



Notice of a meeting of Cabinet

**Tuesday, 3 March 2020
6.00 pm
Pittville Room - Municipal Offices**

Membership	
Councillors:	Steve Jordan, Flo Clucas, Chris Coleman, Rowena Hay, Alex Hegenbarth, Peter Jeffries and Andrew McKinlay

Agenda

10.	CAPITAL, INVESTMENT, TREASURY AND MRP STRATEGIES AND STATEMENTS 2020/21 Report of the Cabinet Member Finance to follow	(Pages 3 - 54)

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Cheltenham Borough Council

Cabinet-3 March 2020

Council – 23 March 2020

Capital, Investment, Treasury and MRP Strategies and Statements 2020/21

Accountable member	Cabinet Member for Finance, Councillor Rowena Hay
Accountable officer	Executive Director Finance and Assets (Section 151 Officer), Paul Jones
Accountable scrutiny committee	Treasury Management Panel
Ward(s) affected	All
Key Decision	Yes
Executive summary	<p>In December 2017, CIPFA published updates to the Prudential Code and The Treasury Management Code of Practice. The new Prudential Code requires the Council to approve a Capital Strategy on an annual basis in advance of the forthcoming financial year. The Ministry of Housing, Communities and Local Government (MHCLG) have also updated statutory guidance on treasury management which has resulted in changes to the Treasury Management Strategy and the introduction of a separate Investment Strategy. For 2020/21 a new set of strategic documents require Council approval: The Council's Capital Strategy, Investment Strategy and Treasury Management Strategy.</p> <p>In accordance with best practice, the Council has adopted and complies with the CIPFA Code of Practice on Treasury Management and the Prudential Code by relevant Capital Finance Regulations.</p>
Recommendations	<p>That Council considers and approves the following :</p> <ul style="list-style-type: none"> • The Capital Strategy 2020/21 at Appendix 2 • The Investment Strategy 2020/21 at Appendix 3 • The Treasury Management Strategy Statement 2020/21 at Appendix 4 • The Minimum Revenue Provision (MRP) Statement 2020/21 at Appendix 5
Financial implications	<p>The financial implications are reported in appendices 2 – 5.</p> <p>Contact officer: Andrew Sherbourne, andrew.sherbourne@publicagroup.uk, 01242 264337</p>

Legal implications	As detailed in the report. Contact officer: Shirin Wotherspoon shirin.wotherspoon@teWKesbury.gov.uk, 01684 272696
HR implications (including learning and organisational development)	None arising directly from this report. Contact officer: Julie McCarthy, julie.mccarthy@publicagroup.uk, 01242 264355
Key risks	As noted in Appendix 1.
Corporate and community plan Implications	The purpose of the strategy is to improve corporate governance, a key objective for the Council.
Environmental and climate change implications	None arising directly from this report.
Property/Asset Implications	As detailed in appendices 2 and 3. Contact officer: Dominic.Stead@cheltenham.gov.uk

1. Background

- 1.1 Local authorities in England are legally obliged to “have regard” to the CIPFA Treasury Management Code and the Prudential Code by relevant Capital Finance Regulations.
- 1.2 Local authority investment decisions have made headlines over the past year with the financial press questioning the role of local authorities investing in property and assets as a means to generate income to compensate for the reduction in government funding. Investing in property and other assets is nothing new for Cheltenham Borough Council whom has historically held major assets such as retail sites and commercial property for some time now. In recent years however the emphasis on using these assets to generate a commercial yield has become much greater and this has involved some councils investing in property outside of its area. The scaling up of investments by local councils has been brought to the attention of the Ministry of Housing, Communities and Local Government (MHCLG) and CIPFA resulting in changes to the Treasury Management Code and the Prudential Code.
- 1.3 Following consultations in February and August 2017, CIPFA published its new 2017 guidelines of Treasury Management in the Public Services: Code of Practice and Cross-sectoral Guidance Notes and the Prudential Code for Capital Finance in Local Authorities just before the end of 2018. The Council is now required to prepare and approve four strategies/statements:
 - Capital Strategy;
 - Investment Strategy;
 - Treasury Management Strategy Statement; and a
 - MRP Statement

2. Consultation

- 2.1 Each strategy is attached at Appendices 2 - 5 based on information relating to the Council's local circumstances with accompanying information and advice supplied by the Council's treasury advisors Arlingclose Limited.
- 2.2 The Treasury Management Strategy Statement has been recommended for approval by the Treasury Management Panel at its meeting on 20th January 2020 to Council.

Report author	Contact officer: Andrew Sherbourne, andrew.sherbourne@cheltenham.gov.uk 01242 264437
Appendices	Appendix 1 – Risk Assessment Appendix 2 – Capital Strategy 2020/21 Appendix 3 – Investment Strategy 2020/21 Appendix 4 – Treasury Management Strategy Statement 2020/21 Appendix 5 – MRP Statement 2020/21
Background information	Section 15(1)(a) of the Local Government Act 2003 Cheltenham Borough Council Treasury Management Practices

The risk				Original risk score (impact x likelihood)			Managing risk				
Risk ref.	Risk description	Risk Owner	Date raised	I	L	Score	Control	Action	Deadline	Responsible officer	Transferred to risk register
	LOBO Loans - If £7m of these loans are recalled by the banks if they choose to exercise their option then we would need to have the resources on the day to repay. Alternative borrowing arrangements at today's current rates would be favourable for the Council	ED Finance & Assets Paul Jones	24 th January 2015	1	2	2	Accept	If the loans are recalled the council could take out temporary borrowing which is currently much lower than the rates on these loans. Any capital receipts available could also be used to repay debt.	May 2021	ED Finance & Assets Paul Jones	
	If the assumptions made within the strategies change, then the aspirations within the capital programme may become unaffordable.	ED Finance & Assets Paul Jones	13 th March 2019	3	2	6	Accept	The Treasury Management Strategy and Prudential and Treasury Indicators reflect various assumptions of future interest rate movements and Government support for capital expenditure. These will be continually monitored and any necessary amendments will be made in accordance with the Strategy		ED Finance & Assets Paul Jones	

	If tenants exercise break-clauses and/or not renew leases, then there may be an impact on income projections and net returns.	Simon Hodges	15 th August 2018	2	3	6	Accept	Should tenants serve notice, the Council will have 6 months prior notice to find new tenants.		Simon Hodges	
	If thorough due diligence is not undertaken when pursuing commercial property investments, the Council may not meet all of the criteria set out within its capital and investment strategies.	ED Finance & Assets Paul Jones	13th March 2019	4	2	8		Due diligence is of paramount importance. All of our commercial investments have individual business cases that are subject to thorough risk assessment and stress testing and we also stress test the whole investment portfolio to ensure all risks are captured and properly controlled. Where appropriate to the size and scale of the project we also commission independent technical, legal, accounting, risk management, property, taxation advice		Simon Hodges	

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1. INTRODUCTION

- 1.1** The purpose of the Council's Capital Strategy is to document the principles and framework that underpin its longer-term capital investment and expenditure proposals. The Capital Strategy was a new requirement for Councils to produce from April 2018 following the publication of the revised Prudential Code for Capital Finance in Local Authorities 2018.
- 1.2** Cheltenham Borough Council's Capital Strategy forms a key part of the Council's overall Corporate Planning Framework. It provides a mechanism by which the Council's capital investment and financing decisions can be aligned with the Council's over-arching corporate priorities and objectives over a medium term planning horizon.
- 1.3** The Strategy sets the framework for all aspects of the Council's capital expenditure; including planning, prioritisation, management and funding. The Strategy has direct links to the Council's Asset Management Strategy, Commercial Strategy, Investment Strategy and Treasury Management Strategy and forms a key part of the Council's Medium Term Financial Strategy (MTFS) as articulated below:

Category	Overall	Revenue	Capital	Treasury Mgmt	Risk Management
Strategies	Medium Term Financial Strategy				
	Commercial Strategy	Investment Strategy	Capital Strategy	Treasury Mgmt (TM) Strategy	Risk Management
			Asset Mgmt Strategy		
Guidance	CIPFA and Technical Guidance	Budget Guidance	Capital Guidelines	CIPFA Code for Practice for TM	Risk Management Guidance
Plans	MTFP Projection	Annual Budget	Capital Programme & Asset Mgmt Plan	Treasury Policy Statements	Risk Register
Governance	Constitution and Annual Governance Statement	Quarterly Performance Reports		Prudential Indicators and Annual Report	Risk Register reporting and regular review
	Contract and Finance Procedure Rules				Audit Committee and Cabinet Reports
	Internal and External Audit Plans and our response to audit review				
Decision making	Cabinet/Council				

