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| **Report of the Head of Finance****To****The Governance and Standards Committee****On****17 February 2021** |
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| **Investment Strategies 2021/22** |

**1. SUMMARY**

1.1 This report presents the Council’s Investment Strategies that the Council is required to produce through various pieces of legislation, and approve at full Council prior to the start of each new financial year.

**2. RECOMMENDATIONS:**

i) That the Governance and Standards Committee undertake the scrutiny of the following annual Strategies that the Council is required to produce under statutory guidance in relation to its investment and borrowing activities:

* The Treasury Management Strategy 2021/22 to 2023/24
* The Minimum Revenue Provision (MRP) Strategy 2021/22
* The Capital Strategy 2021/22 to 2041/42
* The Asset Investment Strategy 2021/22
* The Commercial Property Investment Strategy 2021/22
* The Service Investment Strategy 2021/22

To be recommended to Council:

ii) That the Treasury Management Strategy for the 2021/22 to 2023/24 financial year be approved, as per Appendix 1, including the Prudential Indicators which are set out within the Strategy

iii) That the Minimum Revenue Provision (MRP) Strategy for the 2021/22 financial year be approved, as per Appendix 2 and the Council adopts the Regulatory Method for Supported Borrowing (Option 1) taken out by the Council prior to 1 April 2008 and the Asset Life Method for unsupported borrowing (Option 3) taken out after 1 April 2021 (if any new borrowing is taken on by the council).

Where the Council takes on additional borrowing in order to purchase land and property assets for regeneration or housing purposes (in line with the Asset Investment Policy for non-commercial assets) or to provide a Service Investment the business case will set out whether a MRP charge is appropriate.

iv) That the Capital Strategy for the 2021/22 to 2041/42 financial year be approved, as per Appendix 3

v) That the Commercial Property Investment Strategy for the 2021/22 financial year be approved, as per Appendix 4

vi) That the Service Investment Strategy for the 2021/22 financial year be approved, as per Appendix 5

**3. BACKGROUND**

3.1 Under the Local Government Act 2003, there is a statutory requirement placed on local authorities to have regard to the CIPFA Code of Practice on Treasury Management and Prudential Code, and any directions issued directly under the Act when putting in place processes and procedures which impact on its financial management practices in respect of its investment and borrowing activities.

3.2 In line with the relevant legislation, Local Authorities are required to produce the following strategy documents and get them approved by full Council on an annual basis prior to the commencement of any new financial year:

**3.3 Treasury Management Strategy (Appendix 1)**

3.3.1 Under the Local Government Act 2003, local authorities must have regard to statutory proper practices in their treasury management activities. In effect this means the council must adhere to the Chartered Institute of Public Finance and Accountancy’s 'Treasury Management in the Public Services: Code of Practice' 2017 edition (the CIPFA Code), and the Ministry of Homes, Communities and Local Government (MHCLG) guidance on local authority investments.

3.3.2 The strategy provides the policy framework for the engagement of the council with financial markets in order to fund its capital investment programme, to maintain the security of its cash balances and protect them from credit, liquidity, inflation and interest rate risk.

**3.4 Minimum Revenue Provision (MRP) Strategy (Appendix 2)**

3.4.1 The Local Authorities (Capital Financing and Accounting)(England) Regulations 2007 places a general duty on Council’s to make an amount of MRP which it considers to be prudent.

3.4.2 The MRP requires local authorities to set aside each year an amount to cover any outstanding borrowing, so that it has sufficient resources available to repay the borrowing upon maturity.

3.4.3 This report recommends that Option 1 (“Regulatory Method”) be used for supported borrowing and that Option 3 (“Asset Life Method”) be used for unsupported borrowing in line with the MRP guidance issued by the Secretary of State.

3.4.4 The Local Government Act 2003, which requires Local Authorities to have regard for the MRP guidance. However the guidance does give local authorities flexibility in how they calculate their MRP, provided the calculation is ‘prudent’. In calculating a prudent provision, local authorities are required to have regard to this guidance. The Council has decided to deviate from the MRP guidance in respect of Commercial Property Investments and Service Investments; the reasons for this have been set out within the MRP Strategy 2020/21 contained within Appendix 2.

**3.5 Capital Strategy (Appendix 3)**

3.5.1 The requirement for Local Authorities to have a Capital Strategy is set out in the Prudential Code for Capital Finance in Local Authorities.

3.5.2 The Capital Strategy provides a forward look at the core principles that underpin the Council’s long term capital expenditure and investment decisions, having regard for risk mitigation and the implications on the Council’s financial sustainability.

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

**3.6 Asset Investment Strategy (Appendix 4)**

3.6.1 The objective of the Asset Investment Strategy is to establish a framework for the identification of asset investments which, if acquired, would provide the Council with benefits both to the organisation and to residents, as well as the potential for ongoing revenue benefits. This strategy is relevant to all assets the council intends to purchase in order to further its service objectives. This may include, but is not limited to assets purchased for regeneration purposes, invest-to-save purchases, and the replacement of council assets at the end of their current useful life.

**3.7 Commercial Property Investment Strategy (Appendix 5)**

3.7.1 Under Section 15(1) (a) of the Local Government Act 2003, the Secretary of State issued statutory guidance on local government investments in 2018, which all local authorities are required to adhere to. This requires local authorities to produce Strategy documents setting out their investment activities which sit outside the traditional treasury management (banking) activities to generate on-going revenue income streams, namely investments in financial assets.

3.7.2 The objective of the Commercial Property Strategy is to establish a framework for maintaining and monitoring the current portfolio of commercial properties. In accordance with the lending terms of the Public Works Loan Board, which came into force on 26th November 2020, the Council will not borrow to fund commercial property investments at any point during the life of this strategy. However, borrowing has previously been taken out to fund commercial property investments, and the costs related to this must be covered by the properties in question.

3.7.3 Councils are required to disclose the level of income they rely on as a proportion of their Net Revenue Budget (being the total of Government Grant, Council Tax and other un-ring fenced grant, which for Mansfield District Council includes New Homes Bonus). The following tables show the ratio of commercial property investment income to the Council’s Net Revenue Budget:

Table 1 - Total commercial property investment income (including assets that have been purchased through available capital receipts and borrowing). Investment income includes income from investment properties held within and outside Mansfield and district

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | 2020/21 | 2021/22 | 2022/23 | 2023/24 |
| Net Revenue Budget (\*) (£000) | 9,962 | 10,601 | 10,023 | 9,962 |
| Commercial property investment income (£000) | 3,875 | 3,544 | 3,939 | 4,067 |
| Ratio of commercial property investment income to the Net Revenue Budget (%) | 39% | 33% | 39% | 41% |

Table 2 – Commercial property investment income, whereby the assets have been purchased through internal and external borrowing.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | 2020/21 | 2021/22 | 2022/23 | 2023/24 |
| Net Revenue Budget (\*) (£000) | 9,962 | 10,601 | 10,023 | 9,962 |
| Commercial property investment income (£000) | 3,157 | 3,114 | 3,199 | 3,253 |
| Ratio of commercial property investment income to the Net Revenue Budget (%) | 32% | 29% | 32% | 33% |

Table 3 - Commercial property investment income, whereby the assets have been purchased through external borrowing only

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | 2020/21 | 2021/22 | 2022/23 | 2023/24 |
| Net Revenue Budget (\*) (£000) | 9,962 | 10,601 | 10,023 | 9,962 |
| Commercial property investment income (£000) | 1,932 | 1,932 | 1,932 | 1,960 |
| Ratio of commercial property investment income to the Net Revenue Budget (%) | 19% | 18% | 19% | 20% |

(\*) Taken from the Council’s Medium Term Financial Strategy 2021/22 to 2023/24, as approved which will be presented to Council on 27 January 2021.

**3.8 Service Investment Strategy (Appendix 6)**

3.8.1 Under Section 15(1) (a) of the Local Government Act 2003, the Secretary of State issued statutory guidance on local government investments in 2018, which all local authorities are required to have regard to. This requires local authorities to produce Strategies setting out their investment activities which sit outside the traditional treasury management (banking) activities to generate on-going revenue income streams, namely investments in financial assets.

3.8.2 Service investments made by the Council are largely loans to third parties ranging from short-term to longer-term loans linked to assets or investments in group organisations.

3.8.3 Mansfield District Council only has one service investment that it has entered into, made to Mansfield Homes for which the Council is the sole shareholder, details of which are contained within the Service Investment Strategy 2021/22, as contained within Appendix 5. It is not expected that any further loan advances will be made to Mansfield Homes during 2021/22

3.9 Mansfield District Council has delegated the effective scrutiny of the above Strategies to its Governance and Standards Committee, through its Constitution (2.07.5 Audit Committee Terms of Reference, which was the predecessor to the Governance and Standards Committee, these were subsequently amended to include all the Investment Strategies following Council approval on 19 November 2019). These Strategies are to be presented to full Council for approval on 9 March 2021 following the scrutiny process for adoption prior to the start of the 2021/22 financial year.

3.10 The above strategies provide an approved framework within which the officers undertake the day to day capital and treasury activities.

**4. PUBLIC WORKS LOAN BOARD**

4.1 As part of the Spending Review 2020, HM Treasury issued its response to the consultation on the future lending terms of the Public Works Loan Board (PWLB), which had taken place during Spring 2020.

4.2 In its response, HM Treasury confirmed its aim was to “prevent local authorities from using PWLB loans to buy commercial assets primarily for yield, without impeding their ability to pursue service delivery, housing, and regeneration under the prudential regime as they do now”. This confirms that using PWLB loans to invest in commercial investment properties, with the main aim of generating revenue income, will no longer be permitted.

4.3 The consultation response also stated that, given that borrowing cannot easily be linked to a specific scheme within the capital programme, access to PWLB loans will be denied if a council has plans to buy commercial properties anywhere in their capital programme. This is the case even if that purchase would have been funded from another source.

4.4 The Treasury confirmed that the new lending terms were to be in place from 26th November 2020.

4.5 Given the restrictions on borrowing for commercial properties now in place, the Council can confirm that there are no planned commercial property acquisitions within the 2021/22 – 2023/24 capital programme.

**5. OPTIONS**

5.1 This report fulfils the Council’s legal obligation under the Local Government Act 2003to have regard to the CIPFA Codes and directive issued by the Secretary of State in relation to investment and borrowing activities undertaken by the Council.

