector i.e. pension funds, insurers, hedge funds, asset managers etc., who, when there is \$15trn of corporate and government debt now yielding negative interest rates, have been searching for higher returns in riskier assets. Much of this debt is only marginally above investment grade so any rating downgrade could force some holders into a fire sale, which would then depress prices further and so set off a spiral down. The IMF's answer is to suggest imposing higher capital charges on lending to corporates and for central banks to regulate the investment operations of the shadow banking sector. In October 2019, the deputy Governor of the Bank of England also flagged up the dangers of banks and the shadow banking sector lending to corporates, especially highly leveraged corporates, which had risen back up to near pre-2008 levels.
- Geopolitical risks, for example in North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

### **3.71 Upside risks to current forecasts for UK gilt yields and PWLB rates**

- Brexit – if agreement was reached all round that removed all threats of economic and political disruption between the EU and the UK.
- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.



- UK inflation, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

### 3.72 Treasury Management Practice – Credit and Counterparty Risk Management

**3.73 Specified Investments** - All such investments will be sterling denominated with maturities up to

<b>Institution</b>	<b>Maximum Investment per Group/Institution £M</b>	<b>Maximum Length</b>	<b>Credit Rating/Other Assessment of Risk</b>
UK Banks	30	Up to 364 days	As per Link's matrices
Foreign Banks	5	Up to 364 days	As per Link's matrices
Other Local Authorities	25	Up to 5 years	N/A

maximum of 1 year (except for deposits with local authorities which can be for any period), meeting the minimum 'high' quality criteria where applicable. (If a deposit is made for say 2 years, it starts as being a non-specified investment and remains as a non-specified investment even when it's time to maturity falls under 12 months.)The criteria, time limits and monetary limits applying to institutions or investment vehicles are

**3.74 Non specified Investments** - These are any investments which do not meet the specified investment criteria. A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made, it will fall into one of the above categories. The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

<b>Institution</b>	<b>Maximum Investment per Group/Institution £M</b>	<b>Maximum Length</b>	<b>Credit Rating/Other Assessment of Risk</b>
UK Banks	10 (£5M limit with any one institution)	Up to 2 years	As per Link's matrices
Foreign Banks	2	Up to 2 years	As per Link's matrices
Money Market Funds (max. of 5)	10	N/A	All are AAA rated
Other Local Authorities	10	Up to 5 years	N/A

*Note: Limits for Specified and Non-Specified are combined limits. The maximum limit will also apply to a banking group as a whole.*

### 3.75 Approved Countries for Investments

3.76 This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Hong Kong, Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link Asset Services credit worthiness service.

### 3.77 Based on lowest available rating

#### AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

#### AA+

- Finland
- U.S.A.

#### AA

- Abu Dhabi (UAE)
- Hong Kong
- France
- U.K.

#### AA-

- Belgium
- Qatar

3.78 **Prospect 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, their latest update is provided at Appendix B.

### 3.79 Investment and Borrowing Rates

3.80 Investment returns are likely to remain low during 2020/21 with little increase in the following two years. However, if major progress was made with an agreed Brexit, then there is upside potential for earnings. Borrowing interest rates were on a major falling trend during the first half of 2019-20 but then jumped up by 100 bps on 9.10.19. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. However, the unexpected increase of 100 bps in PWLB rates requires a major rethink of local authority treasury management strategy and risk management.

3.81 While this authority will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and the rundown of reserves, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

### 3.82 Treasury Management Scheme of Delegation

3.83 The governance of the key decisions are set out below:

(i) Full Council

- approval of annual strategy

(ii) Audit Committee

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

(iii) Cabinet

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of amendments to the Authority's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities
- receiving and reviewing regular monitoring reports and acting on recommendations
- approving the selection of external service providers.

**3.84 The Treasury Management Role of the Section 151 Officer**

3.85 The role of the section 151 officer is set out below:

- 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.

3.86 The above list of specific responsibilities of the S151 officer in the 2017 Treasury Management Code has not changed. However, implicit in the changes in both codes, is a major extension of the functions of this role:

- preparation of a capital strategy to include capital expenditure, capital financing, and treasury management, with a long term timeframe (*say 20+ years – to be determined in accordance with local priorities.*)
- 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 investments and is in accordance with the risk appetite of the authority.