- 1.4** Decisions made on capital and treasury management will have financial consequences for the Council for many years into the future.
- 1.5** In particular, the Capital Strategy demonstrates how we will deliver the 5 key priorities for the Council:
- We will work toward making Cheltenham the Cyber Capital of the UK; a national first, which will deliver investment in homes, jobs, infrastructure and enable the Council to deliver inclusive growth for our communities.
 - Deliver a number of Town Centre and wider public enhancements that will continue the revitalisation of the town ensuring its longer-term viability as a retail and cultural destination.
 - Deliver enhancements to our environmental services and develop the way we commission these services.
 - We will be seeking new opportunities to bring in additional resources e.g. introduction of Cheltenham lottery as well as leveraging more value from our assets and commissioned providers to deliver our £100m housing investment plan.
 - Improve the way services and information are accessed by residents and businesses by maximising new technology opportunities and different ways of working the outcome of which will contribute towards our financial self-sufficiency.
- 1.6** Capital expenditure is where the Council spends money on assets, such as land, property or vehicles, which will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. The Council has some limited discretion on what counts as capital expenditure, for example assets costing below £10,000 are not capitalised and are charged to revenue in year.

2. WHAT IS OUR CAPITAL STRATEGY

- 2.1** The key aims of the Capital Strategy are to:
- provide a clear context within which proposals for new capital expenditure are evaluated to ensure that all capital investment is targeted at meeting the Council's Vision and Priorities;
 - Deliver projects that focus on delivering revenue benefits in the form of spend to save, spend to earn or generate growth in revenue income;
 - set out how the Council identifies, programmes and prioritises capital requirements and proposals arising from business plans, the Asset Management Plan (AMP) and other related strategies;
 - consider options available for funding capital expenditure and how resources may be maximised to generate investment in the area and to determine an affordable and sustainable funding policy framework, whilst minimising the ongoing revenue implications of any such investment;
 - identify the resources available for capital investment over the MTFS planning period; and

- establish effective arrangements for the management of capital expenditure including the assessment of project outcomes, budget profiling, deliverability, and the achievement of Value for Money.

2.2 Put simply, our Capital Strategy aims to invest and deliver for the residents of the Borough:

- At the end of August 2019, we completed the purchase of 112 acres of strategically important land for £37.5m which forms part of the West Cheltenham JCS allocation. This was the most expensive land purchase ever made by CBC. It will enable the delivery of the Cyber Central vision – which was formally launched on 17th September 2019 at Hub8 in Cheltenham. In June 2019 the government announced that Cyber Central had been awarded ‘Garden Communities’ status
- We have invested in commercial property which provides for an ongoing sustainable income stream to deliver front-line services, whilst also having a direct impact of the safe-guarding of much needed office accommodation within the town centre;
- We are delivering the affordable homes which the market fails to provide and we will prioritise those people on our Housing Register;
- Public Realm High Street investment focussed on supporting the revitalisation of the high street, complemented by the flagship concept store opening for John Lewis, and the redevelopment of the Brewery Quarter;
- We have invested in a new suite of waste and recycling vehicles to enhance and deliver the service requested by our residents;
- We have invested and delivered a new sport and play hub at leisure@;
- We have invested in a new £8.5 million crematorium, on time and within budget, which will deliver services for future generations.

2.3 Beyond the above, our Capital Strategy will also help us meet our need to upgrade and maintain:

- Operational buildings;
- Infrastructure in the Borough;
- Our vehicle fleet;
- Our ICT infrastructure.

- 2.4** In 2020/21, the Council is planning capital expenditure of £43.938m as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure

	2018/19 actual £000	2019/20 forecast £000	2020/21 budget £000	2021/22 budget £000	2022/23 budget £000
General Fund services	10,438	8,105	2,982	600	692
Council housing (HRA)	9,479	29,846	30,076	36,976	32,082
Capital investments	43,126	28,104	10,880	-	-
TOTAL	63,043	66,055	43,938	37,576	32,774

- 2.5** The Housing Revenue Account (HRA) is a ring-fenced account which ensures that council housing does not subsidise, or is itself subsidised, by other local services. HRA capital expenditure is therefore recorded separately, and includes the aspiration to build 500 new homes.

3. CAPITAL PROGRAMME NEEDS AND PRIORITIES

- 3.1** Underlying the capital strategy is the recognition that the financial resources available to meet corporate priorities are constrained in the current economic and political climate. Central government support for revenue and capital investment has reduced significantly over the last few years. Along with these reductions is the recognition that the Council must rely more on internal resources and seek ways in which investment decisions can be either self-sustaining or generate positive returns both in terms of meeting corporate objectives and producing revenue savings.
- 3.2** The Asset Management Plan (AMP) includes significant backlog maintenance issues across the Council's property portfolio. To provide the necessary investment needed to bring them up to current standards would require a level of investment that is currently unaffordable within the revenue resources of the Council. The Council may wish to prioritise the disposal of any surplus assets which would generate capital resources via capital receipts. These receipts, alongside private sector investment, can be prioritised to maximise outputs with minimal ongoing future revenue costs.
- 3.3** Economic Investment – The Council will continue to seek investments that generate longer term growth. These projects will yield a combination of revenue generation (business rates, property rental or interest), jobs and capital infrastructure investment. Based on sound business cases the Council will aspire to make acquisitions to assist with strategic site assembly for the delivery of investment projects.
- 3.4** Housing – A significant element of past resources (capital receipts and S106 contributions) have been applied to the housing market in the Borough. This work will continue to deliver a commitment from the Cabinet to facilitate the delivery of building affordable new homes and bring void properties back into use, in partnership with Cheltenham Borough Homes. Significant progress has been made in this area and additional funds along with a strategic delivery partner will enhance this project.

- 3.5** Employment – The council is keen to work with other Government agencies and private developers to create long term employment opportunities through capital investment. Such investments will also appraise the ability to generate new business rate income.
- 3.6** Corporate Property – To reduce its backlog maintenance liability the Council needs to rationalise its office accommodation and other operational estate. This is either in the form of commercially letting an element of its existing office accommodation or through the sale of surplus assets. Such action would contribute to ongoing revenue savings and / or capital receipts respectively.
- 3.7** Leisure, Culture & Tourism - A major part of the Borough's economy is based on leisure, culture and tourism. To support such areas the Council will consider the investment in infrastructure projects that bring in significant third party investment. The Council will work with its partners to bid to attract third party funding into its offering, where available.
- 3.8** ICT – The Council will be undertaking appropriate investment and replacement into ICT hardware and software on a case by case basis along with its Publica partners. The primary focus will be on improving the use of technology on an “invest to save” basis.
- 3.9** The Council's capital investment falls within, and needs to comply with, the “Prudential Code for Capital Finance in Local Authorities” (The Code). Under the Code local authorities have greater discretion over the funding of capital expenditure especially with the freedom to determine, within the regulatory framework of the Code, the level of borrowing they wish to undertake to deliver their capital plans and programmes.
- 3.10** The Council has various mechanisms in place which seek to ensure that there is an integrated approach to addressing cross-cutting issues and developing and improving service delivery through its capital investment in pursuance of the Council's over-arching aims. These include:
- Democratic decision-making and scrutiny processes which provide overall political direction and ensure accountability for the investment in the capital programme;
 - The Council which is ultimately responsible for approving investment and the capital programme;
 - The Cabinet which is responsible for setting the corporate framework and political priorities to be reflected in the capital programme; the Cabinet will continue to receive regular performance and monitoring reports which are subject to scrutiny;
 - Officer Groups which bring together a range of service interests and professional expertise;
 - An integrated service and financial planning process, including the corporate performance management framework. Within this framework, all proposals for capital investment are required to demonstrate how they contribute to the achievement of the Council's aims and priorities. This includes an evaluation process for investment proposals which ensures cross-cutting appraisal of projects which are aligned to the Council's key aims and priorities and deliver on the efficiency and value for money agendas.