**6. RISK ASSESSMENT OF RECOMMENDATIONS AND OPTIONS**

|  |  |  |  |
| --- | --- | --- | --- |
| **Risk**  | **Risk Assessment**  | **Risk Level**  | **Risk Management**  |
| **Financial**That investments are lost due to placing money with institutions which are not secure | Loss of investments in the current economic climate is a major issue as institutions fail as a result of the credit crunch and the economic situation in their countries | Medium/ High | A monthly review of the Treasury Management positions and strategy is undertaken by senior Financial Services officers and changes made as appropriate. Several Safeguards have been put into place as a result of the current economic climate including, investing approximately 20% of deposits with the Government and the maximum investment in any single institution or group has been reduced from £7million to £5 million except for the nationalised / part nationalised banks. This does not include investments with the Debt Management Office (DMO) as these are backed by the Government and are considered to be safe. |
| **Reputational**That the Council is borrowing from or investing with inappropriate organisations resulting in the loss of investments | Council assets need to be safe and there is confidence in their management. In the current climate there are few institutions which have retained either high ratings or stable outlooks.In terms of reputation, the Council would be one of many major institutions affected by events over which there is little control | Medium  | A monthly review of the Treasury Management positions and strategy is undertaken by senior Financial Services officers and changes made as appropriate. Several Safeguards have been put into place as a result of the current economic climate including, investing approximately 20% of deposits with the Government and the maximum investment in any single institution or group has been reduced from £7million to £5 million except for the nationalised / part nationalised banks. This does not include investments with the Debt Management Office (DMO) as these are backed by the Government and are considered to be safe. |

**7. ALIGNMENT TO COUNCIL PRIORITIES**

7.1 The recommendations set out in this report ensure the effective financial management of the Council in terms of its investment activities, and therefore ensures that the Council meets all its priorities.

**8. IMPLICATIONS**

(a) Relevant Legislation

 The treasury management and capital functions are governed by provisions set out under Part 1 of the Local Government Act 2003, whereby the Council must have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice. The Council formally adopts the current requirements of these codes as part of its Treasury Management Strategy, its Minimum Revenue Provision (MRP) Strategy and its Capital Strategy. The updated guidance now requires local authorities to adopt an Investment Strategy for areas that are not covered within its existing Treasury Management Strategy; for Mansfield District Council this includes a Commercial Property Investment Strategy and Service Investments Strategy.

(b) Human Rights

 No impact

(c) Equality and Diversity

 No impact

(d) Climate change and environmental sustainability

 No impact

(e) Crime and Disorder

No impact

(f) Budget /Resource

 There are no financial implications arising as a direct result of approving these Strategies. The Strategies set out how the Council will operate on a day to day basis as it manages its investments and borrowing, and how it will attempt to mitigate any risks in relation to these activities.

**9. COMMENTS OF STATUTORY OFFICERS**

(a) Monitoring Officer – the ongoing development and annual review of the strategy and associated documents forms an important part of the Council’s financial and governance assurance.

(b) Section 151 Officer – Own report

**10. CONSULTATION**

None

 **11. BACKGROUND PAPERS**

 None

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**Appendix 1**

**Treasury Management Strategy 2021/22 to 2023/24**

**Treasury Management Strategy Statement 2021/22 to 2023/24**

**Introduction**

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.”*

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 commensurate with the Council’s low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the Treasury Management service is the funding of the Council’s capital plans. These capital plans provide a guide to the borrowing 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 any debt previously drawn may be restructured to meet Council risk or cost objectives.

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. 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.

Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day to day treasury management activities. The Council has a separate Commercial Property Investment Strategy 2021/22 and Service Investment Strategy 2021/22, at Appendix 4 and 5 respectively to this report, which address the management of these specific areas.

The Chartered Institute of Public Finance and Accountancy (CIPFA) revised 2017 Prudential and Treasury Management Codes require, from 2019/20, all local authorities to prepare an additional report, a capital strategy report, which will provide the following:

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

The aim of the capital strategy is to ensure that all elected members fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite. The Council’s Capital Strategy 2021/22 to 2041/42 is contained in Appendix 3 to this report.

**Treasury Management Reporting**

The four reports required to meet the Council’s requirement for reporting on its

Treasury Management activities include:

**Prudential and Treasury Indicators and Treasury Strategy** (This report) – Which covers:

* Treasury Management Strategy, including how the investments and borrowings are to be organised (treasury indicators)
* Investment strategy, including the parameters on how investments are to be managed
* Capital plans (prudential indicators)

A **Minimum Revenue Provision (MRP) Strategy** – This provides details of how residual capital expenditure is charged to revenue over time and includes the MRP Policy; the Council has produced a separate MRP Strategy, which can be found at Appendix 2.

**A mid-year treasury management report** – The Governance & Standards Committee receives a mid-year progress report which provides Members with information regarding the performance of the Treasury Management function and operations for the first two quarters of the year.

**An Annual Treasury Report** – This provides details of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the approved strategy.

The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Governance and Standards Committee.

The Treasury Management Strategy for 2021/22 covers two main areas:

**1. Treasury Management Issues:**

* policy on use of external service providers
* prospects for interest rates
* the current treasury position
* treasury indicators which will limit the treasury risk and activities of the Council
* the borrowing strategy
* policy on borrowing in advance of need
* debt rescheduling
* the investment strategy
* creditworthiness policy

**2. Capital Issues:**

* the capital plans and the associated prudential indicators

These elements outlined above cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the CIPFA Treasury Management Code and the Ministry for Homes, Communities and Local Government (MHCLG) Investment Guidance.

**Training**

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. Training was provided to Members on the Council’s Treasury Management and MRP Strategy in January 2020 and further training will be undertaken prior to this report being presented to the Governance and Standards Committee prior to the Committee referring the report to Council for approval. The training needs of treasury management officers are periodically reviewed.

**Treasury Management Consultants and Policy On the Use of External Service Providers**

The Council uses Link Asset Services, Treasury Solutions as its external Treasury Management Advisors. The contract with Link runs until 31 May 2021. The contract is currently being tendered.

The Council recognises that responsibility for Treasury Management decisions remains with the Council at all times and will ensure that undue reliance is not placed upon its external advisors.

It is also recognised that there is a value in employing external providers of Treasury Management services in order to gain access to specialist skills and resources. The Council will ensure that the terms of their appointment and methods by which their value will be assessed are properly agreed and documented, and subject to regular review.

The scope of investments within the Council’s operations now includes both conventional treasury investments, (the placing of residual cash from the Council’s functions), and in previous year, has also included the purchase of commercial investments, such as investment properties. The commercial investments require specialist advisers, and the Council uses Lambert, Smith Hampton in relation to this activity.

**External Economic Context and Prospects for Interest Rates**

The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Table 1 gives the Link Asset Services central view.



The forecast in the table shows bank base rate remaining at 0.10%until March 2024 with no expected increases.

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meeting on 5 November 2020, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the forecast table above as economic recovery is expected to be only gradual and, therefore, prolonged

**Gilt yields / PWLB rates**

There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was a heightened expectation that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last 30 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. The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets over the last 30 years. Over the year prior to the coronavirus crisis, this has seen many bond yields up to 10 years turn negative in the Eurozone. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 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.

Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March 2020. After gilt yields spiked up during the financial crisis in March, we have seen these yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks took rapid action to deal with excessive stress in financial markets during March, and started massive quantitative easing purchases of government bonds: this also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in “normal” times would have caused bond yields to rise sharply. Gilt yields and PWLB rates have been at remarkably low rates so far during 2020/21.

As the interest forecast table for PWLB certainty rates above shows, there is expected to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. 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, (as shown on 9 November 2020 when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

* **UK.** The Bank of England’s Monetary Policy Committee kept **Bank Rate** unchanged on 5th November. However, it revised its economic forecasts to take account of a second national lockdown from 5th November to 2nd December which is obviously going to put back economic recovery and do further damage to the economy. It therefore decided to do a further tranche of **quantitative easing (QE) of £150bn**, to start in January when the current programme of £300bn of QE announced in March to June, runs out. It did this so that “announcing further asset purchases now should support the economy and help to ensure the unavoidable near-term slowdown in activity was not amplified by a tightening in monetary conditions that could slow the return of inflation to the target”.
* Its forecasts appear to be rather optimistic in terms of three areas:
	+ The economy would recover to reach its pre-pandemic level in Q1 2022
	+ The Bank also expects there to be excess demand in the economy by Q4 2022.
	+ CPI inflation is therefore projected to be a bit above its 2% target by the start of 2023 and the “inflation risks were judged to be balanced”.
* Significantly, there was no mention of **negative interest rates** in the minutes or Monetary Policy Report, suggesting that the MPC remains some way from being persuaded of the case for such a policy, at least for the next 6 -12 months. However, rather than saying that it “stands ready to adjust monetary policy”, the MPC this time said that it will take “whatever additional action was necessary to achieve its remit”. The latter seems stronger and wider and may indicate the Bank’s willingness to embrace new tools.
* However, the minutes did contain several references to **downside risks**. The MPC reiterated that the “recovery would take time, and the risks around the GDP projection were judged to be skewed to the downside”. It also said “the risk of a more persistent period of elevated unemployment remained material”. Downside risks could well include severe restrictions remaining in place in some form during January. Hopefully, restrictions should progressively ease during the spring. It is only to be expected that some businesses that have barely survived the first lockdown, will fail to survive the second lockdown, especially those businesses that depend on a surge of business in the run up to Christmas each year. This will mean that there will be some level of further permanent loss of economic activity, although the extension of the furlough scheme to the end of 31st March will limit the degree of damage done.
* As for **upside risks**, we have been waiting expectantly for news that various **COVID19 vaccines** would be cleared as being safe and effective for administering to the general public. The Pfizer vaccine specifically also has demanding cold storage requirements of minus 70C that might make it more difficult to roll out. However, the logistics of production and deployment can surely be worked out over the next few months. Since these minutes three vaccines have been passed and the vaccination programme is progressing across the country.
* What these results would mean is that **life could largely return to normal during 2021** (although based on the January this may be towards the end of the year), with activity in the still-depressed sectors like restaurants, travel and hotels returning to their pre-pandemic levels, which would help to bring the unemployment rate down. With the household saving rate currently being exceptionally high, there is plenty of pent-up demand and purchasing power stored up for these services. A large-scale roll-out of vaccines might take into late 2021 to fully complete; but if the vaccine really is that effective, then there is a possibility that restrictions could begin to be eased once vulnerable people and front-line workers had been vaccinated. At that point, there would be less reason to fear that hospitals could become overwhelmed any more. Effective vaccines would radically improve the economic outlook once they have been widely administered; it may allow GDP to rise to its pre-virus level a year earlier than otherwise and mean that the unemployment rate peaks at 7% next year instead of 9%. But while this would reduce the need for more QE and/or negative interest rates, increases in Bank Rate would still remain some years away. However, until there is clarity on these issues around the Pfizer vaccine, it would be premature to change the overall economic commentary and forecasting in this report. It also raises a potential question as to whether the relatively optimistic outlook of the Monetary Policy Report was swayed by making positive assumptions around effective vaccines being available soon. It should also be borne in mind that as effective vaccines will take time to administer, economic news could well get worse before it starts getting better.
* **Public borrowing** is now likely to increase by about £30bn to around £420bn (23% of GDP) as a result of the new lockdown. In normal times, such an increase in total gilt issuance would lead to a rise in gilt yields, and so PWLB rates. However, the QE done by the Bank of England has depressed gilt yields to historic low levels, (as has similarly occurred with QE and debt issued in the US, the EU and Japan). This means that new UK debt being issued, and this is being done across the whole yield curve in all maturities, is locking in those historic low levels through until maturity. In addition, the UK has one of the longest average maturities for its entire debt portfolio, of any country in the world. Overall, this means that the total interest bill paid by the Government is manageable. It is also quite possible that the Bank of England will do more QE in 2021 to support the economy, although negative interest rates could also be a usable tool in the tool box later on in 2021.