### 3.87 Summary Treasury Management Budget and Forecast

	2020/21 £,000	2019/20 £'000
Employees	165	165
Transport – leasing costs	1,491	1,250
Supplies and Services	200	200
Interest Paid	14,845	14,845
Debt Management Expenses	30	6
<b>Gross Expenditure</b>	<b>16,731</b>	<b>16,466</b>
Interest Received	0	0
<b>Gross Income</b>	<b>0</b>	<b>0</b>
<b>Net Expenditure</b>	<b>16,731</b>	<b>16,466</b>

#### Notes

- Supplies and Services includes the following main items:
  - Dr/Cr card and bank charges 175k
  - Treasury /Leasing Advice 17k

Interest Received has no budget as cash balances have significantly reduced. Any interest received in respect of cash surpluses may need to be used to offset borrowing costs for negative cash balances

## Appendix A – Economic Background

**UK. Brexit.** 2019 has been a year of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on 31 October 2019, with or without a deal. However, MPs blocked leaving on that date and the EU agreed an extension to 31 January 2020. In late October, MPs approved an outline of a Brexit deal to enable the UK to leave the EU on 31 January; however, even if a Conservative Government gains an overall majority in the general election on 12 December, there will still be much uncertainty as the detail of a trade deal will need to be negotiated by the current end of the transition period in December 2020.

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

If economic growth were to weaken considerably, the MPC has relatively little room to make a big impact with Bank Rate still only at 0.75%. It would therefore, probably suggest that it would be up to the Chancellor to provide help to support growth by way of a fiscal boost by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy. The Government has already made moves in this direction and both of the largest parties have made significant promises in their election manifestos to increase government spending. The Chancellor has also amended the fiscal rules in November to allow for an increase in government expenditure. In addition, it has to be borne in mind that even if the post-election Parliament agrees the deal on 31 January 2020, the current transition period for negotiating the details of the terms of a trade deal with the EU only runs until 31 December 2020. This could prove to be an unrealistically short timetable for such major negotiations which leaves open two possibilities: one the need for an extension of negotiations, probably two years, or a no deal Brexit in December 2020.

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

With regard to the **labour market**, growth in numbers employed has been quite resilient through 2019 until the three months to September where it fell by 58,000. However, this was about half of what had been expected. The unemployment rate fell back again to a 44-year low of 3.8% on the Independent Labour Organisation measure in September, despite the fall in numbers employed, due to numbers leaving the work force. Wage inflation has been edging down from a high point of 3.9% in July to 3.8% in August and now 3.6% in September, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 1.9%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The other message from the fall in wage

growth is that employers are beginning to find it easier to hire suitable staff, indicating that supply pressure in the labour market is easing.

In the **political arena**, a general election could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up although, conversely, a weak international backdrop could provide further support for low yielding government bonds and gilts.

**USA.** President Trump's massive easing of fiscal policy in 2018 fuelled a temporary boost in consumption in that year which generated an upturn in the rate of growth to a robust 2.9% y/y. **Growth** in 2019 has been falling after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2 and then 1.9% in quarter 3; it is expected to fall further. The strong growth in employment numbers during 2018 has weakened during 2019, indicating that the economy is cooling, while inflationary pressures are also weakening; CPI inflation fell from 2.3% to 2.0% in September.

**The Fed** finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not intended to be seen as the start of a series of cuts to ward off a downturn in growth. It also ended its programme of quantitative tightening in August, (reducing its holdings of treasuries etc). It then cut rates by 0.25% again in September and by another 0.25% in its October meeting to 1.50 – 1.75%. At its September meeting it also said it was going to **start buying Treasuries again**, although this was not to be seen as a resumption of quantitative easing but rather an exercise to relieve liquidity pressures in the repo market. Despite those protestations, this still means that the Fed is again expanding its balance sheet holdings of government debt. In the first month, it will buy \$60bn, whereas it had been reducing its balance sheet by \$50bn per month during 2019. As it will be buying only short-term (under 12 months) Treasury bills, it is technically correct that this is not quantitative easing (which is purchase of long-term debt).

Investor confidence has been badly rattled by the progressive ramping up of increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This **trade war** is seen as depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China.

However, in early November, a phase one deal was agreed between the US and China to roll back some of the tariffs which gives some hope of resolving this dispute.