4. RESOURCING STRATEGY

- 4.1 The Council's current approach to capital financing is geared towards ensuring the maximisation of resources available to the Council. As such funding is applied in order from the following sources:
- Specific grants (e.g. Growth Fund, Better Care Fund)
 - S106 monies (developer contributions) / Partnership funding
 - Useable capital receipts
 - Revenue Contributions for Capital Outlay (RCCO)
 - Reserves
 - Prudential Borrowing
- 4.2 This enables the Council to maintain a greater degree of flexibility, as usable capital receipts can only be used to finance capital spending, whereas both revenue and reserves can be used for both capital and revenue purposes.
- 4.3 In order to progress new capital schemes not already identified within the capital programme, the Council will need to prioritise the use of available resources which could involve the disposal of existing assets or prudential borrowing on a scheme by scheme basis.
- 4.4 Whilst predominately linked to financing of the Housing Capital Programme, capital receipts derived from 'Right to Buy Sales' have been used in the past to support affordable housing provision.
- 4.5 The Prudential Code for Capital Finance in Local Authorities commenced throughout Great Britain in April 2004. The code allows councils to undertake unsupported borrowing to meet its objectives if this is considered to be affordable, prudent and sustainable, measured using prudential indicators. The code enables authorities to take greater control of their investment in the capital assets such as local authority housing, office accommodation, and infrastructure which are central to the delivery of quality local public services. The arrangements provide a flexible framework within which they can be procured, managed, maintained and developed. When considering the potential use of prudential borrowing, the Council must satisfy itself that the borrowing will be undertaken to deliver specific key priorities or be used to finance projects which will provide on-going revenue savings in excess of the financing costs (invest to save).
- 4.6 Given the pressure on the Council's revenue budget in future years, prudent use will be made of this discretion in cases where there is a clear financial benefit, such as "invest to save", "spend to earn" or major regeneration schemes which do not increase expenditure levels in the longer term.
- 4.7 Such schemes will focus on clear priorities, attracting significant third party investment and those that generate revenue benefits in future financial years - namely income, interest, council tax or business rate yield.
- 4.8 The Council will continue to consider on a cautious and prudent basis the extent to which prudential borrowing may be undertaken to fund new capital investment, which generates returns over and above the revenue costs of the debt.
- 4.9 New sources of funding are also being identified through the Local Economic Partnership (LEP) working on a County Region basis. The strategy, the outcomes of which inform the Medium Term Financial Strategy, is intended to consider all potential funding options open to the Council and to maximise the financial resources available

for investment in service provision and improvement within the framework of the MTFS.

- 4.10** The Council will continue to work with the private sector to utilise redundant assets and vacant land to bring them into a useful economic purpose to facilitate regeneration and employment creation.
- 4.11** The Council will continue to work with Local Health Partners and other public agencies to consider sharing facilities to the mutual benefit of all parties.
- 4.12** Capital receipts from asset disposal represent a finite funding source and it is important that a planned and structured manner of disposals is created to support the priorities of the Council. Cash receipts from the disposal of surplus assets are to be used to fund new capital investment as and when received. The Council's property estate is mainly held for operational service requirements and administrative buildings although it does have a significant commercial investment portfolio. This estate is managed through the Asset Management Plan which identifies property requirements and, where appropriate, properties which are surplus to requirements and which may be disposed.
- 4.13** The Council will continue to maintain a policy of not ring-fencing the use of such capital receipts to fund new investment in specific schemes or service areas, but instead, to allocate resources in accordance with key aims and priorities, subject to the following exceptions:
- capital receipts received in respect of right to buy sales will be wholly invested in the provision of additional housing;
 - any receipts from the sales of properties previously acquired for site assembly where borrowing has previously incurred will be used to repay the debt incurred on that particular acquisition.
- 4.14** Council resources will be allocated to programmes based on asset values to manage the long term yield and revenue implications. Capital receipts and reserves will be focused on those assets with short term life span (e.g. vehicles and IT investments) and the unsupported borrowing on long term assets (e.g. land and buildings).
- 4.15** All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing and leasing). The planned financing of the above expenditure is as follows:

Table 2: Capital financing

	2018/19 actual £000	2019/20 forecast £000	2020/21 budget £000	2021/22 budget £000	2022/23 budget £000
External sources	1,427	1,742	4,555	5,095	9,255
Own resources	12,327	20,607	9,253	7,880	8,836
Debt	49,289	43,706	30,130	24,601	14,683
TOTAL	63,043	66,055	43,938	37,576	32,774

- 4.16** Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP) as detailed in Appendix 5. Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and use of capital receipts are as follows:

Table 3: Replacement of debt finance

	2018/19 actual £000	2019/20 forecast £000	2020/21 budget £000	2021/22 budget £000	2022/23 budget £000
Own resources	1,465	2,233	2,313	2,434	2,469

- 4.17** The Council's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt. The CFR is expected to increase by £27.8m during 2020/21. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement

	31.3.2019 actual £000	31.3.2020 forecast £000	31.3.2021 budget £000	31.3.2022 budget £000	31.3.2023 budget £000
General Fund services	78,317	105,580	114,997	112,564	110,095
Council housing (HRA)	56,908	71,118	89,517	114,118	128,801
TOTAL CFR	135,225	176,698	204,514	226,682	238,896

- 4.18** *Asset management:* To ensure that capital assets continue to be of long-term use, the Council has an asset management strategy in place.
- 4.19** *Asset disposals:* When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. The Council is currently also permitted to spend capital receipts on service transformation projects until 2021/22. Repayments of capital grants, loans and investments also generate capital receipts. The Council plans to receive capital receipts in the coming financial year as follows:

Table 5: Capital

	2018/19 actual £m	2019/20 forecast £m	2020/21 budget £m	2021/22 budget £m	2022/23 budget £m
GF Asset sales	0.170	0.016	-	-	-
HRA Asset sales	2.849	0.900	1.500	1.500	1.500
Capital loans and grants repaid	0.856	1.035	1.152	1.135	1.140
TOTAL	3.875	1.951	2.652	2.635	2.640

5. Treasury Management

5.1 Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Council is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing. Due to decisions taken in the past, the Council currently has £160.239m borrowing at an average interest rate of 2.49% and £21.807m treasury investments at an average rate of 2.24%.

5.2 Borrowing strategy: The Council's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.75%) and long-term fixed rate loans where the future cost is known but higher (currently 2.5% to 3.5%).

5.3 Projected levels of the Council's total outstanding debt which comprises borrowing are shown below, compared with the capital financing requirement (see above).

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

	31.3.2019 actual £000	31.3.2020 forecast £000	31.3.2021 budget £000	31.3.2022 budget £000	31.3.2023 budget £000
Debt	120,595	163,294	193,802	218,443	233,173
Capital Financing Requirement	135,225	176,698	204,514	226,682	238,896

5.4 Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 6, the Council expects to comply with this in the medium term.

5.5 Liability benchmark: To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes that cash and investment balances are kept to a

minimum level of £17m at each year-end. This benchmark is currently £17m and is forecast to remain the same over the next three years.

Table 7: Borrowing and the Liability Benchmark

	31.3.2019 actual £000	31.3.2020 forecast £000	31.3.2021 budget £000	31.3.2022 budget £000	31.3.2023 budget £000
Outstanding borrowing	120,595	163,294	193,802	218,443	233,173
Liability benchmark	101,290	146,294	176,802	201,443	216,173

5.6 The table shows that the Council expects to remain borrowed above its liability benchmark. The liability benchmark is the total amount borrowed less investments held at year end or forecast. The Council wishes to have a treasury investment portfolio which achieves significant revenue income.

5.7 Affordable borrowing limit: The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. In line with statutory guidance, a lower “operational boundary” is also set as a warning level should debt approach the limit.

Table 7: Prudential Indicators: Authorised limit and operational boundary for external debt

	2019/20 limit £000	2020/21 limit £000	2021/22 limit £000	2022/23 limit £000
Authorised limit - total external debt	298,000	320,000	350,000	370,000
Operational boundary - total external debt	288,000	310,000	340,000	360,000

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

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

Table 8: Treasury management investments

	31.3.2019 actual £000	31.3.2020 forecast £000	31.3.2021 budget £000	31.3.2022 budget £000	31.3.2023 budget £000
Near-term investments	11,536	9,000	9,000	9,000	9,000
Longer-term investments	8,000	8,000	8,000	8,000	8,000
TOTAL	19,536	17,000	17,000	17,000	17,000

- 5.10 Governance:** Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Executive Director Finance Assets and his staff, who must act in line with the treasury management strategy approved by Full Council. Quarterly reports on treasury management activity are presented to cabinet. The Treasury Management Panel is responsible for scrutinising treasury management decisions.