Overall, **the pace of recovery** was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp but after a disappointing increase in GDP of only 2.1% in August, this left the economy still 9.2% smaller than in February; this suggested that the economic recovery was running out of steam after recovering 64% of its total fall during the crisis. The last three months of 2020 were originally expected to show zero growth due to the impact of widespread local lockdowns, consumers probably remaining cautious in spending, and uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year also being a headwind. However, the new national lockdown for one month is now expected to depress GDP by 8% in November while the rebound in December is likely to be muted and vulnerable to the previously mentioned downside risks. Unemployment is also now expected to increase from 4.5% in August to a peak of 9% around the middle of 2021. Due to the number of adverse factors that have built up during the autumn, there is wide expectation that the Bank of England could resort to expanding quantitative easing by a further £100bn during 2021 to sustain momentum in the economy. Even so, it is now expected that the second national lockdown will push back recovery of GDP to pre pandemic levels by six months and into sometime during 2023. However, the graph below shows what Capital Economics forecast could happen if a successful vaccine was widely administered in the UK in the first half of 2021; this would cause a much quicker recovery.

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

* One key addition to **the Bank’s** **forward guidance** in August was a new phrase in the policy statement, namely that “it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably”. That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years’ time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. Our Bank Rate forecast currently shows no increase through to quarter 1 2024 but there could well be no increase during the next five years due to the slow rate of recovery of the economy and the need for the Government to see the burden of the elevated debt to GDP ratio falling significantly **Inflation** is unlikely to pose a threat requiring increases in Bank Rate during this period as there is likely to be spare capacity in the economy for a considerable time. It is expected to briefly peak at around 2% towards the end of 2021, but this is a temporary short lived factor and so not a concern.

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

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

EU – In early December, the figures for Q3 GDP confirmed that the economy staged a rapid rebound from the first lockdowns. This provides grounds for optimism about growth prospects for next year.

Japan - A third round of stimulus in early December took total fresh fiscal spending this year in response to the virus close to 12% of pre-virus GDP. That’s huge by past standards, and one of the largest national fiscal responses. The budget deficit is now likely to reach 16% of GDP this year. Coupled with Japan’s relative success in containing the virus without draconian measures so far, and the likelihood of effective vaccines being available in the coming months, the government’s latest fiscal arrow should help ensure a strong recovery and to get back to pre-virus levels by Q3 2021 – around the same time as the US and much sooner than the Eurozone.

China – Current out performance of Western economies is due to Government infrastructure spending, weakening growth expected in the future.

World Growth - World growth will have been in recession in 2020. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis. 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.

**Investment and Borrowing Rates**

**Investment returns** are likely to remain exceptionally low during 2021/22 with little increase in the following two years.

**Borrowing interest rates** fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England: indeed, gilt yields up to 6 years were negative during most of the first half of 2020/21. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years.  The unexpected increase of 100 bps in PWLB rates on top of the then current margin over gilt yields of 80 bps in October 2019, required an initial major rethink of local authority treasury management strategy and risk management. However, in March 2020, the Government started a consultation process for reviewing the margins over gilt rates for PWLB borrowing for different types of local authority capital expenditure. *(Please note that Link has concerns over this approach, as the fundamental principle of local authority borrowing is that borrowing is a treasury management activity and individual sums that are borrowed are not linked to specific capital projects.)* It also introduced the following rates for borrowing for different types of capital expenditure: -

* + **PWLB Standard Rate** is gilt plus 200 basis points (G+200bps)
	+ **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)
	+ **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
	+ **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
	+ **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

As a consequence of these increases in margins, many local authorities decided to refrain from PWLB borrowing unless it was for HRA or local infrastructure financing, until such time as the review of margins was concluded.

On 25.11.20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme. The new margins over gilt yields are as follows: -*.*

* + - **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
		- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
		- **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
		- **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
		- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

**Borrowing for capital expenditure.** As Link’s long-term forecast for Bank Rate is 2.00%, and all PWLB rates are under 2.00%, there is now value in borrowing from the PWLB for all types of capital expenditure for all maturity periods, especially as current rates are at historic lows. However, greater value can be obtained in borrowing for shorter maturity periods so the Council will assess its risk appetite in conjunction with budgetary pressures to reduce total interest costs. Longer-term borrowing could also be undertaken for the purpose of certainty, where that is desirable, or for flattening the profile of a heavily unbalanced maturity profile.

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.

**Local Context**

As at 31 March 2020 the Council had £98.229million of external borrowing and £20.620million of investments. Forecast changes in these sums are shown in the balance sheet analysis in table 2 below:



The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources.

CIPFA’s Prudential Code for Capital Finance in Local Authorities recommends that the Council’s total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council forecasts that borrowing will peak at £121.628Million (including maintaining a minimum £10million liquid funds) and so expects to comply with this recommendation during the next three years. This view takes into account the Capital expenditure plans included in the 2021/22 budget report.

The Council is expected to remain in an under borrowed position, this position which represents a risk should interest rates rise however there is a cost of carry

Balances for investment are forecast to fall to a core £10million balance.

**The Council’s Borrowing Need (the Capital Financing Requirement)**

The current projections for the CFR are stated in Table 3:



The increase in lease liabilities is due to the implementation of IFRS16 Leases and is based on the estimated liability connected to the lease of Walkden Street Car Park which was previously accounted for off balance sheet as an operating lease.

**Treasury Management Strategy**

The capital expenditure plans 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 the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

**Current Portfolio Position**

The Council’s treasury portfolio position at 31 March 2020, with forward projections are summarised below. Table 4 shows the actual external borrowing (the treasury management operations), against the underlying capital borrowing need (the CFR), highlighting any over or under borrowing.



**Treasury Indicators: Limits to Borrowing Activity**

The Operational Boundary is the limit beyond which external borrowing 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 borrowing. The Council’s Operational Boundary levels for the financial years 2020/21 to 2023/24 have been shown in Table 5. The operational boundary limits have been increased to provide headroom to allow external borrowing to be taken to finance the capital expenditure plans laid out in table 13. It is however likely that internal borrowing will be used.



The Authorised Limit for external borrowing is a further key prudential indicator and represents a control on the maximum level of borrowing. This represents a 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. The Council’s Authorised Limit levels for the financial years 2020/21 to 2023/24 have been shown in Table 6:



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.

**Borrowing Strategy**

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (CFR), has not been fully funded with loan debt as cash supporting the Council’s reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is high. There will be a requirement to borrow in 2020/21 and 2021/22.

Against this background and the risks within the economic forecast, caution will be adopted with the 2021/22 treasury operations. The Head of Finance 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 long and short term rates, for exampledue to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered
* if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast,for example arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

**Treasury Management Limits On Activity**

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance*.* The indicators include:

* Upper limits on variable interest rate exposure - this identifies a maximum limit for variable interest rates based upon the debt position net of investments
* Upper limits on fixed interest rate exposure - this is similar to the previous indicator and covers a maximum limit on fixed interest rates
* Maturity structure of borrowing - 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.

The limits for the three indicators have been set out in Table 7:



**Policy on Borrowing In Advance of Need**

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

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

**Debt Rescheduling**

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

* the generation of cash savings and / or discounted cash flow savings;
* helping to fulfil the treasury strategy;
* enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the Councilat the earliest meeting following its action.

**New Financial Institutions As A Source of Borrowing And / Or Types of Borrowing**

As an alternative to borrowing from the PWLB, 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 (no issuance at present but there is potential)

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.

**Annual Investment Strategy**

**Investment Policy**

The Council’s investment policy has regard to the following:

* MHCLG’s Guidance on Local Government Investments (“the Guidance”)
* CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 (“the CIPFA TM Code”).
* CIPFA Treasury Management Guidance Notes 2018.

The Council’s investment priorities will be security first, liquidity second, then return.

In accordance with MHCLG and CIPFA guidance, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agengy. Using the Link Asset Services ratings service counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

Furthermore, the Council’s officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to contiunally 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 this end 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. This is fully integrated into the credit methodology provided by the advisors, Link Asset Services in producing its colour codings which show the varying degrees of creditworthiness.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable divesification and thus avoidance of concentration risk.

The intention of the strategy is to provide security of investment and minimisation of risk.

Investment instruments identified for use in the financial year are listed in Appendix 1.C under the ‘Specified’ and ‘Non-Specified’ Investments categories. Counterparty limits will be as set through the Council’s Treasury Management Practices.

**Creditworthiness Policy**

The primary principle governing the Council’s investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure that:

* It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below
* It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council’s prudential indicators covering the maximum principal sums invested

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

The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council’s minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Council’s criteria, the other does not, the institution will fall outside the lending criteria.

Credit rating information is supplied by Link Asset Services, the Council’s treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) is:

* Banks 1 - good credit quality–the Council will only use banks which:
	+ are UK banks; and/or
	+ are non-UK and domiciled in a country which has a minimum sovereign long term rating of AA- and have, as a minimum, the following Fitch and Moody’s credit ratings (where rated):
		- Short term – F1 (Fitch), P1 (Moody’s)
		- Long term – AA – (Fitch)
		- Viability – bbb (Fitch)
* Banks 2 – Part nationalised UK banks –Royal Bank of Scotland Group. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
* Banks 3 – The Council’s own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
* Building societies – The Council will use societies which meet the ratings for banks above.
* Money Market Funds (MMFs) – Constant Net Asset Value (CNAV), Low Volatility Net Asset Value (LVNAV), Variable Net Asset Value (VNAV)
* UK Government (including gilts, Treasury Bills and DMADF)
* Local authorities, parish councils

Appendix 1.A lists all the banks and building societies that the Council can use to place investments at the 31 December 2020.