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

**The European Central Bank (ECB)** ended its programme of quantitative easing purchases of debt in December 2018, which then meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by quantitative easing purchases of debt. However, the downturn in EZ growth in the second half of 2018 and into 2019, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the ECB to take new measures to stimulate growth. At its March meeting it said that it expected to leave interest rates at their present levels "at least through the end of 2019", but that was of little help to boosting growth in the near term. Consequently, it announced a **third round of TLTROs**; this provides banks with cheap borrowing every three months from September 2019 until March 2021 that means that, although they will have only a two-year maturity, the Bank was making funds available until 2023, two years

later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of a bank's eligible loans. However, since then, the downturn in EZ and world growth has gathered momentum; at its meeting on 12 September, it cut its deposit rate further into negative territory, from -0.4% to -0.5%, and announced a **resumption of quantitative easing purchases of debt for an unlimited period**; (at its October meeting it said this would start in November at €20bn per month - a relatively small amount compared to the previous buying programme). It also increased the maturity of the third round of TLTROs from two to three years. However, it is doubtful whether this loosening of monetary policy will have much impact on growth and, unsurprisingly, the ECB stated that governments will need to help stimulate growth by 'growth friendly' fiscal policy.

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

**CHINA.** Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and shadow banking systems. In addition, there still needs to be a greater switch from investment in industrial capacity, property construction and infrastructure to consumer goods production.

**JAPAN** - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

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

The trade war between the US and China is a major concern to **financial markets** due to the synchronised general weakening of growth in the major economies of the world, compounded by fears that there could even be a recession looming up in the US, though this is probably overblown. These concerns resulted in **government bond yields** in the developed world falling significantly during 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy

measures, when rates are already very low in most countries, (apart from the US). There are also concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks and the use of negative central bank rates in some countries. The latest PMI survey statistics of economic health for the US, UK, EU and China have all been predicting a downturn in growth; this confirms investor sentiment that the outlook for growth during the year ahead is weak.



## Appendix B – Interest Rate Forecasts

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

The above forecasts provided by Link Asset Services have been based on an assumption that there is some sort of muddle through to an agreed deal on Brexit, including agreement on the terms of trade between the UK and EU, at some point in time. Given the current level of uncertainties around the uncertainties following the general election and then subsequent developments, this is a major assumption and so forecasts may need to be materially reassessed in the light of events over the coming weeks or months.

**Bond yields / PWLB rates.** There has been much speculation recently that we are currently in a bond market bubble. However, given the context that there are heightened expectations that the US could be heading for a recession, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last thirty years. We have therefore seen over the last year, many bond yields up to ten years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby ten-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated, as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities. However, stock markets are also currently at high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.

During the first half of 2019-20 to 30 September, gilt yields plunged and caused a near halving of longer term PWLB rates to completely unprecedented historic low levels. (*See paragraph 3.7 for comments on the increase in the PWLB rates margin over gilt yields of 100bps introduced on 9.10.19.*) There is though, an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth. If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but also in the UK due to a correlation between US treasuries and UK gilts; at various times this correlation has been strong but at other times weak. However, forecasting the timing of this and how strong the correlation is likely to be is very difficult to forecast with any degree of confidence. Changes in UK Bank Rate will also impact on gilt yields.

One potential danger that may be lurking in investor minds is that Japan has become mired in a twenty-year bog of failing to get economic growth and inflation up off the floor, despite a combination of massive monetary and fiscal stimulus by both the central bank and government. Investors could be fretting that this condition might become contagious to other western economies.

Another danger is that unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), may end up doing more harm than good through prolonged use. Low interest rates have encouraged a debt-fuelled boom that now makes it harder for central banks to raise interest rates. Negative interest rates could damage the profitability of commercial banks and so impair their ability to lend and / or push them into riskier lending. Banks could also end up holding large amounts of their government's bonds and so create a potential doom loop. (A doom loop would occur where the credit rating of the debt of a nation was downgraded which would cause bond prices to fall, causing losses on debt portfolios held by banks and insurers, so reducing their capital and forcing them to sell bonds – which, in turn, would cause further falls in their prices etc.). In addition, the financial viability of pension funds could be damaged by low yields on holdings of bonds.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

In addition, PWLB rates are subject to ad hoc decisions by H.M. Treasury to change the margin over gilt yields charged in PWLB rates: such changes could be up or down. It is not clear that if gilt yields were to rise back up again by over 100bps within the next year or so, whether H M Treasury would remove the extra 100 bps margin implemented on 9.10.19.

Economic and interest rate forecasting remains difficult with so many influences weighing on UK gilt yields and PWLB rates. 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