6. THE CAPITAL PROGRAMME

- 6.1** The Capital Programme is laid out in a separate report to Cabinet and Council each financial year as part of the annual budget setting process. The report reflects the most recent forecasts of expenditure based on Government announcements.
- 6.2** Annually capital bids are invited for assessment and consideration. In preparing the annual capital programme, new schemes will be appraised using the assessment against corporate priorities and objectives business case template.
- 6.3** The annual capital programme contains a projection of the capital investment required over a 4 year period. Typically, the capital programme consists of 4 areas of expenditure (i) replacement of vehicles (ii) replacement of ICT equipment / infrastructure (iii) housing grants for disabled facilities adaptations and (iv) to enable the provision of increased affordable housing.

Investments for Service Purposes

- 6.4** The Council makes investments to assist local public services, including making loans to the Council's subsidiaries and other local service providers that provide services to promote economic growth. In light of the public service objective, the Council is willing to take more risk than with treasury investments; however, it still plans for such investments to generate a small surplus after all costs.
- 6.5 Governance:** Decisions on service investments are made by Full Council under the guidance of the Executive Director Finance and Assets. Most loans are capital expenditure and purchases will therefore also be approved as part of the capital programme.

7. PROGRAMMED MAINTENANCE

- 7.1** The Council's Planned Maintenance Programme for property is reviewed annually

and the programme includes the following types of expenditure:

- Planned – cyclical, programmed maintenance work for buildings based on regular condition surveys
- Routine – includes electrical and mechanical installation service contracts for the maintenance of infrastructure e.g. security/fire alarms and lifts
- Reactive – emergency / ad-hoc / unplanned expenditure.

7.2 The Council budgets for an annual revenue contribution of £470k (2020/21) to the Planned Maintenance Reserve and an £200k contribution (2020/21) to the Capital Reserve. In order to assess the longer-term maintenance obligations, it is considered necessary for a programme covering the next 10 years to be estimated to ensure adequate resources are in place to mitigate known and expected liabilities. It should be noted that maintenance expenditure can only be funded from revenue sources.

8. COMMERCIAL ACTIVITIES

8.1 Local authorities have a key role in facilitating the long term regeneration and economic growth of their local areas and they may wish to hold investments to facilitate this. When determining whether to acquire, the Council needs to recognise the contribution the asset will make. The contribution could be classified as direct service delivery and/or place-making, for example economic growth, business rates growth, responding to market failure or sustainability of certain asset classifications.

8.2 With central government financial support for local public services declining, the Council invests in commercial property mainly for financial gain. Total commercial investments are currently valued at £76.309m, providing a net return after all costs of 4.19% for 2019/20 and a predicted return of 4.44% for 2020/21. The net yield is calculated to be 5.25% for both 2019/20 and 2020/21.

8.3 With financial return being the main objective, the Council accepts higher risk on commercial investment than with treasury investments. The Priorities for the Council when acquiring property interests for investment purposes are detailed below and each property will be assessed on a case by case basis:

- **Covenant Strength** - in the case of a let property, the quality of the tenant and, more importantly, their ability to pay the rent on time and in full. The Council's primary reason and objective for this strategy is financial gain. It is however worth noting that the Council, as a public body, may not wish to invest in properties where the occupiers are generally seen to be undertaking a business which is contrary to its corporate values.
- **Lease length** - in the case of a let property, the unexpired length of the term of the lease or a tenant's break clause is of key importance in ensuring that the landlord's revenue stream is uninterrupted. The Council will take into consideration the risks associated with a tenant vacating and the potential to attract good quality replacement tenants at acceptable rental levels. Generally occupiers are moving away from 25 year leases which were more common back in the late twentieth century with 10 to 15 years now becoming more acceptable unless some form of lease break provisions are included in favour of the tenant.
- **Rate of return** - the rate of return from the property (for example through annual rental incomes) will need to be equivalent or better to the returns that could be earned from alternate investments, such as placing monies on deposit, following adjustment for risks and potential growth. The property will also need to produce an annual return in excess of the cost of PWLB borrowing or any other institution (principle and interest payments). The Council will therefore aim to achieve a

minimum net yield of 5%, excluding the cost of debt financing (principle and interest) but including other expenses.

- **Risk** - rate of return needs to be balanced against risk. In general, the higher the return from an investment, the higher level of risk that it carries. For example, a higher return may lead to longer voids at lease end or lower covenant strength of tenant and therefore higher risk of default, or over-rented against current market rents and risk of lower future income.
- **Lease Terms** - The terms of leases vary and even those held on an "Institutionally acceptable basis" can be very different in nature particularly as such leases have developed over time. The Council is seeking to invest in modern leases with full repairing and insuring obligations on the Tenant and a full Service Charge recovery to include any management fees where applicable. This will ensure a certain income/return to the Council.
- **Growth** - property has the potential for both revenue and capital growth. The Council will take into account that potential when assessing the strength of the investment opportunity. Property values can fall as well as rise and mechanisms to minimise revenue reductions should be identified. Generally the nature of standard, institutional leases is that rent review clauses are upward only which protects landlords from any downward pressure on rental income giving some security as to the level of income. However, this can lead to over-renting in a downward market and the Council needs to be aware of this at lease end or tenant forfeiture.
- **Location** - should a tenant default or vacate, the location of the property is the key factor in influencing the ability to re-let and find another tenant. Location is also important when considering future redevelopment or regeneration opportunities. The Council will be able to undertake inspections and to deal with any management issues without the need to employ specialists or agents. Preference should be given to properties located within Cheltenham or in close proximity such as Gloucestershire Airport. This does not prevent investment outside of Cheltenham, subject to the appropriate justification and business case and correct governance procedure.
- **Sector** - information as to the sector of use of the property (e.g. office, retail, industrial, leisure) will assist in deciding on the risks associated with specific properties and the mix of sectors within the portfolio. It is essential that the overall portfolio is balanced with no overall exposure to one particular asset classification.
- **Building Age and Specification** - in the case of a let property, whilst the Council, as an investor, may be principally concerned with the characteristics of the tenant and lease, the age and specification of the property will also affect the ability of the Council to let or sell the property in the future, or the costs incurred to bring the property up to a lettable standard at the end of an existing lease. It must also be taken into consideration in respect of the cost of protecting the investment. An example of this would be the undertaking of repairs and refurbishment if the cost cannot be fully recovered from the tenant. Any permitted development rights will also be a consideration for the future.

8.4 In summary, the strategy for acquiring investment property assets is therefore to:

- Seek property let to tenants who are of strong covenant strength and sound financial standing with at least more than five years remaining on an FRI lease.
- Minimise risk.
- Maximise rental income and minimise management costs to ensure the best return is generated, thus making a positive contribution to the MTFS.
- Identify opportunities for future growth, redevelopment or regeneration via property in commercially popular or development areas.

- Prioritise Cheltenham.
- Pursue opportunities to increase returns and improve the investment value of commercial assets.

8.5 Governance: Decisions on commercial investments are made by the Cabinet and Full Council in line with the criteria and limits approved by Full Council in December 2016. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme.

8.6 Further details on commercial investments and limits on their use are on pages 2 of the investment strategy report.

9. Revenue Budget Implications

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

Table 9: Prudential Indicator: Proportion of financing costs to net revenue stream

	2018/19 actual	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget
Financing costs (£m)	3.134	3.889	4.002	4.002	4.002
Proportion of net revenue stream	6.26%	9.46%	9.59%	9.58%	9.58%

9.2 Sustainability: Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 50 years into the future. The Executive Director Finance and Assets is satisfied that the proposed capital programme is prudent, affordable and sustainable as detailed in paragraph 10.4 below.

10. CONCLUSION

10.1 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Executive Director Finance and Assets is a qualified accountant of fellowship status with over 20 years' experience. The Managing Director Place and Growth has over 30 years' experience in regeneration and development industry, and has worked in both the private and public sectors, in a delivery and advisory capacity. The Head of Property Services and Asset Management has over 25 years' experience in the public/private retail estate market. The Council pays and actively encourages staff to study towards relevant professional qualifications.