Due care will be taken to consider the country, group and sector exposure of the Council’s investments. In part the country selection will be chosen by the credit rating of the sovereign state in Banks 1 above. In addition:

* Limits in place above will apply to a group of companies
* Sector limits will be monitored regularly for appropriateness

Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

The time and monetary limits for institutions on the Council’s counterparty list are as set out in Table 8 (these will cover both Specified and Non-Specified Investments):



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

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

When compared to previous years Table 1 forecasts that the Council’s investments will be at a reduced level from 2021/22 onwards. Therefore the Council will consider the risks of the proportionality of investments in any one single institution compared to the total amount of investments as well as the criteria in table 8 and 9.

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of Credit Default Swaps (CDS) spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the duration for investments. The Council will therefore use counterparties within the following durational bands, as shown in Table 9.

 

The Link Asset Services creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency’s ratings.

All credit ratings will be monitored daily. The Council is alerted to changes to ratings of all three agencies through its 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 against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council’s lending list.

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

**Country Limits**

Whilst the Council has determined that it will not limit investments to UK banks, it will only use approved counterparties from other 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 Appendix 1.B. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

**Investment Strategy**

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

Bank Rate is not forecast to increase over the next few years. Bank Rate forecasts for financial year ends (March) have been set out in Table 10 below:

 

The suggested budgeted investment earnings rates for returns on investments placed for periods up to three months during each financial year for the next four years are set out in Table 11 below:

 

The overall balance of risks to economic growth in the UK is probably now skewed to the upside, but is subject to major uncertainty due to the virus and how quickly successful vaccines may become available and widely administered to the population.

There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, or a return of investor confidence in equities, could impact gilt yields, (and so PWLB rates), in the UK.

**Negative investment rates**

While the Bank of England said in August / September 2020 that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, and in November omitted any mention of negative rates in the minutes of the meeting of the Monetary Policy Committee, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the COVID crisis; this has caused some local authorities to have sudden large increases in cash balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

As for money market funds (MMFs), yields have continued to drift lower. Some managers have already resorted to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a surfeit of money swilling around at the very short end of the market. This has seen a number of market operators, now including the DMADF, offer nil or negative rates for very short term maturities. This is not universal, and MMFs are still offering a marginally positive return, as are a number of financial institutions for investments at the very short end of the yield curve.

Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government.

The Invesment treasury indicator and limits are 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 availablility of funds after year end. The maximum principal sums that can be invested has been set out in Table 12:

 

**End of Year Investment Report**

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

**Scheme of Delegation**

Please see Appendix 1.D for the Scheme of Delegation.

**Role of the Section 151 Officer**

Please see Appendix 1.E for the role of the Section 151 Officer, the Council’s Head of Finance.

**Capital Expenditure Plans**

The Table below is a summary of the Council’s capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.



Table 14 summarises how the Council’s capital plans are being financed by capital or revenue resources. Any shortfall of resources would result in the Council needing to take out additional borrowing.



\* Commercial activities / non-financial investments relate to areas such as capital expenditure on investment properties, loan to Mansfield Homes Limited.

The net financing need for commercial activities / non-financial investments included in the above table against expenditure is shown in table 15:



**Core Funds and the Expected Investment Balances**

The application of resources (such as, capital receipts and reserves) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (such as asset sales).

Estimates of the year end balances for each resource and anticipated day to day cash flow balances have been detailed below in Table 16.

Table 16 shows that the level of expected investments will reduce. Fund balances / reserves are forecast to reduce to finance the General Fund Transformation / capital schemes and the HRA new build programme. If there is slippage on the capital programme and /or if the Council receives capital receipts not included in these forecasts then there will be higher balances for external investment.



**Affordability Prudential Indicators**

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council’s overall finances.

**Ratio of Financing Costs to Net Revenue Stream**

This indicator, set out in Table 17, 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 report. The net revenue stream is excluding income from investment properties.



Table 18 shows the ratio of financing costs to net revenue stream including income from investment properties.



**Housing Revenue Account (HRA) Debt**

The Government removed the HRA Debt Cap in November 2018 which had limited the Council to a maximum HRA CFR. The following local indicators are to be adopted for the HRA debt which measure the HRA’s capacity to borrow.

Ratio of debt to revenues shows the number of times the level of HRA debt is greater than the HRA gross revenue income. The ratio increases as the HRA debt level is expected to increase in order to deliver new build housing schemes.



Loan To Value - calculates the level of debt (the HRA CFR) compared to the Value of the HRA assets. The regional average for the East Midlands and Northern Regions is between the ranges of 35% to 48%. Table 20 shows that the HRA is slightly below the lower end of this range.



Interest Cover Rate (ICR) calculates how many times the operating surplus covers the interest costs (the greater the ICR the more affordable the level of borrowing). The average ICR for Council’s with an HRA is 2.23 with Council’s ranging between 1.20 to 4.50 therefore the Council is above the average.



**Appendix 1.A**

**Full Individual Listings of Counterparties and Counterparty Limits as at 31 December 2020**

|  |  |  |
| --- | --- | --- |
|  | **Sovereign rating** | **Institution** |
|  |   | **BANKS** |
| **UK** | AA- | Bank of Scotland |
|  |   | Barclays Bank Plc |
|  |   | Close Brothers Ltd |
|  |  | Handelsbanken |
|  |   | HSBC Bank Plc |
|  |   | Lloyds Bank Plc |
|  |   | Santander UK plc |
|  |   | Standard Chartered Bank |
| **Australia** | AAA | Australia & New Zealand Banking Group Ltd |
|  |   | Commonwealth Bank of Australia |
|  |   | Macquarie Bank Limited |
|  |   | National Australia Bank |
|  |   | Westpac Banking Corporation |
| **Belgium** | AA- | BNP Paribas Fortis |
|  |   | KBC Bank NV |
| **Canada**  | AA+ | Bank of Montreal |
|  |   | Bank of Nova Scotia |
|  |   | Canadian Imperial Bank of Commerce |
|  |   | National Bank of Canada |
|  |   | Royal Bank of Canada |
|  |   | Toronto Dominion Bank |
| **Denmark** | AAA | Danske Bank |
| **Finland** | AA+ | Nordea Bank Finland plc |
| **France** | AA | BNP Paribas |
|  |   | Credit Industriel et Commercial |
|  |   | Credit Agricole SA |
|  |   | Societe Generale |
| **Germany** | AAA | Bayerische Landesbank |
|  |  | Landesbank Baden Wuerttemberg |
| **Netherlands** | AAA | ABN AMRO Bank NV |
|  |  | Cooperatieve Rabobank UA |
|  |   | ING Bank NV |
| **Qatar** | AA- | Qatar National Bank |
| **Singapore** | AAA | DBS Bank Ltd |
|  |   | Oversea-Chinese Banking Corporation Ltd |
|  |   | United Overseas Bank Ltd |
| **Sweden** | AAA | Skandinaviska Enskilda Banken AB |
|  |   | Swedbank AB |
|  |   | Svenska Handelsbanken |
| **Switzerland** | AAA | Credit Suisse  |
|  |   | UBS AG |
| **United Arab Emirates** | AA | First Abu Dhabi Bank PJSC |
| **US** | AAA | Bank of America NA |
|  |   | Bank of New York Mellon |
|  |   | Citibank NA |
|  |   | JP Morgan Chase Bank |
|  |   | Wells Fargo Bank NA |
|  |   |   |
|  |   | **BUILDING SOCIETIES** |
| **UK** | AA- | Coventry BS |
|  |   | Nationwide BS |
|  |   |   |
|  |   | **UK Nationalised and Part Nationalised Banks** |
|  |   | ROYAL BANK OF SCOTLAND GROUP |
|  |   | National Westminster |
|  |   | Royal Bank of Scotland  |

**Appendix 1.B**

**Approved Countries for Investments (as at 31 December 2020).**

**Country List**

Australia

Belgium

Canada

Denmark

Finland

France

Germany

Netherlands

Qatar

Singapore

Sweden

Switzerland

United Arab Emirates

United Kingdom

United States of America

**Appendix 1.C**

**Specified and Non-Specified Investments**

**SPECIFIED INVESTMENTS:**

(All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum ‘high’ rating criteria where applicable)

|  |  |  |
| --- | --- | --- |
|  | **Minimum ‘High’ Credit Criteria** | **Use** |
| Debt Management Agency Deposit Facility | -- | In-house |
| Term deposits – banks and building societies | GreenShort-term F1, Individual C | In-house |

**Nationalised banks** in the UK have credit ratings which do not conform to the credit criteria usually used by local authorities to identify banks which are of high creditworthiness. In particular, as they no longer are separate institutions in their own right, it is impossible for Fitch to assign them an individual rating for their stand-alone financial strength. Accordingly, Fitch have assigned an F rating which means that at a historical point of time, this bank failed and is now owned by the Government. However, these institutions are now recipients of an F1+ short term rating as they effectively take on the creditworthiness of the Government itself i.e. deposits made with them are effectively being made to the Government. They also have a support rating of 1; in other words, on both counts, they have the highest ratings possible.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Minimum Credit Criteria** | **Use** | **Max £ of total investments** | **Max. maturity period** |
| UK nationalised banks | Blue | In-house  | £7million per banking group | 12 months |

**2. Maturities in excess of 1 year**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Minimum Credit Criteria** | **Use** | **Max £ of total investments** | **Max. maturity period** |
| Term deposits – banks and building societies  | Purple | In-house | £10million | 2 years |

**Appendix 1.D**

**Treasury Management Scheme of Delegation**

**Allocation of Responsibilities**

**Council**

* Receiving and reviewing reports on treasury management policies, practices and activities
* Approval of annual strategy approval of amendments to the organisation’s adopted clauses, treasury management policy statement and treasury management practices
* Budget consideration and approval
* Approval of the division of responsibilities, as per the Treasury Management Practices

**Executive**

* Receiving and reviewing regular monitoring reports and acting on recommendations

**Governance and Standards Committee**

* Reviewing the contents and operation of the Council’s Annual Treasury Management and Investment Strategy and Minimum Revenue Provision Strategy.

**Appendix 1.E**

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

The Section 151 Officer is responsible for the administration of the Council’s financial affairs in line with part 3 of the Council’s Constitution. The responsibilities of the Section 151 Officer for Treasury Management are stipulated in part 16 of the Council’s Financial Regulations which form part of the Council’s Constitution.

**The Section 151 Officer:**

* Recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
* Submitting regular treasury management policy reports
* Submitting budgets and budget variations
* Receiving and reviewing management information reports
* Reviewing the performance of the treasury management function
* Ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
* Ensuring the adequacy of internal audit, and liaising with external audit
* Recommending the appointment of external service providers
* Approving the selection of external service providers and agreeing terms of appointment.

**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, especially in respect of non-financial investments, (which CIPFA has defined as being part of treasury management)**:

* preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe.
* ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
* ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
* ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
* ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
* ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
* provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
* ensuring that members are adequately informed and understand the risk exposures taken on by an authority
* ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
* creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following:
	+ Risk management, including investment and risk management criteria for any material non-treasury investment portfolios;
	+ Performance measurement and management, including methodology and criteria for assessing the performance and success of non-treasury investments;
	+ Decision making, governance and organisation , including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;
	+ Reporting and management information, including where and how often monitoring reports are taken;
	+ Training and qualifications, including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.



**Appendix 2**

**Minimum Revenue Provision (MRP) Strategy 2021/22**

 **Minimum Revenue Provision (MRP)**

**Strategy 2021/22**

**Introduction**

Minimum Revenue Provision (MRP) is the annual revenue provision that local authorities which are not debt free have to make in respect of their debts and credit liabilities. The requirement to make MRP has existed since 1990, and only relates to borrowing undertaken on non-Housing Revenue Account (HRA) capital schemes.

Under the Local Authorities (Capital Financing and Accounting)(Amendment) (England) Regulations 2007 a general duty is placed on local authorities to make an amount of MRP which is considered to be prudent, with the responsibility being placed upon full Council to approve an Annual MRP Strategy each year.

The 2007 Regulations require that an Annual MRP Strategy be adopted by Council prior to the start of each financial year. Once a method has been approved for a particular year, any assets purchased through borrowing thereafter must continue to have MRP charged in the same way (that is, the Council cannot change the method of calculating MRP on individual assets).

**Minimum Revenue Provision (MRP) Options Available**

There are four options outlined within the 2007 Regulations for Councils to follow as to the calculation of MRP, however there are certain factors which predetermine the option the Council must adhere to, depending whether the borrowing is supported or unsupported:

Option 1 (“Regulatory Method”) and Option 2 (“Capital Financing Requirement (CFR) Method“) can only be used for supported borrowing, excluding HRA borrowing for capital expenditure.

**The preferred option for the Council for supported borrowing is option 1, the “Regulatory Method”.**

Option 3 (“Asset Life Method”) and Option 4 (“Depreciation Method”) can only be used to calculate the MRP for new schemes that require the Council to take on unsupported borrowing, excluding HRA borrowing for capital expenditure.

**The preferred option for the Council for unsupported borrowing is option 3, the “Asset Life Method”, with the exception of any:**

* **Commercial Property Investments**
* **Service Investment Loans**

**Which have been dealt with separately below.**

Appendix 2.A demonstrates the calculations required for each Method and a worked example to show the difference between options 1 and 2 for supported borrowing and options 3 and 4 for non-supported borrowing.

**Minimum Revenue Provision (MRP) Options for Commercial Property Investments**

Guidance issued by the Ministry for Housing, Communities and Local Government (MHCLG) in February 2018 states that option 4 (“Depreciation Method”) is not a suitable approach for investment properties as depreciation is not charged on this classification of assets.

The MHCLG guidance indicates that Option 3 (the “Asset Life Method”) is an appropriate method for calculating MRP on all assets, however the guidance does give local authorities flexibility in how they calculate their MRP, provided the calculation is ‘prudent’. In calculating a prudent provision, local authorities are required to have regard to this guidance.

In order to determine an appropriate approach to be adopted by the Council in respect of calculating a MRP for Commercial Property Investments, the following considerations have been taken account of by the Council:

* The underlying principle around MRP is that Local Authorities makes a prudent provision each year to provide cover for/and reduce over time the CFR liability of the Council
* In doing so, Local Authorities should align the period over which they charge MRP to one that is commensurate with the period over which the capital expenditure provides benefit.
* A charge to the revenue account for MRP cannot be Nil, if the Local Authority has a positive CFR.
* Paragraph 49 of the informal commentary to the MRP guidance issued in February 2018 states that the maximum life for MRP relating to investment properties should be 50 years.
* Paragraph 32 of the informal guidance provides for authorities to make voluntary repayments of MRP (known as VRP).
* Paragraph 26 of the main guidance also confirms that where an overpayment has been made previously, through a VRP, this can be offset against a future years provision, but must be disclosed in the MRP strategy and any remaining cumulative amounts of overpayment should also be declared to Full Council.

The main issue is in ensuring that prudent provision is made to reduce the Capital Financing Requirement (CFR)/debt liability of the Council over a period of time. The CFR liability is incurred as soon as the Council makes any capital expenditure (including commercial property investments) which is not financed at the time, and as such the Council is required to fund the expenditure through borrowing. As also noted above, the level of MRP in any one year under the revised 2018 guidance cannot be Nil.

From the Council’s perspective the following considerations need to be borne in mind:

* MRP cannot be Nil, but any amount above Nil would therefore meet the requirements in theory.
* In addition to a nominal MRP each year, the Council could consider making a VRP each year (from an earmarked reserve established to manage the investment returns achieved each year on the funds, aside of capital growth), to ensure prudent provision is made each year. By making and declaring a VRP, the Council would have the ability to unwind such provisions, if it could be argued at a later date that an overpayment has been made. As noted above, this would need to be declared formally in the annual MRP strategy.

The Council has approximately £26m invested in commercial property investments which is funded from external borrowing from other financial institutions. Using MRP guidance for the maximum life of 50 years would result in an MRP charge of £520,000 per annum to revenue if a nil value was assumed at the end of the 50 years. If 50% of the property value was deemed to be land then a charge of £260,000 would be required. Using the loan periods of between 19 to 48 years would result in an MRP charge of £688,000 per annum to revenue if a nil value was assumed at the end of the loan term. If 50% of the property value was deemed to be land, then a charge of £344,000 would be required.

This approach, however, assumes that the asset’s value will completely diminish over its life, whereas, in reality, each of the Council’s Commercial Property Investments will be actively managed with the intention that capital value is at least maintained over time and where an individual commercial property investment fails to achieve the Council’s expectations, then consideration will be given to an exit strategy. In addition, the movement in the value of money over time will mean that, in 50 years, the real value of the borrowing will diminish significantly. For example, an average 1% annual uplift would increase the fund value from £26million to almost £42.8million.

Prudence needs to be considered from both perspectives in that it is equally important not to overcharge current taxpayers for MRP as it is to undercharge.

On the basis of the example set out above, there could be a suggestion that the Council charges each year a provision of £520,000 which would fall as a charge on the taxpayers and revenue budget each year. Provided the value of the asset/investment is sufficient to cover the future repayment of the debt liability (CFR), then the Council takes the view that it would be imprudent to charge such an amount to current taxpayers, when at any time in the future the investment could be cashed in, repaid and the subsequent receipt set aside to reduce the CFR liability of the council. Rather than charging a fixed amount each year, the Council believes that a prudent approach would be to review the value of the commercial property investments each year and then consider any requirement to set aside a prudent provision based on the value and expected trajectory of the holding.

This would cover the requirement to set aside a prudent provision each year without unnecessarily overcharging current taxpayers. Any initial gains in the value of the holdings will be set aside in an earmarked reserve to cover any potential volatility in the early years.

Based on the above information the Council’s MRP Policy in respect of commercial property investments will be to determine the amount of MRP and VRP based on the combined value of its holdings at the end of each financial year and as part of the budget setting process.

The Council has approved a Commercial Investment Volatility Earmarked Reserve which the General Fund revenue budget will make an annual contribution into, in order to put resources aside to reduce any volatility in income due to, for example a unit becoming vacant . This is so that the impact on the Council’s ability to deliver services is minimised in the event that the Council doesn’t achieve the income target set within the budget. The annual contribution to the Commercial Investment Volatility Earmarked Reserve will be monitored to ensure that adequate resources are built up over time and maintained in the event that an MRP or VRP is made from the reserve.

The Council will ensure that any capital receipts generated from the sale of commercial property investments will be earmarked and set aside when received to reduce the CFR liability by the amount of the original borrowing for units sold if MRP/VRP has not previously been provided for.

The Council will also monitor the performance of its Commercial Property Investments on a regular basis with performance reported to the Governance & Standards Committee alongside Treasury Management monitoring reports.

This policy may need to be reviewed in the future if circumstances change by the issue of updated directions, accounting pronouncements from CIPFA or MHCLG.

**Minimum Revenue Provision (MRP) Options for Service Investments**

Service investments made by the Council are largely loans to third parties ranging from short-term to longer-term loans linked to assets or investments in group organisations.

Where the Council takes out additional borrowing to support a service investment to a third party, the MRP guidance requires that an MRP charge is made to meet the cost of repaying that loan when it becomes due for repayment.

Provided the Council doesn’t have any reason to believe that the third party will default on the repayment of the amount owed to the Council for the service investment, then there will be sufficient resources to cover the future repayment of the debt liability (CFR), then the Council takes the view that it would be imprudent to charge such an amount to current taxpayers, when at any time in the future the investment will be repaid and the subsequent receipt set aside to reduce the CFR liability of the council. The Council will make an assessment of the potential for default on the service investment as part of the business case that is presented.

**MRP Overpayments**

A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. As at 31 December 2020 there have been VRP overpayments of £1,000. If a decision is made to make a VRP contribution at the end of the 2020/21 financial year as part of the year end accounts process, this will be reported as part of Treasury Management outturn information for 2020/21.

**Appendix 2.A – MRP Calculation Examples**

The following shows how the MRP figure is calculated under each of the options discussed above, along with an example which compares the different options for both supported and unsupported borrowing:

**Future supported Borrowing and any Previous Borrowings**

**Option 1 (“Regulatory Method”)** – This is the method currently used by the Council, as set out in the 2003 Regulations. Option 1 is calculated as 4% of the total Capital Financing Requirement for all borrowing, excluding HRA borrowing less Adjustment A:

4% (CFR – HRA – AA)

Where:

CFR = Capital Financing Requirement

HRA = HRA borrowing

AA = Adjustment A

**Option 2 (“Capital Financing Requirement (CFR) Method”)** – this uses the same formula as Option 1 but does not take account of Adjustment A.