10.2 Where Council employed staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The

Council currently employs Arlingclose Limited as treasury management advisers. The Council employs other specialist advisers to advise upon specific, extra-ordinary transactions as required. Examples of such transactions include property acquisitions, and loans to third parties. This approach is more cost effective than employing such staff directly, and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

- 10.3** Given that the Council's capital resources are diminishing, the importance of working with external partners to jointly fund schemes is recognised. The Council has well established working relationships with other major public service bodies at a single-service level, for instance the provision of new affordable housing, where the Council not only works with Cheltenham Borough Homes and the other Housing Authorities in Gloucestershire, but also with active Registered Social Landlords and the private sector.
- 10.4** All capital investment must be sustainable in the long term through revenue support by the Council or its partners. All capital investment decisions consider the revenue implication both in terms of servicing the finance and running costs of the new assets. The impact of the revenue implications is a significant factor in determining approval of projects. The use of capital resources has been fully taken into account in the production of the Council's MTFS.
- 10.5** The Council continues to make significant strides forward in ensuring that a more coherent approach to capital planning and asset management is taken.

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Investment Strategy Report 2020/21

Cheltenham Borough Council

Introduction

The Authority 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 (known as **treasury management investments**),
- to support local public services by lending to other organisations (**service investments**), and
- to earn investment income (known as **commercial investments** where this is the main purpose).

This investment strategy for 2020/21 meets the requirements of statutory guidance issued by the government in January 2018, and focuses on the second and third of these categories.

Treasury Management Investments

The Authority typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure. These activities lead to a cash surplus at various points of the year which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy. The balance of treasury management investments is expected to fluctuate between £26.3m and £32.0m during the 2020/21 financial year.

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

Further details: Full details of the Authority's policies and its plan for 2020/21 for treasury management investments are covered in a separate document – the treasury management strategy - which is available via the Council's website.

Service Investments: Loans

Contribution: Subject to a business case, the Council will lend money to its subsidiaries. The Council also lends money to support local public services and stimulate local economic growth. These include loans to organisations and residents within the Borough which support the priorities of the Council.

Security: The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Authority, upper limits on the outstanding loans to each category of borrower have been set as below in table 1. Most of the loans made in the past have been to subsidiaries Cheltenham Borough Homes (CBH) and Gloucestershire Airport which is 50% shared with Gloucester City Council.

Table 1: Loans for service purposes in £

Category of borrower	31.3.2019 actual £			2020/21
	Balance owing	Loss allowance	Net figure in accounts	Approved Limit
Charities	563,989	-	563,989	700,000
Cheltenham Borough Homes	6,520,875	-	6,520,875	107,000,000
Gloucestershire Airport	511,141	-	511,141	1,750,000

Accounting standards require the Authority to set aside loss allowance for loans, reflecting the likelihood of non-payment. The loans that the Council has made are limited to specific service areas and subsidiaries and the likelihood of non-payment is minimal. There is no history of non-payment and no evidence to suggest that there will be any default against the loans granted. As a result, no allowance for loss has been included against the loan balances. Should any indication be given that there is a risk of default then the risk will be assessed and a provision established at that time. Should a loan default, the Authority will make every reasonable effort to collect the full sum lent and recover any overdue repayments.

In addition to the loans granted the Council has included provision in its Treasury Management Strategy to loan up to £500,000 to both Ubico Limited and Cheltenham Borough Homes (CBH) and up to £100,000 to Publica Group (Support) Limited, Cheltenham Festivals, The Cheltenham Trust and Cheltenham BID should any company require our support. The Council is a shareholder in Gloucestershire Airport, Ubico and SWAP (South West Audit Partnership) and a shared owner in Publica. In these cases, the loan facility is to enable the Council to be able to provide a loan for short-term cash flow purposes.

Risk assessment: The Authority assesses the risk of loss before entering into and whilst holding service loans by undertaking credit checks and ensuring that appropriate legal documentation is in place to secure the Council's money.

The Council also receives independent financial advice on its financial dealings from Arlingclose Limited.

Service Investments: Shares

Contribution: The Council has a £1 shareholding in Ubico Ltd. Ubico Ltd is wholly-owned by seven local authorities and operates as a not for profit enterprise. Ubico Ltd is an environmental services company which provides household and commercial refuse collection, recycling, street cleansing, grounds maintenance and fleet maintenance services to the Council. Also the Council has £435,222 shareholding in Gloucestershire Airport which equates to 50%. The other 50% is retained by Gloucester City Council.

Security: One of the risks of investing in shares is that they could fall in value meaning that the initial outlay may not be recovered. The Council has no other shareholdings.

Table 2: Shares held for service purposes in £

Category of company	31.3.2019 actual £		
	Amounts invested at cost	Gains or losses	Value in accounts
UBICO	1	-	1
Gloucestershire Airport	435,222	1,264,778	1,700,000
TOTAL	435,223	1,264,778	1,700,001

Risk assessment: the Council has not invested into Ubico or Gloucestershire Airport to generate a financial return. The Council has invested purely to support service provision. Ubico is a cost sharing company – any surplus generated within Ubico is returned to the partner Councils [shareholders] similarly with any deficit met by the Councils. Through regular budget monitoring and sound financial management by Ubico and transparency within calculation of contract sums, the risk of any financial loss is mitigated.

Liquidity: the Council has not invested into Ubico or Gloucestershire Airport to generate a financial return. The Council has invested purely to support service provision. The Council has no intention to dispose of its investment in the foreseeable future.

Non-specified Investments: Shares are the only investment type that the Authority has identified that meets the definition of a non-specified investment in the government guidance. The limits above on share investments are therefore also the Authority's upper limits on non-specified investments. The Authority has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition. The fair value of Gloucestershire Airport has not yet been assessed, however is likely to be significantly in excess of the cost of the shares as indicated in table 2 above.

Commercial Investments: Property

Investment Property is defined in the CIPFA code of practice on Local Authority Accounting as property (land or buildings, or both) held solely to earn rentals or for capital appreciation, or both. The Council holds a number of assets which it classifies as Investment Properties.

Contribution: The Council owns a number of Investment Properties within Cheltenham, with the intention of generating a revenue income to support the revenue budget.

Table 3: Property held for investment purposes in £ (including HRA Investment properties)

Property	Purchase Price	01.4.18	31.3.2019 actual £		31.3.2020
		Value in accounts £	Purchases, Gains or (losses)	Value in accounts £	Expected value* £
Investment Property within Cheltenham	Various	35,320,000	40,673,000	75,993,000	104,097,200

**During 2019/20 the council purchased land to develop, costing £39.6m, of which £28.1m (the General Fund proportion) is classified as Investment property, the value of which at 31st March 2020 is currently being assessed for the year end accounts.*

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

A fair value assessment of the Authority's investment property portfolio is made each year as part of the final accounts process. Investment Property is valued at market value.

The fair value of the Authority's investment property portfolio is included in the Statement of Accounts, based upon 'market value'. The Council's Investment Property is held primarily to generate a stable income stream to support the revenue budget. Should a property be sold any profit/loss on disposal will be recognised at that point. The Council has no plans to dispose of any Investment Property in the near future.

Risk assessment: The Council aims to generate a revenue return from its Investment Property assets which is greater than the return generated by its Treasury Management activity. It is understood that the fair value of property will fluctuate, although it is anticipated that the revenue returns in 2020/21 will remain constant. The Authority assesses the risk of movement in asset values before entering into and whilst holding property investments and mitigates the risk by purchasing property with secure tenants on long leases.

Liquidity: Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. To ensure that the Council has cash funds that can be accessed when they are needed, the Treasury management policy includes the provision of liquid investments should the Council be in need of cash. It is not anticipated that the Council would need to sell any Investment Property at short notice.

Loan Commitments and Financial Guarantees

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

The Authority is a shareholder of Ubico Ltd and Gloucestershire Airport Ltd, and owner by guarantee and is a joint partner in Publica Group (Support) Limited (¼ owner). In both cases, should the company overspend the Council would be liable for its share of the additional costs. In both companies, sound financial management and budgetary control mitigate the risk that additional sums will be required without adequate notice.

Proportionality

The Authority is dependent on investment activity to achieve a balanced revenue budget. Table 4 below shows the extent to which the General Fund expenditure planned to meet the service delivery objectives of the Authority is dependent on achieving the expected income from treasury investments over the lifecycle of the Medium Term Financial Plan. Should it fail to achieve the expected income targets, the Authority will be required to draw additional balances from reserves, or generate savings elsewhere within the budget to continue to provide its services.