4% (CFR – HRA)

Where:

CFR = Capital Financing Requirement

HRA = HRA borrowing

Once calculated Adjustment A remains a fixed variable within the calculation; in the case of Mansfield District Council Adjustment A is £491,000 meaning that the MRP calculated under Option 1 will always be £19,640 (4% of £491,000) less compared to Option 2.

The following demonstrates the different MRP calculated under Option 1 and Option 2 based on the Council’s Capital Financing Requirement for the financial year:

Total Capital Financing Requirement for future supported borrowing and any previous borrowing for the financial year was £44,840,525.

HRA borrowing for the financial year is £32,263,142

Adjustment A is £491,000

|  |  |  |
| --- | --- | --- |
| MRP  | Option 1 | Option 2 |
| Financial Year | £483,455 | £503,095 |

**Unsupported Borrowing**

**Option 3 (“Asset Life Method”)** – The MRP for each asset acquired through unsupported borrowing is calculated using the following formulae:

A – B

C

Where:

A = Capital expenditure (unsupported borrowing) on asset

B = Total MRP already made against the asset

C = Remaining useful life of the asset

**Option 4 (“Depreciation Method”)** - The MRP for each asset acquired through unsupported borrowing is calculated using the following formulae:

A – B – D

C

Where:

A = Capital expenditure (unsupported borrowing) on asset

B = Total MRP already made against the asset

C = Remaining useful life of the asset

D = Residual Value of the Asset

The following demonstrates the different MRP calculations under Option 3 and Option 4:

A wind turbine is purchased for £100,000 with an asset life of 20 years, using prudential borrowing taken out over 20 years. At the end of the asset life there is expected to be a residual scrap value of £10,000; this scrap value might fluctuate over time.

Option 3:

MRP = £100,000 – 0 = £5,000 per year

 20

Total MRP over the 20 years = 20 X £5,000 = £100,000

Meaning that the Council has set aside the full value of the loan over the life of the asset, which it can use to pay off the borrowing on maturity.

Option 4:

MRP = £100,000 – £10,000 = £4,500 per year

 20

Total MRP over the 20 years = 20 X £4,500 = £90,000

Meaning that the Council has only set aside £90,000, which is £10,000 less that the full value of the loan over the life of the asset, meaning that the Council will have to find £10,000 to add to the £90,000 in order to pay off the borrowing on maturity.



**Appendix 3**

**Capital Strategy**

**2021/22 to 2041/42**

**Capital Strategy 2021/22 to 2041/42**

**Introduction**

The Capital Strategy is a requirement for Local Authorities to produce from April 2019 following the publication of the revised Prudential Code for Capital Finance in Local Authorities 2017.

The Capital Strategy is intended to give a high level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability. The Capital Strategy is a forward looking document that focuses on the core principles that underpin the Council’s long term capital expenditure and investment decisions.

The Strategy maintains a strong and current link to the Council’s priorities and to its key strategy documents notably; **Making Mansfield** **Towards 2030:**, Medium Term Financial Strategy, Treasury Management Strategy, Asset Investment Strategy, Service Investment Strategy, Transformation Strategy and the Flexible Use of Capital Receipts Strategy.

The Capital Strategy covers the following areas:

* Governance Processes
* Capital Programme
* Asset Management Planning
* Debt and Borrowing and Treasury Management
* Non Treasury Investments Strategy
* Knowledge and Skills

**Governance Processes**

Capital Strategy and Capital Programme - The overarching Capital Strategy is required to be approved by the Full Council prior to the start of the new financial year. A three year capital programme is approved annually by the Full Council as part of the budget setting process through the Medium Term Financial Strategy (the Council’s Medium Term Financial Strategy 2021/22 to 2023/24 will be presented to Council on 27 January 2021 for approval).

Appraisal – As part of the budget setting process requests are made by Heads of Service for schemes to be included in the Capital Programme. For each scheme a business case will be completed by the project officer which details the costs and benefits of the scheme including any on-going revenue costs. Project mandates require approval at Head of Service level or above.

Approval – In accordance with the Council’s constitution, Capital schemes require approval prior to being included on the capital programme. The following levels of approval apply for additions and increases to the capital programme:

|  |  |  |
| --- | --- | --- |
| **Approval by:** | **Method** | **Approval Limit from /to** |
| Executive Member | Delegated Decision | Up to £50,000  |
| Full Council | Full Council decision | Over £50,000 |

Monitoring – Expenditure and progress of individual schemes are monitored against the approved individual capital scheme budget by the Capital and Housing Accountant and the General Fund and Housing Capital Monitoring Groups. Meetings are held between the Capital and Housing Accountant and project officers. Reports are presented to the Overview and Scrutiny Committee (Corporate Resources) during the financial year together with an out-turn report being produced at the year end.

Virements - Where there is a need to increase a capital scheme budget by utilising an unspent budget a virement will be agreed between the Head of Finance and the relevant director. Approval of such virements shall be subject to the following financial limits:

|  |  |  |
| --- | --- | --- |
| Approval by: | Method | Approval Limit from /to |
| Head of Finance | Virement Form  | Up to £10,000 |
| Portfolio Holder for Corporate and Finance | Virement Form | £10,001 to £49,999 |
| Executive | Delegated Decision | £50,000 to £250,000 |
| Full Council | Full Council decision | Over £250,000  |

**Capital Programme**

The General Fund and Housing Revenue Account Consolidated Capital Programme for 2021/22 to 2023/24 are set out in the Medium Term Financial Strategy (MTFS) which will be presented to Council on 27 January 2021. The priorities of the current capital programme and the capital programme for the next three years are as follows:

**General Fund**

* Refurbishment of Walkden Street and Four Seasons Car Parks
* Works to Secure Berry Hill Quarry Cliff Face
* Planned works on the Council’s operational buildings
* Continuous replacement of the vehicle fleet

**Housing Revenue Account**

* Maintain the Decency of the Council’s Housing Stock
* New Build Properties

Further schemes will be added to the Consolidated Capital Programme to enhance existing assets and to acquire and build new assets where there is a business case.

Assets that have a physical substance and are held for the production or supply of goods or services for rental to others or for administrative purposes and that are expected to be used during more than one financial year are classified as property, plant and equipment. Acquisitions of assets which are less than £10,000 (the Council’s de minimis level) are charged straight to the Comprehensive Income and Expenditure Statement.

Expenditure on the acquisition, creation or enhancement of property, plant and equipment is capitalised, provided that it is probable that the future economic benefits or service potential associated with the item flow to the Council and the cost of the item can be measured reliably. Expenditure that maintains but does not add to an assets potential to deliver future economic benefits (for example, repairs and maintenance) is charged as an expense when it is incurred.

A Flexible Use of Capital Receipts Strategy has been approved for the Financial Years 2018/19 and 2019/20. The Flexible Use of Capital Receipts Strategy for the years 2020/21 and 2021/22 will be presented to Council on 9 March 2021. The Council can use capital receipts flexibility to deliver the Council’s Transformation Strategy where this presents itself as the best option; each case will be considered and assessed on its own merit, with a report being recommended for decision in line with the Council’s Constitution.

This Strategy extends beyond the three year Capital Programme to 2041/42. As part of the Council’s Asset Management Planning condition surveys are carried out of the Council’s Operational assets this is likely to identify future schemes for inclusion in the capital programme.

The Council currently has a fleet of vehicles which it uses to deliver services. It is expected that the Council will continue to replace older vehicles to minimise the revenue costs of repairs. The capital programme includes a £472,000 each year for vehicle purchases, due to revenue budget pressures it is unlikely that this amount will be able to be increased, therefore alternatives to purchasing vehicles are currently being explored.

New stock condition surveys are planned to be carried out of the HRA housing stock to inform what capital works need to be undertaken to maintain the decency of the housing stock. This may result in further capital works being identified for inclusion in the capital programme and which will need to be financed from HRA resources.

The current Housing Revenue Account (HRA) Business Plan covers the period from 2015/16 to 2045/46. The results of the stock condition surveys will be used to calculate the capital expenditure required to maintain the decency of the HRA Housing stock and this inform a revised HRA business plan to replace the current plan.

The current item 8 determination requires that the HRA Major Repairs Reserve is credited with an amount equal to depreciation each year. It is forecast that should this statutory override remain in place there will be additional resources available in the Major Repair Reserve (MRR) to maintain the decency of the housing stock.

The HRA resources are used to fund HRA revenue and capital expenditure. Should the decision be made to use the HRA capital receipts to finance General Fund capital expenditure then the HRA CFR would be reduced by the equivalent amount.

**Asset Management Planning**

The Council has a property portfolio of assets. This consists of operational property, investment property and property held for specific community or regeneration purposes. The Council has specific reasons for owning and retaining property which are in line with the Council’s Corporate Priorities:

• Operational Assets – supporting core business and service delivery

• Investment Property – to provide a financial return to the Council

• Community Assets – to provide green spaces for recreation

• Commercial /Regeneration – supporting small businesses and economic growth

Condition surveys have been carried out of the Council’s operational assets this work has identified Planned Preventative Works (PPW) that are required to be carried out over the next three years. Budgets for these works are included in the consolidated capital programme included in the Medium Term Financial Strategy 2021/22 to 2023/24.

Over the 20 years covered by this Capital Strategy further works will be required to be carried out.

Leisure Centres – Under the current Leisure Contract whereby the Council’s leisure facilities, (namely leisure centres) the Council retains responsibility for buildings and major equipment whilst the contractor is responsible for day to day repairs. The works which have been identified to maintain the buildings and major equipment are set out below. The highest priority works are included the capital programme within the MTFS, financing will need to be identified to cover works required in the years beyond the next three years.:

**Water Meadows -**

Roof replacement

Pool plant/ leak flume resolution

Air handling unit

Window replacement

Pool plant refurbishment

**Rebecca Adlington SC -**

Wet-side Flooring

Pool swimming pool tank refurbishment

Boiler replacement

Air handling units replacement

**Oak Tree Leisure Centre -**

Roof replacement

Boiler replacement

The method of funding this investment is dependent upon the nature and the scale of the work, whether it merely maintains the asset or whether it enhances and lengthens its useful life.

The property portfolio is regularly reviewed to identify assets which have become surplus to the Council’s requirements which could be disposed of to generate a capital receipt and or reduce the Council’s costs.

**Debt and Borrowing and Treasury Management**

Capital expenditure is a key driver of Treasury Management activity. The Treasury Management Strategy (included at Appendix 1 to this report) includes a projection of the level of external and internal borrowing based on the Council’s capital expenditure plans.

The Treasury Management Strategy covers the following areas particularly relevant to the Capital Strategy:

* Forecast financing of the capital programme including future prudential borrowing
* The Council’s Capital Financing Requirement (CFR) (The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council’s underlying borrowing need).
* Actual and forecast CFR for the General Fund and HRA.
* Actual external debt and forecast external debt.
* Operational Boundary and Authorised Limit for the level of external debt.

Treasury Management decisions and risks – The Treasury Management sets out basis for making investment decisions and the risk management when undertaking this activity. The Strategy for 2020/21 was approved by Council in March 2020.

Scrutiny – The Treasury Management Strategy is scrutinised by the Council’s Governance and Standards Committee and is then recommended for approval by full Council. The Governance and Standards Committee receives a half year update and outturn reports on Treasury Management activities in line with the Treasury Management Code of Practice 2017.

**Non-Treasury Investments Strategy**

The Council has invested in non-treasury management investments primarily for financial return, these being investment properties and loans to a third party housing development company (Mansfield Homes Ltd).

The following non-treasury investment strategies for 2020/21 were approved by Council in March 2020 which covered the Council’s commercial activities:

* Commercial Property Investment Strategy
* Service Investments Strategy

The non-treasury investment strategies for 2021/22 will be presented for approval as part of this report; a copy can be found at Appendix 4 and Appendix 5, respectively.

**Knowledge and Skills**

The council has professionally qualified staff across a range of disciplines including, finance, legal and property that follow continuous professional development (CPD) and attend courses on an ongoing basis to keep abreast of new developments and skills.

The council establishes project teams from all professional disciplines from across the council as and when required. External professional advice is taken where

required and will always be sought in consideration of any major commercial property investment decision.

Internal and external training is offered to members to ensure they have up to date knowledge and expertise to understand and challenge capital and treasury decisions taken by the Head of Finance.



**Appendix 4**

**Asset Investment Strategy 2021/22**

**Asset Investment Strategy**

**2021/22**

**Introduction**

The core function of the Council is to deliver statutory and other services to local residents.

The Council invests its money for three broad purposes:

* because it has surplus cash as a result of its day-to-day activities. For example, when income is received in advance of expenditure
* to support local public services and invest in the local area on a longer-term basis
* to earn investment income generated by council-owned assets

The objective of the Asset Investment Strategy (the Strategy) is to establish a framework for the identification of asset investments which, if acquired, would provide the Council with benefits both to the organisation and to residents, as well as the potential for ongoing revenue benefits. .

The Strategy aims to provide a robust and viable framework for the acquisition of asset investments. The key underlying objectives of this Strategy are:

* **Governance Arrangements** – to provide a decision making framework aligned to the requirements of the Statutory Guidance Relating to Local Authority Investments
* **Investment Criteria** – to identify suitable asset investment opportunities that fulfil the aims of the strategy “Making Mansfield: Towards 2030”
* **Risk Management** – to balance the requirement for income return with an acceptable level of managed risk
* **Financial Viability** – each potential investment will have a full business case and be evaluated to ensure the income received is sufficient to provide an acceptable rate of return following the payment of borrowing costs (where applicable), management fees and any other running costs

Under this Strategy, the Council may:

* Purchase property in order to further service objectives
* Purchase smaller assets such as vehicles and equipment, as required by services
* Build or develop property to be let to interested parties
* Acquire land to be developed or make available for development
* Purchase tenanted property and carry out landlord functions
* Purchase assets as part of Invest to Save initiatives, in order to generate longer-term savings for the authority
* Undertake any other investments for which it has legal powers to do so

Investment in financial institutions, such as banks and building societies are classed as Treasury Management investments and are not covered in this Strategy; these are addressed within the Council’s Annual Treasury Management Strategy.

**Decision Making**

Asset investments may require agile and quick decision making. In order to ensure appropriate governance arrangements are maintained, investment decisions will be made in accordance with the Council’s existing decision making process, threshold levels and the Scheme of Delegation, as set out within the Council’s Constitution.

**Monitoring Arrangements**

Monitoring of capital schemes is included within quarterly Revenue and Capital forecasting, which is referred to Overview & Scrutiny Committee (Corporate Resources) on a quarterly basis.

Monitoring of the overall Investment Strategy is delegated to the Governance & Standards committee, who receive reports at halfway through the financial year, and at the year-end.

**Investment Criteria**

All investments must reflect the requirements set out in the Statutory Guidance on Local Government Investments issued under Section 15(1) (a) of the Local Government Act 2003, which came into force of 1 April 2018. Further details of this statutory guidance can be found at:

<https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/678866/Guidance_on_local_government_investments.pdf>

Table 1 sets out the summary of the statutory guidance requirements:

**Table 1**

|  |  |
| --- | --- |
| Requirement | Considerations |
| Clearly show how investments contribute to Council’s objectives | * Need to align with Corporate Plan priorities
* Clarify purpose and extent to which it supports deficit reduction and /or economic regeneration in the District
 |
| Strategy must include indicators to show how Councillors have assessed the total risk exposure on decision | * How is it funded
* Rate of return expected and why (benchmarked)
* Show additional debt costs
* Risks over the repayment period
* Extent of support for deficit gap
* Mitigation if returns fail and / or borrowing increases
* Assessment of capital depreciation
 |
| Clearly show how the investment is proportionate | * Loan corresponds in size or degree (terms/rate/returns)
* Risk exposure is reasonable, accepted and balanced across the portfolio
* Within agreed and defined ‘affordability‘ limit
 |
| Risk assessment should be robust | * Market assessment (competition, demand, trends)
* Proper quality external advice and expertise
* Credit ratings
 |
| Contingency | * Loss of investment return / Increase in loan repayments
* Capital depreciation
* Extra costs and budget impact
* Loss of revenue stream - service delivery
 |

**Financial Viability**

The financial viability of each individual potential investment opportunity will be fully assessed within a comprehensive business case. In order to reflect the potential risk that may arise as a consequence of purchasing assets, and provide a sufficient financial contribution to the Council’s General Fund, a positive Internal Rate of Return (IRR) is required. However, the Council may still consider pursuing a property acquisition if the IRR is positive but low if a social and/or regeneration opportunity is identified.

The cumulative effect of investments will be monitored to ensure that cases are not just considered on an individual basis but as part of an overall portfolio with consideration given to the overall level of borrowing.

The level of return will be heavily influenced by the below factors:

* The whole life costing, taking account of any borrowing that the Council is required to take out at the time or at a later date where it can initially borrow internally to reduce actual debt costs incurred
* Whether an investment generates a positive Internal Rate of Return (IRR)
* The regulatory requirements of the Minimum Revenue Provision (MRP) or the potential requirement to increase resources held within the Commercial Property Volatility Earmarked Reserve, if applicable.

**Whole Life Costing**

When considering the potential acquisition of an asset, the Council will have to build a solid business case which supports the decision to invest. In order to understand the financial viability of a potential investment, whole life costing should be included showing all potential commitments on the Council’s financial resources as a result of benefiting from the revenue income stream, over the expected period that the Council intends to own the investment. This should include:

* Costs associated with purchasing the investment:
	+ Acquisition costs
	+ Stamp duty
	+ Solicitors / legal fees
	+ Development costs
	+ Interest costs where borrowing was incurred
	+ Minimum Revenue Provision (MRP), where it is deemed a charge is necessary (See below)
	+ Any other costs associated with acquiring the asset
* Annual revenue income streams, if applicable:
	+ Property rental
	+ Other income, such as service charges
* Annual running costs:
	+ Utilities
	+ Business rates
	+ Repairs and maintenance
	+ Insurances
	+ Security
	+ Management costs
	+ Any other on-going running costs

The above requirements focus solely on the financial elements of an investment. However, there may be times when an investment is required in order to provide non-monetary value to the district, such as:

* Promoting future economic growth
* Enhancing social or environmental wellbeing

In these instances, the non-monetary benefits arising from the investment, including how the project will meet corporate objectives, will be documented in the business case submitted for approval, to be considered as part of the overall case for investment.

In order to evaluate investment proposals, the following considerations will be required:

* Benefits of the investment
	+ Does the project help meet statutory objectives?
	+ Does the project align with corporate objectives?
* Costs
	+ Value for money (benefits received in relation to costs)
	+ Impact on future revenue costs
* Deliverability/risks
	+ Will the project be delivered on time and within budget?
	+ Any possible negative effects of the project?

**Risk Management**

As with all investments, there are risks that capital values and rental values can fluctuate. To mitigate against future unfavourable market forces, acquisitions will be made on the basis that the Council is willing and able to:

* Take on investments for the medium to long term; this will ensure that income and capital returns are considered over the long term thereby smoothing out any cyclical economic and/or property downturns. Property maintenance over the long term will be factored into the business case for each potential acquisition opportunity

Individual investments must not expose the Council to an inappropriate level of risk. Consideration will be given to defect liability periods when reviewing a potential property which is either new build or off-plan.

**Annual Review of Fair Value**

As part of the final accounts process each year, a rolling valuation of Property, Plant & Equipment held by the Council is undertaken, to give assurance that properties held by the Council are reflected correctly in the Statement of Accounts. As not all properties are revalued every year, a review is undertaken by Financial Services to confirm that there is no material impact on the Council’s financial statements as a result of this process.

**Exit Strategy**

The period of time during which the Council is expected to hold an investment will be documented within the business case at the time of requesting the investment. This will set out how long the Council expects to hold the asset for, and any potential revenue costs that may be required upon disposal of the asset.

**Minimum Revenue Provision**

The Council is required to produce an annual Minimum Revenue Provision Strategy which sets out its policy for setting aside resources to meet the repayment of loans; this is approved at full Council as part of the Treasury Management and Annual Investment Strategy, and can be found at Appendix 2 to that Strategy.



**Appendix 5**

**Commercial Property Investment Strategy 2021/22**

**Commercial Property Investment Strategy**

**2021/22**

**Principles of any Commercial Property Investment**

The key principles for the Council when investing in commercial property are:

* To build a balanced portfolio of commercial assets/properties that diversify the risk to the Council through holding commercial investments
* The target yield of an individual commercial investment is a minimum of 5%, although each proposed investment opportunity will be assessed on its own merits, and a potential yield below 5% would not automatically be discounted if there were other desirable attributes involved that could be demonstrated
* Investments are to be freehold or long leasehold
* Covenants strength of tenants are to be of a sufficient strength that on balance the property has an institutionally acceptable grade of income which is deemed to be safe at the time of the purchase
* No investments in speculative developments
* No investments in areas classed as being:
	+ in an area that is classed as a high risk flood zone or
	+ with high land contamination risk
	+ any investment that is considered to be high risk

The Council will always give preference to potential investment opportunities which are within the District, however careful consideration may be given to commercial investment properties which are outside the District.