Table 4: Proportionality of Investments in £

	2018/19 Actual	2019/20 Forecast	2020/21 Budget	2021/22 Forecast	2022/23 Forecast
Gross service expenditure*	35,498,605	35,720,115	34,904,403	35,602,491	36,314,541
Investment income	3,125,720	4,996,209	4,851,409	4,851,409	4,851,409
Proportion	8.8%	13.99%	13.9%	13.6%	13.4%

* Excluding Housing Benefit payments.

Borrowing in Advance of Need

Government guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. The Authority has plans to borrow in 2020/21 to invest in new capital schemes. Any funds borrowed will be in relation to specific schemes and based upon the cash required for the chosen schemes. There are no plans to borrow in advance of need.

Capacity, Skills and Culture

Summary of knowledge and skills available to the authority:

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Executive Director Finance and Assets is a qualified accountant of fellowship status with 20 years' experience. The Managing Director Place and Growth has over 30 years' experience in regeneration and development industry, and has worked in both the private and public sectors, in a delivery and advisory capacity. The Head of Property Services and Asset Management has over 25 years' experience in the public/private retail estate market. The Council pays and actively encourages staff to study towards relevant professional qualifications.

Where Council employed staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers. The Council employs other specialist advisers to advise upon specific, extra-ordinary transactions as required.

Examples of such transactions include property acquisitions, and loans to third parties. This approach is more cost effective than employing such staff directly, and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

The Council has experience of investing in commercial property in recent years. The Council's property service's officers have the following qualifications or status:

- BSc Hons Real Estate Management
- Member Royal Institute Chartered Surveyors
- Royal Institute Chartered Surveyors Registered Valuer
- Member Chartered Institute of Public Finance and Accountancy

The Council's legal team, provided by One Legal, have experience of carrying out legal due diligence checks, particularly for commercial property acquisitions, and the legal officers have the following qualifications or status:

- Chartered Legal Executive
- Solicitor
- Para-Legals

The Property and Legal teams work together with the Finance team to support the Council's Executive Director Finance and Assets in developing investment proposals for the Council. External specialist advice is obtained when required to support these teams.

The Council has previously invested in a range of diversified commercial properties which are delivering a sustainable revenue stream to the Council. Any further investment in non-treasury management transactions will be set out in this, or future iterations of this strategy.

Scrutiny Arrangements:

The Cabinet will make decisions or make recommendations to full Council on new investments that are not part of Treasury Management Activity.

Financial Performance is reported quarterly to Cabinet. This will include the financial performance of the Treasury management function and any other revenue generating investments.

Treasury Management performance is reported at half-year and year-end to the Treasury Management Panel and to full Council.

The Council's internal audit provider (South West Audit Partnership Ltd) regularly audits the Council's treasury management activity and its processes and procedures for approving investment and performance management. SWAP report to the Council's Audit Committee.

Investment Indicators

The Authority has set the following quantitative indicators to allow elected members and the public to assess the Authority's total risk exposure as a result of its investment decisions.

Total risk exposure: The first indicator shows the Authority's total exposure to potential investment losses. This includes amounts the Authority is contractually committed to and any guarantees the Authority has issued over third party loans.

Table 5: Total investment exposure in £

Total investment exposure	31.03.2019 Actual	31.03.2020 Forecast	31.03.2021 Forecast
Treasury management investments	19,493,550	19,000,000	19,000,000
Service investments: Loans	7,834,503	7,434,135	7,170,599
Service investments: Shares (at cost)	435,224	435,224	435,224
Commercial investments: Property	75,993,000	104,087,400	115,817,820
TOTAL INVESTMENTS	103,756,277	130,956,759	142,423,643
Commitments to lend ¹	-	-	-
TOTAL EXPOSURE	103,756,277	130,956,759	142,423,643

¹ This excludes the potential loan facility offered to Ubico Limited, Publica Group (Support) Limited and Cheltenham Trust for cash flow purposes.

How investments are funded: Government guidance is that these indicators should include how investments are funded. The Council's plans for borrowing are limited to a small number of schemes – which are primarily for service delivery – which do not form part of this report. As a result, investments funded by borrowing can be presented as follows:

Table 6: Investments funded by borrowing in £

Investments funded by borrowing	31.03.2019 Actual	31.03.2020 Forecast	31.03.2021 Forecast
Treasury management investments	-	-	-
Service investments: Loans	7,834,503	7,434,135	7,170,599
Service investments: Shares	-	-	-
Commercial investments: Property	52,553,048	79,527,259	90,102,936
TOTAL FUNDED BY BORROWING	60,387,551	86,961,394	97,273,535

Rate of return received: This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the

sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Table 7: Investment rate of return (net of all costs)

Investments net rate of return	2018/19 Actual	2019/20 Forecast	2020/21 Forecast
Treasury management investments	1.85%	2.00%	2.00%
Service investments: Loans			
Cheltenham Borough Homes	3.93%	3.93%	3.93%
Gloucestershire Airport	1.80%	1.80%	1.80%
Everyman Theatre	3.93%	3.93%	3.93%
St Margarets Hall	3%	3%	3%
Service investments: Shares	0%	0%	0%
Commercial investments: Property yield/contribution (net of borrowing)	£1,747,275	£3,194,651	£3,390,745
Commercial investments: Property	5.24%	4.19%	4.44%

Net Yield: This indicator calculates the annual profit (income minus costs) generated by an asset, divided by its price. The costs that you would normally consider include agent fees, insurance, an allowance for repairs, an allowance for voids (the property being empty), service charge and ground rent. In order to provide consistency across the property portfolio, net yield is used to assess the returns.

Table 8: Net yield on commercial property investments

Net Yield	2018/19 Actual	2019/20 Forecast	2020/21 Forecast
Commercial investments: Property	5.86%	5.25%	5.25%

TREASURY MANAGEMENT STRATEGY STATEMENT 2020/21

1. Introduction

Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Authority's prudent financial management.

Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy.

2. Economic Background

The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2020/21.

UK Consumer Price Inflation (CPI) for November registered 1.5% year on year, unchanged from the previous month. Core inflation, which excludes the more volatile components, was also 1.5% in November. The most recent labour market data for the three months to October 2019 showed the unemployment rate remained at 3.8% while the employment rate was 76.2%, just above recent record-breaking highs. The headline 3-month average annual growth rate for pay was 3.2% in October as wages dipped steadily. In real terms, after adjusting for inflation, pay growth decreased to 3.5%.

GDP growth rose by 0.3% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.0% from 1.2%. Services and construction added positively to growth, by 0.6% and 0.4% respectively, while production was flat and agriculture recorded a fall of 0.2%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

The Bank of England maintained Bank Rate to 0.75% in December following a 7-2 vote by the Monetary Policy Committee. Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report suggest the Committee may now be less convinced of the need to increase rates even with the Brexit deal.

Growth in Europe remains soft, driven by a weakening German economy which saw GDP fall -0.1% in Q2 and is expected to slip into a technical recession in Q3. Euro zone inflation was 0.8% year on year in September, well below the European Central Bank's target of 'below, but close to 2%' and leading to the central bank holding its main interest rate at 0% while cutting the deposit facility rate to -0.5%. In addition to maintaining interest rates at ultra-low levels, the ECB announced it would recommence its quantitative easing programme from November.

In the US, the Federal Reserve began easing monetary policy again in 2019 as a pre-emptive strike against slowing global and US economic growth on the back on of the ongoing trade war with China. At its last meeting the Fed cut rates to the range of 1.50-1.75% and financial markets expect further loosening of monetary policy in 2020. US GDP growth slowed to 1.9% annualised in Q3 from 2.0% in Q2.

3. Credit outlook

Credit conditions for larger UK banks have remained relatively benign over the past year. The UK's departure from the European Union was delayed three times in 2019 and while there remains some concern over a global economic slowdown, this has yet to manifest in any credit issues for banks. Meanwhile, the post financial crisis banking reform is now largely complete, with the new ringfenced banks embedded in the market.

Challenger banks hit the news headlines in 2019 with Metro Bank and TSB Bank both suffering adverse publicity and falling customer numbers.

Looking forward, the potential for a "no-deal" Brexit and/or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits remains advisable.

4. Interest rate forecast

The Authority's treasury management adviser Arlingclose is forecasting that Bank Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be significantly weighted to the downside, particularly given the recent general election, the need for greater clarity on Brexit and the continuing global economic slowdown. The Bank of England, having previously indicated interest rates may need to rise if a Brexit agreement was reached, stated in its December Monetary Policy Report and its Bank Rate decision (7-2 vote to hold rates) that the MPC now believe this is less likely even in the event of a deal.

Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose's interest rate projections. The central case is for 10-year and 20-year gilt yields to rise to around 1.00% and 1.40% respectively over the time horizon, with broadly balanced risks to both the upside and downside. However, short-term volatility arising from both economic and political events over the period is a near certainty.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix A.

For the purpose of setting the budget, it has been assumed that new treasury management investments will be made at an average rate of 0.70% to 0.80%.

5. Balances

On 31st December 2019, the council held £160.239m of borrowing and £17.738m of investments. This is set out in further detail at Appendix 2. Forecast changes in these sums are shown in the balance sheet analysis in the table below.

Table 1: Balance sheet summary and forecast

	31.3.19 Actual £m	31.3.20 Estimate £m	31.3.21 Forecast £m	31.3.22 Forecast £m	31.3.23 Forecast £m
General Fund CFR	78,317	105,580	114,997	112,564	110,095
Housing (HRA) CFR	56,908	71,118	89,517	114,118	128,801
Total CFR	135,225	176,698	204,514	226,682	238,896
Less: Usable reserves	(28,712)	(20,816)	(13,254)	(13,254)	(13,254)
Less: Working capital	(5,454)	(1,500)	(1,500)	(1,500)	(1,500)
Net borrowing	101,059	154,382	189,760	211,928	224,142

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 Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. The Authority has an increasing CFR due to the HRA capital programme, but minimal investments and will therefore be required to borrow up to £71m over the forecast period.

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2020/21.

6. Borrowing Strategy

6.1 The Authority currently holds £160.239m of loans, an increase on the previous year, as part of its strategy for funding previous year's capital programmes by temporary loans. The balance sheet forecast in table 1 shows that the Authority expects to borrow up to £23m in 2020/21 in respect of asset purchases for the HRA. The Authority may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £233m for 2020/21.

The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs

over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.

Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal or short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2020/21 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

Alternatively, the Authority may arrange forward starting loans during 2020/21, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the Authority may borrow short-term loans to cover unplanned cash flow shortages.

6.2 Sources of borrowing:

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

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except our local) Pension Fund
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

Public Works Loan Board: The Authority has previously raised the majority of its long-term borrowing from the PWLB but the government increased PWLB rates by 1% in October 2019 making it now a relatively expensive option. The Authority will now look to borrow any long-term loans from other sources including banks, pension funds and local

authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.

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

LOBOs: The Authority holds £7m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. £2m of these LOBOS have options during 2020/21, and although the Authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Authority will take the option to repay LOBO loans at no cost if it has the opportunity to do so.

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

Debt rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

7. Investment Strategy

7.1 Introduction

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has averaged from as high as £30m and as low as £14m over the last twelve months.

7.2 Objectives

Both the CIPFA Code requires the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from

defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

7.3 Negative interest rates

If the UK enters into a recession in 2020/21, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Given the increasing risk and low returns from short-term unsecured bank investments, the Authority aims to remain with a diversified investment portfolio. This is especially the case for the estimated £8m that is available for longer-term investment. The majority of the Authority's surplus cash is currently invested in short-term unsecured bank deposits, certificates of deposit, money market funds and Pooled Funds. This diversification will represent a continuation of the strategy over the coming year.

Approved counterparties: The Authority may invest its surplus funds with any of the counterparty types in table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 2: Approved investment counterparties and limits

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£6m 5 years	£6m 20 years	£7m 50 years	£5m 20 years	£5m 20 years
AA+	£6m 5 years	£6m 10 years	£7m 25 years	£4m 10 years	£5m 10 years
AA	£6m 4 years	£6m 5 years	£7m 15 years	£4m 5 years	£5m 10 years
AA-	£6m 3 years	£6m 4 years	£7m 10 years	£3m 4 years	£5m 10 years
A+	£6m 2 years	£6m 3 years	£7m 5 years	£3m 3 years	£5m 5 years
A	£6m 13 months	£6m 2 years	£6m 5 years	£3m 2 years	£3m 5 years
A-	£6m 6 months	£6m 13 months	£5m 5 years	£2m 13 months	£3m 3 years
None	£2m 6 months	£2m 6 months	n/a	n/a	n/a
MMF Pooled funds	£3m per fund £5m per fund manager				

7.4 Credit rating

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

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

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

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment as part of a diversified pool in order to spread the risk widely.

Registered providers: Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing, formerly known as housing associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services; they retain the likelihood of receiving government support if needed.

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

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available

for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

Operational bank accounts

The Council banks with Lloyds (Lloyds Banking Group). On adoption of this Strategy, it will meet the minimum credit criteria of A- (or equivalent) long term. It is the Council's intention that even if the credit rating of Lloyds Bank falls below the minimum criteria A- the bank will continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements.

Policy investments

Over the years the Authority has provided cash-flow cover for a number of third-party organisations linked to the Authority. The following limits are set for 2018/19:

• Cheltenham Festivals	£100k up to one year duration
• Gloucestershire Everyman Theatre	£100k up to one year duration
• Ubico Limited	£500k up to one year duration
• Cheltenham BID	£100k up to one year duration
• The Cheltenham Trust	£100k up to one year duration
• Publica Group	£100k up to one year duration
• Cheltenham Borough Homes	£97m Non-specified duration*
• Cheltenham Borough Homes	£10m Equity Non- Specified duration**
• Cheltenham Borough Homes	£500k up to one year
• Gloucestershire Airport Limited	£1.75m Non-specified duration
• Folk2Folk (Peer to Peer lending)	£75k Non-specified duration***

*Cheltenham Borough Homes is looking to borrow £90m and a further **£10m Equity Investment from the council to assist in three areas over the coming years to provide substantial new housing in the town by providing Private Rented Sector (PRS) housing, purchasing 106 sites and building new homes. The drawdown of the loans will be over a period of 40 years.

***Folk2Folk is a peer to peer lending platform in which the council can lend to support local, rural and entrepreneurial businesses. The investment limit will be £75,000 (in total) up to a maximum of 5 years. Interest rates earned can be between 4.5% and up to 9% per annum.

Renewable Energy investments

Over recent years significant investments from Local Authorities in the Renewable Energy markets has occurred by way of investing in an energy bond. Currently the council has approved the use of Corporate Bonds and has used them on a regular basis but only for a maximum of two years previously. To be able to potentially invest in Green Renewable energy recommendation was made following consultation with members of the Treasury Management Panel on the 5th June 2017 and approved by Council on 24th July 2017 that up to £2m in relation to Green Investment bonds can be invested up to 5 years.

7.5 Risk assessment and credit ratings

Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

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

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

7.6 Other information on the security of investments

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

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

7.7 Specified investments

The CLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,

- not defined as capital expenditure by legislation, and
- invested with one of:
 - the UK Government,
 - a UK local authority, parish council or community council, or
 - a body or investment scheme of “high credit quality”.

The Authority defines “high credit quality” organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds “high credit quality” is defined as those having a credit rating of A- or higher.

7.8 Non-specified investments

Any investment not meeting the definition of a specified investment is classed as non-specified. The Authority does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in table 3 below.

Table 3: Non-specified investment limits

	Cash limit
Total long-term investments	£15m
Total investments without credit ratings or rated below A- (except UK Government and local authorities)	£10m
Total investments (except pooled funds) with institutions domiciled in foreign countries rated below AA+	£10m

7.9 Investment limits

The Authority’s revenue reserves available to cover investment losses are forecast to be £22.3 million on 31st March 2020. In order that no more than 25% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £6 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers’ nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£6m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£6m per group
Any group of pooled funds under the same management	£5m per manager
Foreign countries	£4m per country
Registered providers	£5m in total
Unsecured investments with building societies	£5m in total
Loans to unrated corporates – Renewable Energy	£4m in total-£2m max in each
Money Market Funds	£10m in total

7.10 Liquidity management

The Authority uses purpose-built cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium term financial plan and cash flow forecast.

8. Non-Treasury Investments

Although not classed as treasury management activities and therefore not covered by the CIPFA Code or the CLG Guidance, the Authority may also purchase property for investment purposes and may also make loans and investments for service purposes. Such loans and investments will be subject to the Authority's normal approval processes for revenue and capital expenditure and need not comply with this treasury management strategy.

9. Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

9.1 Security

The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	Target
Portfolio average credit rating	A

Interest rate exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

	2019/20	2020/21	2021/22
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	50%	50%	50%

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

Maturity structure of borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and within 20 years	100%	0%
20 years and within 30 years	100%	0%
30 years and within 40 years	100%	0%
40 years and above	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal sums invested for periods longer than 364 days: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

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

10. Other Items

There are a number of additional items that the Authority is obliged by CIPFA or MHCLG to include in its Treasury Management Strategy.

10.1 Policy on the use of financial derivatives

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

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

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

10.2 Policy on apportioning interest to the HRA

On 1st April 2012, the Authority notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow

(adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured each year and interest transferred between the General Fund and HRA at the Authority's average interest rate on investments, adjusted for credit risk.

10.3 Markets in Financial Instruments Directive

The Authority has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

10.4 Investment training

The needs of the Authority's treasury management staff for training in investment management are assessed as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

Officers regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA.

10.5 Investment advisers

The Authority appointed Arlingclose Limited as treasury management advisers for three years plus the option for a further two years after a joint tender with Gloucestershire County Council, South Gloucestershire Council and the Forest of Dean District Council back in December 2017. The Authority receives specific advice on investment, debt and capital finance issues.

10.6 Investment of money borrowed in advance of need

The Authority may, from time to time, borrow in advance of need, where this is expected to provide the best long-term value for money. Since amounts borrowed will be invested until spent, the Authority is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Authority's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £320m. The maximum period between borrowing and expenditure is expected to be two years, although the Authority is not required to link particular loans with particular items of expenditure.

10.7 Financial Implications

The budget for investment income in 2020/21 is £437k, based on an average investment portfolio of £22 million at an interest rate of 2.00%. On top of this interest received on third parties loans amounts to £266k. The budget for debt interest to be paid in 2020/21 is forecast to be £4.002 million, based on an average debt portfolio of £160m at an average interest rate of 2.5%. The HRA will reimburse the General Fund £1.784m for its share of the debt it holds as at 1st April 2020. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

10.8 Alternative options

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer, having consulted the Cabinet Member for Finance, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Annex A – Arlingclose Limited Economic & Interest Rate Forecast December 2019

Underlying assumptions:

- The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased.
- Some positivity on the trade negotiations between China and the US has prompted worst case economic scenarios to be pared back. However, information is limited, and upbeat expectations have been wrong before.
- The new conservative UK government will progress with achieving Brexit on 31st January 2020. The more stable political environment will prompt a partial return in business and household confidence in the short term, but the subsequent limited Brexit transitional period, which the government is seeking to enforce, will create additional economic uncertainty.
- UK economic growth has stalled in Q4 2019. Inflation is running below target at 1.5%. The inflationary consequences of the relatively tight labour market have yet to manifest, while slower global growth should reduce the prospect of externally driven pressure, although escalating geopolitical turmoil could continue to push up oil prices.
- The first few months of 2020 will indicate whether the economy benefits from restored confidence. The government will undertake substantial fiscal easing in 2020/21, which should help support growth in the event of a downturn in private sector activity.
- The weak outlook for the UK economy and low inflation has placed pressure on the MPC to loosen monetary policy. Two MPC members voted for an immediate cut in the last two MPC meetings of 2019. The evolution of economic data and political moves over the next few months will inform policy, but upside risks to Bank Rate are very limited.
- Central bank actions and escalating geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- Although Arlingclose have maintained the Bank Rate forecast at 0.75% for the foreseeable future, there are substantial risks to this forecast, dependant from the government's policy around Brexit and the transitionary period.
- Arlingclose judges that the risks are weighted to the downside.
- Gilt yields remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy.
- We expect gilt yields to remain at relatively low levels for the foreseeable future and judge the risks to be broadly balanced.

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.21
Arlingclose Central Case	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.73
3-month money market rate														
Upside risk	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.25
Arlingclose Central Case	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.73
1yr money market rate														
Upside risk	0.10	0.20	0.20	0.20	0.20	0.20	0.20	0.25	0.30	0.30	0.30	0.30	0.30	0.23
Arlingclose Central Case	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85
Downside risk	-0.30	-0.50	-0.55	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.60
5yr gilt yield														
Upside risk	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.45	0.45	0.45	0.37
Arlingclose Central Case	0.50	0.50	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.57
Downside risk	-0.35	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.56
10yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	0.37
Arlingclose Central Case	0.75	0.75	0.80	0.80	0.85	0.85	0.90	0.90	0.95	0.95	1.00	1.00	1.00	0.88
Downside risk	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.45
20yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	0.37
Arlingclose Central Case	1.20	1.20	1.25	1.25	1.25	1.30	1.30	1.30	1.35	1.35	1.35	1.40	1.40	1.30
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.45
50yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	0.37
Arlingclose Central Case	1.20	1.20	1.25	1.25	1.25	1.30	1.30	1.30	1.35	1.35	1.35	1.40	1.40	1.30
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.45

Appendix B – Existing Investment Position

	31 st December 2019 Actual Portfolio £m	31 st December 2019 Average Rate %
Treasury investments:		
Banks & building societies (unsecured)	8.258	0.86
Government (incl. local authorities)	2.000	1.00
Glos Airport	0.450	3.75
Money Market Funds	0.030	0.70
Other pooled funds		
CCLA Property Investment Management	3.000	4.34
CCLA Diversified Income	2.000	3.20
Schroders Unit Trusts Ltd	2.000	7.45
Total treasury investments	17.738	1.91%

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Minimum Revenue Provision Statement 2020/21

Where the Authority finances capital expenditure by borrowing, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Authority to have regard to the Ministry of Housing, Communities and Local Government's (MHCLG's) *Guidance on Minimum Revenue Provision* (the Guidance) most recently issued in 2018.

The broad aim of the Guidance is to ensure that capital expenditure is financed over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The Guidance requires the Authority to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance as well as locally determined prudent methods:

- For capital expenditure incurred before 1st April 2008, MRP will be determined in accordance with the former regulations that applied on 31st March 2008, modified to a more prudent basis as permitted by the Guidance. Since 2016/17 such MRP has been based on repaying the non-housing debt in equal annual instalments over a 35 year period (this is Option 1 in the Guidance).
- For capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset in equal instalments *or* equal to the principal repayment on an annuity with an annual interest rate equal to the average relevant PWLB rate for the life of the asset, starting in the year after the asset becomes operational (Option 3 of the guidance).

MRP on purchases of freehold land will be charged over 50 years, *except* where the land is subsequently held for sale as part of an Investment / economic development / regeneration project (in which case no MRP will be charged, the debt being repaid by applying the capital receipts / sale proceeds when received), or where the land is being held for future council development (in which case the MRP will be based on the asset life of the building(s) resulting from the development, commencing the year after those building(s) become operational).

MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years.

- For capital expenditure loans to third parties that are repaid in annual or more frequent instalments of principal, the Council will make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement. In years where there is no principal repayment, MRP will be charged in accordance with the MRP policy for the assets funded by the loan, including where appropriate, delaying MRP until the year after the assets become operational.

No MRP will be charged in respect of assets held within the Housing Revenue Account.

Capital expenditure incurred during 2020/21 will not be subject to a MRP charge until 2021/22 or until the year after an asset becomes operational.

Based on the Authority's latest estimate of its Capital Financing Requirement on 31st March 2020, the budget for MRP and voluntary revenue overpayments (or VRP) has been set as follows:

	31.03.2020 Estimated CFR £m	2020/21 Estimated MRP/VRP £m
Capital expenditure before 01.04.2008	6.887	0.222
Capital expenditure after 31.03.2008	91.259	1.657
Loans to other bodies repaid in instalments	7.434	0.012
Voluntary overpayment	n/a	0.171
Total General Fund	105.580	2.062
Housing Revenue Account	71.118	Nil
Total	176.698	2.062

Overpayments: In earlier years, the Authority has made voluntary overpayments of MRP that are available to reduce the revenue charges in later years. It is planned to make a further £171,441 overpayment (known as Voluntary Revenue Provision or VRP) in 2020/21.

MRP Overpayments	£
Expected balance 31.03.2020	889,486
Planned overpayment/(drawdown) 2020/21	171,441
Forecast balance 31.03.2021	1,060,927