In accordance with the lending terms of the Public Works Loan Board, which came into force on 26th November 2020, the Council will not borrow to fund commercial property investments at any point during the life of this strategy. However, borrowing has previously been taken out to fund commercial property investments, and the costs related to this must be covered by the properties in question.

**Commercial Property Investment Portfolio**

The Chartered Institute of Public Finance and Accountancy (CIPFA) recommends that the security and liquidity of investments should take priority over yield: this is reflected in the Council’s approach when acquiring commercial property investments.

The objectives of the Council’s commercial property investment portfolio are:

* To generate a medium to long term sustainable and predictable income stream that contributes towards the cost of delivering public services provided to residents and users of its services
* To achieve an appropriate balance of risk and return through portfolio diversification to protect the Council from shifts or decline in a specific sector
* To acquire standing commercial investment properties that generate an immediate income through being let on commercial terms, or from properties which are contracted to be let
* To provide an income stream with a clear margin over the cost of capital
* To acquire a suitable grade of properties which possess the characteristics required to retain liquidity and preserve capital

In order to diversify the risk of its commercial property investment, the Council has worked towards a predetermined balance of its portfolio across the following sectors:

* Retail
* Office
* Industrial
* Alternative

The Council has sought advice from External Property Advisors as to the balance of its property portfolio in order to help mitigate exposure to any inherent risks of specific sectors.

**Commercial Property Investment Assessment Matrix**

The Council has adopted a Commercial Property Investment Assessment Matrix which allows the relative merits of each potential commercial property investment opportunity to be measured and evaluated against a target threshold. This Matrix has been refined in partnership with the Council’s appointed property advisors in order to develop a balanced asset portfolio.

This Commercial Property Investment Assessment Matrix is designed to address what are considered to be the key characteristics of a sound investment. Each investment has been assessed using the following criteria:

* **Location** – Location is deemed to be an important consideration when critiquing the asset. It is important to acquire an asset in an area that is viewed to be economically buoyant and has the ability of sustainable financial and economic growth, over the life time of the asset. Greater scoring weight is given to prime locations. The quality of the location relevant to the sector that the property traded in is also deemed to be of significance.
* **Tenant Covenant** – The financial standing and viability of the tenant is also considered and objectively scored. Paragraph 6 Statutory Guidance on Local Government Investments cites the use of Standard and Poor’s; Moody’s Investors Service Ltd or Fitch Ratings Ltd. The Council uses a recognised financial referencing agency and provider of business credit information and data intelligence.
* **Building Quality** – The age and construction of the building is reviewed and taken into account in the decision making process. The potential for future structural repair, retro fit and refurbishment expenses for both the Council and the Tenant, should be limited as much as possible. A modern, well-constructed, energy efficient building scores highly.
* **Average Weighted Unexpired Lease Term (AWULT)** – The AWULT is taken from the average length of the unexpired lease term. In the case of multi tenanted property it is the average of the combined occupational leases. Longer AWULT are viewed more positively than shorter ones, with twenty five years being aspirational. In addition the ability of the tenant(s) to end the lease before its contractual end date is becoming more common in commercial leases. They have the effect of guaranteeing the income only for the period up until the next break option. A lack of break options within a lease is viewed as desirable.
* **Tenure** – The acquisition of the freehold interest in a property is considered more favourably than a leasehold acquisition and this is reflected in the scoring matrix.
* **Energy Performance Certificate Rating/Potential** – The energy performance of a building is considered essential in view of current legislation and future let-ability of a building and cost of operating from the premises.

In summary applying the Commercial Property Investment Assessment Matrix will produce the highest score for properties which have the following attributes:

* Tenants who have a strong covenant strength and sound financial standing with at least 5 years remaining on the lease.
* Prime/good secondary locations meaning at the end of the lease term the property should be re-let with minimum void periods.
* The building will not become obsolescent.
* Opportunities during hold period for rental growth and capital value increases through active asset management, that is, lease re-gear, RPI/CPI and open market rent reviews, refurbishment
* Minimise risk
* Maximise rental income and minimise management costs to ensure the best return is generated.
* No investment in speculative development.

**Portfolio Management**

To mitigate the risk of void periods where the property is either partially or fully vacant, or a tenant has defaulted on its rental obligations, the commercial property investment portfolio will be actively managed either by the Council’s Property Services Team or by an appointed Management Company.

In addition, the investment criteria specified in the scoring matrix will favour secure property investments, that is, high quality buildings, thus mitigating the risk of void periods on re-letting.

**Third Party Expertise**

Property investment markets are, in general, controlled by national and regional commercial property agencies and establishing links and relationships with a number of such property agents is the best method of sourcing suitable properties for acquisition.

Whilst staffing resources will be made available in order to source suitable property assets for acquisition that match the Commercial Property Investment Assessment Matrix set under the Strategy, it is recognised that third party expertise is essential to enable informed decision making and may be brought in to support the Council with its commercial property investment acquisitions.

**Monitoring Arrangements**

The Council will maintain a summary of current material investment properties, the monitoring of which will be referred to the Council’s Governance and Standards Committee; this will form part of the Council’s overall Investment Strategy updates which are presented to the group twice a year.

**Exit Strategy**

Where a commercial property investment no longer meet the requirements of the Council either as a result of a shift in the diversification of its property portfolio or as a result of underperformance against the Commercial Property Investment Assessment Matrix, then it will look to dispose of the asset. Upon disposal, the Council will look at potential opportunities to re-invest in relevant assets within the district that further the Council’s priorities, if it is in the Council’s interest at that time, or use the receipt to repay any attributable outstanding debt.

**Governance Arrangements**

**Asset Board**

The Asset Board has considered potential investments on behalf of the Council. This Group comprises of:

* Elected Mayor
* Portfolio Holder for Corporate and Finance
* Chief Executive Officer
* Strategic Director
* Head of Finance
* Head of Law and Governance
* Head of Planning and Regeneration
* Corporate Asset Manager

As the strategy moves from purchasing assets to maintaining the current portfolio, the Asset Board will receive relevant updates from Property Services and external advisors where required, on the condition of existing assets, the remaining term on their leases and whether an exit strategy needs to be investigated on any particular properties.

The Asset Board has its own Council approved Terms of Reference which were approved at Council on 19 November 2019.

**Commercial Property Volatility Earmarked Reserve**

The Council has created a Commercial Property Volatility Earmarked Reserve which aims to mitigate the impact of any loss of capital investment upon the sale of an asset in order to meet the shortfall against any outstanding debt.

The Commercial Property Volatility Earmarked Reserve will also be used to meet any shortfall in revenue income resulting in loss of tenure to protect the Council against fluctuations in revenue income which would impact on the Council’s ability to deliver services.

An annual review will be carried out as part of the Medium Term Financial Strategy to assess whether there are sufficient resources held within the Commercial Property Volatility Earmarked Reserve. Where it is deemed there are insufficient resources, provision will be made to top up the reserve over a period of time as part of the budget setting process (through the Medium Term Financial Strategy).

**Annual Reporting**

As part of any investment strategy it is very important to keep the investment criteria and guidelines under review. A failure to do so may result in the portfolio under-performing the market or its risk profile increasing due to changes in both the macro-economic and micro-economic position around the real estate market.

As such the Council will undertake a comprehensive annual review of the portfolio which will be completed by a suitably professionally qualified surveyor who is actively involved in the UK property investment market.

The Asset Board will be responsible for monitoring performance of the Council’s commercial property investment portfolio, and providing updates to the Governance and Standards Committee through the Treasury Management monitoring reports.

The annual portfolio review should cover:

* + **Section A – Investment (assisted by externally appointed surveyor)**
* A market update on investment trends, activity and forecasts
* An update on the occupational markets
* A review of current investment strategy
* Re-confirmation of investment criteria and asset target weightings
* Identification of any re-alignment required to match market changes and forecasts
* Benchmarking the existing portfolio and asset level investment returns
* Reporting on performance of the portfolio and individual assets
* Reporting on any KPI or performance criteria
* Provision of annual property business plans to evaluate added value opportunities
* Provision of a review of portfolio activity and the added value created over the previous 12 months
* An update of five year cash flow forecast
* An update of Retain/Dispose asset designation
	+ **Section B – Management (Property Services)**
	+ Reporting on portfolio management performance including rent collection rates, bad debt provision and service charge reconciliations
	+ Advice on all critical lease dates, break options, rent reviews and lease expiries
	+ Reporting on any health and safety incidents and insurance claims
	+ Reporting on dilapidations claims and status
	+ Capital expenditure requirements

This review will provide a clear understanding of the commercial property investment portfolio’s position and management, its risk and return profile and any latent value that can be driven out through strategic asset management. A regular review of the five-year cash flow is important to understand future working capital requirements, as well as assessing the accuracy of the predicted rental income.

The annual review will also feed into considerations given as to whether there are sufficient resources held in the Commercial Property Volatility Reserve.

The Council’s Governance and Standards Committee will receive monitoring updates on Commercial Property Investments as part of regular updates on the Investment Strategies.



**Appendix 6**

**Service Investment Strategy 2021/22**

**Service Investment Strategy**

**2021/22**

Service investments made by the Council are largely loans to third parties ranging from short-term to longer-term loans linked to assets or investments in group organisations.

Following a detailed assessment, a loan will have an interest rate applied which reflects any appropriate legislation (e.g. State Aid). Scrutiny for Service Investments is undertaken by officers within the Council giving due regard to the relevant formal approval. This scrutiny will include a due diligence assessment to ensure that the Council has the appropriate level of:

* Security – due diligence is carried out on the loan counterparty to assess their credit strength and ability to make loan repayments. Security is also achieved by obtaining charges on assets, but could also include guarantees (e.g. Parent Company Guarantee)
* Liquidity – third party business cases to be critically assessed to identify financial performance including if the scheme has early year deficits
* Yield – reflecting market risk / return and the opportunity cost to the Council of not being able to use those funds elsewhere

Request for service investments are likely to be unique in nature and each will need to be considered on its own merits. Approval for any requests will be contained within a report setting out the purpose of the loan, the amount requested and recommended, and the terms of the re-payment (including the period the loan is to be repaid back to the Council and interest payable) and will be dealt with under the Council’s appropriate Delegations as set out within its Constitution.

The Council currently has one Service Investment, made to Mansfield Homes for which the Council is the sole shareholder, details of which are contained within the table below:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Company | Maximum loan agreed | Total amount loaned at 31 December 2020 | Interest rate payable to the Council | Amounts repaid at 31 December 2020 |
| Mansfield Homes | £8.8million | £8,603,236 | 3% | nil |